

IRONWOOD PHARMACEUTICALS INC

Form 10-Q

August 12, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 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: 001-34620

IRONWOOD PHARMACEUTICALS, INC.

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(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

04-3404176
(I.R.S. Employer
Identification Number)

301 Binney Street
Cambridge, Massachusetts
(Address of Principal Executive Offices)

02142
(Zip Code)

(617) 621-7722

(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 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of August 1, 2011, there were 56,472,788 shares of Class A common stock outstanding and 43,849,074 shares of Class B common stock outstanding.

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IRONWOOD PHARMACEUTICALS, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2011

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****Ironwood Pharmaceuticals, Inc.****Condensed Consolidated Balance Sheets**

(in thousands, except share and per share amounts)

(unaudited)

	June 30, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 48,185	\$ 44,321
Available-for-sale securities	152,912	203,706
Accounts receivable	110	19
Related party accounts receivable, net	2,517	2,876
Prepaid expenses and other assets	4,658	5,320
Restricted cash		2,833
Total current assets	208,382	259,075
Restricted cash	7,647	7,647
Property and equipment, net	33,484	34,369
Other assets	214	274
Total assets	\$ 249,727	\$ 301,365
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 6,507	\$ 4,302
Accrued research and development costs	5,429	8,140
Accrued expenses	6,648	8,938
Current portion of capital lease obligations	229	197
Current portion of deferred rent	3,282	2,799
Current portion of deferred revenue	48,555	40,050
Other current liabilities	194	
Total current liabilities	70,844	64,426
Capital lease obligations, net of current portion	540	393
Deferred rent, net of current portion	14,379	14,612
Deferred revenue, net of current portion	33,144	62,383
Other liabilities	703	

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Commitments and contingencies (Note 8)

Stockholders' equity:

Preferred stock, \$0.001 par value, 75,000,000 shares authorized, no shares issued and outstanding

Class A common stock, \$0.001 par value, 500,000,000 shares authorized and 51,589,856 and 48,202,089 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively

51 48

Class B common stock, \$0.001 par value, 100,000,000 shares authorized and 48,658,805 and 50,970,247 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively

49 51

Additional paid-in capital

534,749 526,991

Accumulated deficit

(404,785) (367,540)

Accumulated other comprehensive income

53 1

Total stockholders' equity

130,117 159,551

Total liabilities and stockholders' equity

\$ 249,727 \$ 301,365

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

Table of Contents**Ironwood Pharmaceuticals, Inc.****Condensed Consolidated Statements of Operations**

(in thousands, except share and per share amounts)

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Collaborative arrangements revenue	\$ 11,262	\$ 9,188	\$ 21,499	\$ 18,026
Operating expenses:				
Research and development	19,409	19,897	38,964	37,446
General and administrative	10,805	6,601	20,029	12,386
Total operating expenses	30,214	26,498	58,993	49,832
Loss from operations	(18,952)	(17,310)	(37,494)	(31,806)
Other income (expense):				
Interest expense	(17)	(44)	(33)	(97)
Interest and investment income	125	189	279	257
Other income			3	
Other income (expense), net	108	145	249	160
Net loss from continuing operations	(18,844)	(17,165)	(37,245)	(31,646)
Net loss from discontinued operations		(44)		(1,816)
Net loss	(18,844)	(17,209)	(37,245)	(33,462)
Net loss from discontinued operations attributable to noncontrolling interest		73		402
Net loss attributable to Ironwood Pharmaceuticals, Inc.	\$ (18,844)	\$ (17,136)	\$ (37,245)	\$ (33,060)
Net loss per share attributable to Ironwood Pharmaceuticals, Inc. basic and diluted:				
Continuing operations	\$ (0.19)	\$ (0.18)	\$ (0.37)	\$ (0.39)
Discontinued operations				(0.02)
Net loss per share	\$ (0.19)	\$ (0.18)	\$ (0.37)	\$ (0.41)
Weighted average number of common shares used in net loss per share attributable to Ironwood Pharmaceuticals, Inc. basic and diluted	99,674,969	97,642,330	99,458,336	80,893,200

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

Table of Contents**Ironwood Pharmaceuticals, Inc.****Condensed Consolidated Statements of Cash Flows****(in thousands)****(unaudited)**

	Six Months Ended	
	June 30,	
	2011	2010
Cash flows from operating activities:		
Net loss	\$ (37,245)	\$ (33,462)
Loss from discontinued operations		(1,816)
Loss from continuing operations	(37,245)	(31,646)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	5,037	2,718
Loss on disposal of property and equipment		223
Share-based compensation expense	5,649	3,253
Accretion of discount/premium on investment securities	1,342	487
Changes in assets and liabilities:		
Accounts receivable	268	621
Restricted cash	2,833	(2,348)
Prepaid expenses and other current assets	662	(1,253)
Other assets	60	(277)
Accounts payable and accrued expenses	1,571	425
Accrued research and development costs	(2,711)	(3,828)
Deferred revenue	(20,734)	(17,223)
Deferred rent	250	6,814
Other liabilities	897	
Net cash used in operating activities from continuing operations	(42,121)	(42,034)
Net cash used in operating activities from discontinued operations		(2,443)
Total net cash used in operating activities	(42,121)	(44,477)
Cash flows from investing activities:		
Purchases of available-for-sale securities	(57,082)	(274,131)
Sales and maturities of available-for-sale securities	106,586	37,467
Purchases of property and equipment	(5,467)	(8,604)
Net cash provided by (used in) investing activities from continuing operations	44,037	(245,268)
Net cash provided by investing activities from discontinued operations		1
Total net cash provided by (used in) investing activities	44,037	(245,267)
Cash flows from financing activities:		
Proceeds from initial public offering		203,167
Proceeds from exercise of stock options, stock purchase plan and issuance of restricted stock	2,094	466
Payments on borrowings	(146)	(657)
Net cash provided by financing activities from continuing operations	1,948	202,976

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Net cash used in financing activities from discontinued operations			(181)
Net cash provided by financing activities	1,948		202,795
Net increase (decrease) in cash and cash equivalents	3,864		(86,949)
Cash and cash equivalents, beginning of period	44,321		122,306
Cash and cash equivalents, end of period	\$ 48,185	\$	35,357
Supplemental cash flow disclosures:			
Cash paid for interest (including discontinued operations)	\$ 35	\$	180
Purchases under capital leases	\$ 325	\$	487

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

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Nature of Business

Ironwood Pharmaceuticals, Inc. (the Company) is an entrepreneurial pharmaceutical company that discovers, develops and intends to commercialize differentiated medicines that improve patients' lives. The Company's lead product candidate is linaclotide, a guanylate cyclase type-C (GC-C) agonist being developed for the treatment of patients with irritable bowel syndrome with constipation (IBS-C) or chronic constipation (CC). Linaclotide achieved positive results in each of two Phase 3 IBS-C and CC clinical trials. The Company also has a pipeline focused on both research and development of early stage product candidates and preclinical research in multiple therapeutic areas, including gastrointestinal disease, pain and inflammation, respiratory disease and cardiovascular disease.

Prior to September 2010, the Company held a majority ownership interest in Microbia, Inc. (formerly known as Microbia Precision Engineering), a subsidiary formed in September 2006. Microbia, Inc. (Microbia) engaged in a specialty biochemicals business based on a proprietary strain-development platform. In September 2010, the Company sold its interest in Microbia to DSM Holding Company USA, Inc. (DSM) (Note 2).

The Company was incorporated in Delaware on January 5, 1998. On April 7, 2008, the Company changed its name from Microbia, Inc. to Ironwood Pharmaceuticals, Inc.

The Company has generated an accumulated deficit as of June 30, 2011 of approximately \$404.8 million since inception. In February 2010, the Company completed its initial public offering of Class A common stock and raised a total of approximately \$203.2 million in net proceeds (Note 3).

2. Summary of Significant Accounting Policies

Unaudited Interim Financial Statements

The accompanying condensed consolidated financial statements and the related disclosures as of June 30, 2011 and for the three and six months ended June 30, 2011 and 2010 are unaudited and have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) and the applicable rules and regulations of the Securities and Exchange Commission (SEC) for interim financial information.

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Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K filed with the SEC on March 30, 2011. The December 31, 2010 condensed consolidated balance sheet included herein was derived from the audited financial statements as of that date, but does not include all disclosures including notes required by GAAP for complete financial statements.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments of a normal recurring nature considered necessary to present fairly the Company's financial position as of June 30, 2011 and results of its operations for the three and six months ended June 30, 2011 and 2010, and its cash flows for the six months ended June 30, 2011 and 2010. The interim results for the three and six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

Principles of Consolidation

The accompanying condensed consolidated financial statements of Ironwood Pharmaceuticals, Inc. include the revenue, expenses and cash flows of Microbia, over which the Company exercised control until September 21, 2010, when the Company sold its 85% interest in Microbia to DSM. The Company recorded noncontrolling interest in its condensed consolidated statements of operations for the ownership interest of the minority owners of Microbia. All intercompany transactions and balances are eliminated in consolidation.

Sale of Subsidiary and Discontinued Operations

On September 21, 2010, the Company sold its interest in Microbia to DSM in exchange for cash proceeds of \$9.5 million, the payment of approximately \$1.1 million of Microbia debt and interest by DSM and future contingent consideration based on the sale of products incorporating Microbia's technology. As a result of the sale of its interest in Microbia, the Company ceased to have any financial interest in Microbia. The Company maintained no further investment in Microbia and recorded a gain on the sale of Microbia in its consolidated statements of operations of approximately \$12.2 million at the time of the sale.

Additionally, in accordance with the applicable accounting standards, the Company considered if the operations and cash flows of Microbia had been eliminated from the ongoing operations of the Company and if the Company would have any significant continuing involvement in the operations of Microbia after the sale in order to determine whether or not to present Microbia as discontinued operations in the financial statements. The Company determined that Microbia met the requirements for presentation as discontinued operations and accordingly, the Company classified the assets, liabilities, operations and cash flows of Microbia as discontinued operations for all periods presented prior to the sale.

The agreement with DSM also included future contingent consideration in the form of a royalty on future sales of products incorporating Microbia's technology through the earlier of a) 2024, b) the invalidity of any Microbia patent, or c) the maximum agreed upon amount is reached. As of June 30, 2011, no amounts have been recorded for the contingent consideration in the Company's condensed consolidated financial statements.

Reclassifications

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Amounts associated with the Company's former subsidiary, Microbia, have been presented as discontinued operations for all periods in the condensed consolidated financial statements.

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires the Company's management to make estimates and judgments that may affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company's management evaluates its estimates, including those related to revenue recognition, available-for-sale securities, impairment of long-lived assets, income taxes including the valuation allowance for deferred tax assets, research and development expense, contingencies and share-based compensation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. Changes in estimates are reflected in reported results in the period in which they become known.

Cash and Cash Equivalents

The Company considers all highly liquid investment instruments with an original maturity when purchased of three months or less to be cash equivalents. Investments qualifying as cash equivalents consist of money market funds and certain U.S. government sponsored securities. The carrying amount of cash equivalents approximates fair value. The amount of cash equivalents included in cash and cash equivalents was approximately \$43.6 million and \$39.2 million at June 30, 2011 and December 31, 2010, respectively.

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

Available-for-Sale Securities

The Company classifies all short-term investments with an original maturity when purchased of greater than three months as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses reported in other comprehensive income (loss). The amortized cost of debt securities in this category is adjusted for the amortization of premiums and accretion of discounts to maturity. Such amortization is included in interest and investment income. Realized gains and losses, and declines in value judged to be other than temporary on available-for-sale securities, are included in interest and investment income.

The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest and investment income. To determine whether an other-than-temporary impairment exists, the Company considers whether it has the ability and intent to hold the investment until a market price recovery, and whether evidence indicating the recoverability of the cost of the investment outweighs evidence to the contrary. There were no other-than-temporary impairments for the three months ended June 30, 2011.

Concentrations of Credit Risk

Financial instruments that subject the Company to credit risk primarily consist of cash and cash equivalents, restricted cash, available-for-sale securities and accounts receivable. The Company maintains its cash and cash equivalent balances with high-quality financial institutions and, consequently, the Company believes that such funds are subject to minimal credit risk. The Company's available-for-sale investments primarily consist of U.S. government-sponsored securities and U.S. Treasury securities and potentially subject the Company to concentrations of credit risk. The Company has adopted an investment policy which limits the amounts the Company may invest in any one type of investment, and requires all investments held by the Company to be A+ rated, thereby reducing credit risk concentration.

Accounts receivable primarily consist of amounts due under the collaboration agreement with Forest Laboratories, Inc. (Forest) and license agreements with Almirall, S.A. (Almirall) and Astellas Pharma Inc. (Astellas) (Note 5) for which the Company does not obtain collateral. Accounts receivable from Forest and Almirall are presented as related party accounts receivable on the condensed consolidated balance sheets as both entities own common stock of the Company.

At June 30, 2011 and December 31, 2010, accounts receivable from Forest, net of any payables due Forest, accounted for approximately 79% and 89%, respectively, of the Company's total accounts receivable. At June 30, 2011 and December 31, 2010, Almirall accounted for approximately 17% and 10%, respectively, of the Company's total accounts receivable.

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The percentages of revenue from continuing operations recognized from significant customers of the Company in the three and six months ended June 30, 2011 and 2010 are included in the following table:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Collaborative Partner:				
Forest	48%	59%	51%	60%
Almirall	44%	30%	40%	32%
Astellas	8%	11%	9%	8%

For the three and six months ended June 30, 2011 and 2010, no additional customers accounted for more than 10% of the Company's revenue from continuing operations. Tate & Lyle Investments, Ltd. (T&L) accounted for approximately 99% and 98% of the Company's revenue from discontinued operations for the three and six months ended June 30, 2010, respectively.

Revenue Recognition

The Company's revenue is generated through collaborative research and development and licensing agreements. The terms of these agreements contain multiple deliverables which may include (i) licenses, (ii) research and development activities, and (iii) the manufacture of active pharmaceutical ingredient (API) and development materials for the collaborative partner. Payments to the Company under these agreements may include non-refundable license fees, payments for research and development activities,

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

payments for the manufacture of API and development materials, payments based upon the achievement of certain milestones and royalties on product sales. In addition, prior to September 2010, the Company generated services revenue through agreements that generally provided for fees for research and development services rendered.

For arrangements that include multiple deliverables, the Company follows the provisions of the Accounting Standards Codification (ASC) Topic 605-25, *Revenue Recognition - Multiple-Element Arrangements*, in accounting for these agreements. Effective January 1, 2011, the Company adopted Accounting Standards Update (ASU) No. 2009-13, *Multiple-Deliverable Revenue Arrangements* (ASU 2009-13), which amends ASC Topic 605-25. Refer to Note 2, Recently Adopted Accounting Standards, for additional discussion of this standard and its impact on the Company's accounting for collaboration and license agreements. In order to account for these agreements, the Company must identify the deliverables included within the agreement and evaluate which deliverables represent separate units of accounting based on if certain criteria are met, including whether the delivered element has standalone value to the collaborator. The consideration received is allocated among the separate units of accounting, and the applicable revenue recognition criteria are applied to each of the separate units. The Company recognizes revenue when there is persuasive evidence that an arrangement exists, services have been rendered or delivery has occurred, the price is fixed or determinable, and collection is reasonably assured.

At June 30, 2011, the Company had collaboration and license agreements with Forest, Almirall and Astellas. Refer to Note 5, Collaboration and License Agreements, for additional discussion on these agreements.

There are no performance, cancellation, termination or refund provisions in any of the Company's arrangements that contain material financial consequences to the Company.

Collaboration and License Agreements

The significant deliverables under the Company's collaboration and license agreements generally include the license to develop and commercialize linaclotide, the Company's GC-C agonist, and may also include deliverables related to research and development activities, and the manufacture of API and development materials for the collaborative partner.

Generally, collaboration and license agreements contain non-refundable terms for payments and, depending on the terms of the agreement, provide that the Company will (i) provide research and development activities, including participation on a joint development committee, (ii) manufacture API and development materials which are reimbursed at a contractually determined rate, (iii) earn payments upon the achievement of certain milestones, and (iv) earn royalty payments on sales of linaclotide. In determining the separate units of accounting,

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management evaluates whether the license has standalone value to the partner based on the consideration of the relevant facts and circumstances for each arrangement. Factors considered in this determination include the research capabilities of the partner and the availability of peptide research expertise in the general marketplace. In addition, the Company considers whether the collaborator can use the license for its intended purpose without the receipt of the remaining deliverables, and whether the value of the license is dependent on the undelivered items and whether there are other vendors that can provide the undelivered item.

For all of the collaboration and license agreements discussed in Note 5, the licenses and research and development activities did not qualify as separate units of accounting since the licenses did not have standalone value without the research and development activities. Up-front payments on a license are deferred if facts and circumstances dictate that the license does not have standalone value. The determination of the length of the period over which to defer revenue is subject to judgment and estimation and can have an impact on the amount of revenue recognized in a given period. The Company generally estimates this period as the estimated period of performance, which is typically the research and development term due to the Company's continuing involvement in the performance of research and development activities, primarily through its participation on a joint development committee. Typically the research and development term begins at the inception of the collaboration or license agreement and concludes when the Company's significant research and development obligations under the agreement have concluded. The Company believes this period of involvement is 60 months for the Forest collaboration, 41 months for the Almirall license agreement and 115 months for the Astellas license agreement. Quarterly, the Company reassesses its periods of substantial involvement over which the Company amortizes its up-front license fees and makes adjustments as appropriate. In the event that a license were to be terminated, the Company would recognize as revenue any portion of the up-front fee that had not previously been recorded as revenue, but was classified as deferred revenue at the date of such termination.

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

Up-front payments on a license may be recognized upon delivery of the license if facts and circumstances dictate that the license has standalone value from the undelivered elements, which generally include research and development activities and manufacture of API and development materials.

At the inception of each agreement that includes milestone payments, the Company evaluates whether each milestone is substantive and at risk to both parties on the basis of the contingent nature of the milestone, specifically reviewing factors such as the scientific and other risks that must be overcome to achieve the milestone, as well as the level of effort and investment required. Milestones that are not considered substantive are accounted for as license payments and recognized on a straight-line basis over the remaining period of performance. Refer to Note 5 for details on the specific milestones in each of the Company's agreements.

In those circumstances where a substantive milestone is achieved, collection of the related receivable is reasonably assured and the Company has remaining obligations to perform under the collaboration arrangement, the Company has historically recognized as revenue on the date the milestone was achieved an amount equal to the applicable percentage of the performance period that had elapsed as of the date the milestone was achieved, with the balance being deferred and recognized on a straight-line basis over the remaining period of performance. Effective January 1, 2011, the Company adopted ASU No. 2010-17, *Revenue Recognition - Milestone Method* (ASU 2010-17). Refer to Note 2, Recently Adopted Accounting Standards, for additional discussion of the adoption of this standard and its prospective impact on the Company's accounting for collaboration and license agreements. Under ASU 2010-17, beginning January 1, 2011, in those circumstances where a substantive milestone is achieved and collection of the related receivable is reasonably assured, the Company will recognize revenue related to the milestone in its entirety in the period in which the milestone is achieved. Milestone payments received in prior periods will continue to be recognized based upon the remaining period of performance.

The Company produces development materials and API for its collaborators and is reimbursed for its costs to produce the material. The Company recognizes revenue on development material and API when the material has passed all quality testing required for collaborator acceptance, delivery has occurred, title and risk of loss have transferred to the collaborator, the price is fixed or determinable, and collection is reasonably assured.

The Company receives research and development funding under the Forest collaboration agreement and considers the factors or indicators within this arrangement to determine whether reporting such funding on a gross or net basis is appropriate. The Company records revenue transactions gross in the condensed consolidated statements of operations if it is deemed the principal in the transaction, which includes being the primary obligor and having the risks and rewards of ownership.

Services Revenue

Prior to September 2010, the Company recognized services revenue when there was persuasive evidence that an arrangement existed, services had been rendered or delivery had occurred, the price was fixed and determinable, and collection was reasonably assured. Revenue from research and development services rendered was recognized as services were performed. As a result of the sale of the Company's interest in Microbia in September 2010, services revenue is included in net loss from discontinued operations.

Research and Development Costs

The Company expenses research and development costs to operations as incurred. The Company defers and capitalizes non-refundable advance payments made by the Company for research and development activities until the related goods are received or the related services are performed.

Research and development expenses are comprised of costs incurred in performing research and development activities, including salaries and benefits, share-based compensation expense, laboratory supplies and other direct expenses, facilities expenses, overhead expenses, contractual services, including clinical trial and related clinical manufacturing expenses, and other outside expenses. As a result of the sale of the Company's interest in Microbia in September 2010, costs of revenue related to the Microbia services contracts and costs associated with Microbia's research and development activities are included in net loss from discontinued operations.

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

The Company has entered into a collaboration agreement in which it shares research and development expenses with a collaborator. The Company records the expenses for such work as research and development expense. Because the collaboration arrangement is a cost-sharing arrangement, the Company concluded that when there is a period during the collaboration arrangement during which the Company receives payments from the collaborator, the Company records the payments by the collaborator for their share of the development effort as a reduction of research and development expense.

Share-Based Compensation

Share-based compensation is recognized as an expense in the financial statements based on the grant date fair value. Compensation expense recognized relates to stock awards, restricted stock and stock options granted, modified, repurchased or cancelled on or after January 1, 2006. Stock options granted to employees prior to that time continue to be accounted for using the intrinsic value method. Under the intrinsic value method, compensation associated with share-based awards to employees was determined as the difference, if any, between the fair value of the underlying common stock on the date compensation was measured, generally the grant date, and the price an employee must pay to exercise the award. For awards that vest based on service conditions, the Company uses the straight-line method to allocate compensation expense to reporting periods. The grant date fair value of options granted is calculated using the Black-Scholes option-pricing model, which requires the use of subjective assumptions including volatility, expected term and the fair value of the underlying common stock, among others.

The Company records the expense for stock option grants subject to performance-based milestone vesting over the remaining service period when management determines that achievement of the milestone is probable. Management evaluates when the achievement of a performance-based milestone is probable based on the relative satisfaction of the performance conditions as of the reporting date.

The Company records the expense of services rendered by non-employees based on the estimated fair value of the stock option using the Black-Scholes option-pricing model. The fair value of unvested non-employee awards are remeasured at each reporting period and expensed over the vesting term of the underlying stock options.

Noncontrolling Interest

Noncontrolling interest represents the noncontrolling stockholder's proportionate share of equity and net income or net loss of the Company's former consolidated subsidiary, Microbia. On September 21, 2010, the Company sold its interest in Microbia, resulting in the deconsolidation of its former subsidiary bringing the noncontrolling interest balance to zero.

Net Loss Per Share

The Company calculates basic and diluted net loss per common share by dividing the net loss by the weighted average number of common shares outstanding during the period. The Company has excluded unvested restricted stock and shares that are subject to repurchase by the Company from the weighted average number of common shares outstanding. The Company's potentially dilutive shares, which include outstanding common stock options and unvested shares of restricted stock, have not been included in the computation of diluted net loss per share for all periods as the result would be antidilutive. The Company presents the net loss per share attributable to both continuing and discontinued operations. The loss attributable to the noncontrolling interest is included in the net loss per share from discontinued operations.

Income Taxes

The Company provides for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates in effect when the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to reflect the uncertainty associated with their ultimate realization.

Management of the Company has evaluated the positive and negative evidence bearing upon the realizability of its deferred tax assets. Management has considered the Company's history of operating losses and concluded, in accordance with the applicable accounting standards, that it is more likely than not that the Company will not realize the benefit of its deferred tax assets.

Table of Contents**Ironwood Pharmaceuticals, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)**

Accordingly, the deferred tax assets have been fully reserved at June 30, 2011 and December 31, 2010. Management reevaluates the positive and negative evidence on a quarterly basis.

The Company accounts for uncertain tax positions recognized in the condensed consolidated financial statements by prescribing a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. There were no income tax provisions or benefits for the three and six months ended June 30, 2011 and 2010 given the Company's continued net operating loss position.

Impairment of Long-Lived Assets

The Company regularly reviews the carrying amount of its long-lived assets to determine whether indicators of impairment may exist which warrant adjustments to carrying values or estimated useful lives. If indications of impairment exist, projected future undiscounted cash flows associated with the asset are compared to the carrying amount to determine whether the asset's value is recoverable. If the carrying value of the asset exceeds such projected undiscounted cash flows, the asset will be written down to its estimated fair value. There were no indicators of impairment at June 30, 2011.

Comprehensive Income (Loss)

All components of comprehensive income (loss) are required to be disclosed in the condensed consolidated financial statements. Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions, and other events and circumstances from non-owner sources and consists of net loss and changes in unrealized gains and losses on available-for-sale securities. Comprehensive loss from operations was calculated as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Net loss attributable to Ironwood Pharmaceuticals, Inc.	\$ (18,844)	\$ (17,136)	\$ (37,245)	\$ (33,060)
Change in unrealized gain (loss) on investments	1	143	52	44
Comprehensive loss attributable to Ironwood Pharmaceuticals, Inc.	\$ (18,843)	\$ (16,993)	\$ (37,193)	\$ (33,016)

Segment Information

Operating segments are components of an enterprise for which separate financial information is available and is evaluated regularly by the Company's chief operating decision-maker in deciding how to allocate resources and in assessing performance.

Prior to the sale of its interest in Microbia in September 2010, the Company had two reportable business segments: human therapeutics and biomanufacturing (Note 12). Revenue from the Company's human therapeutics segment is presented in the condensed consolidated statements of operations as collaborative arrangements revenue. Revenue from the Company's biomanufacturing segment is presented as a component of the net loss from discontinued operations.

New Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board (FASB) or other standard setting bodies that are adopted by the Company as of the specified effective date. Unless otherwise discussed, the Company believes that the impact of recently issued standards that are not yet effective will not have a material impact on its consolidated financial position or results of operations upon adoption.

Recently Adopted Accounting Standards

In October 2009, the FASB issued ASU 2009-13. ASU 2009-13 amends existing revenue recognition accounting pronouncements that are currently within the scope of FASB ASC Subtopic 605-25 (previously included within EITF 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21)). The consensus to ASU 2009-13 provides accounting principles and application guidance on whether multiple deliverables exist, how the arrangement should be separated, and the consideration

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Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

allocated. This guidance eliminates the requirement to establish the fair value of undelivered products and services and instead provides for separate revenue recognition based upon management's estimate of the selling price for an undelivered item when there is no other means to determine the fair value of that undelivered item. EITF 00-21 previously required that the fair value of the undelivered item be the price of the item either sold in a separate transaction between unrelated third parties or the price charged for each item when the item is sold separately by the vendor. Under EITF 00-21, if the fair value of all of the elements in the arrangement was not determinable, then revenue was deferred until all of the items were delivered or fair value was determined. This new approach is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. On January 1, 2011, the Company adopted ASU 2009-13 on a prospective basis. The adoption did not have a material impact on the Company's consolidated financial position or results of operations.

In April 2010, the FASB issued ASU 2010-17. ASU 2010-17 provides guidance in applying the milestone method of revenue recognition to research or development arrangements. Under this guidance, management may recognize revenue contingent upon the achievement of a milestone in its entirety, in the period in which the milestone is achieved, if the milestone meets all the criteria within the guidance to be considered substantive. This ASU is effective for research and development milestones achieved in fiscal years, beginning on or after June 15, 2010. On January 1, 2011, the Company adopted ASU 2010-17 to change its accounting policy to begin applying the milestone method on a prospective basis. As the Company elected prospective adoption, there was no material impact on its consolidated financial position or results of operations. However, the adoption of ASU 2010-17 is expected to impact the Company's accounting for any milestone payments received in future periods.

Recently Issued Accounting Standards

In December 2010, the FASB issued ASU No. 2010-27, *Fees Paid to the Federal Government by Pharmaceutical Manufacturers* (ASU 2010-27) which provides guidance on how to recognize and classify the fees mandated by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act (together, the Acts). The Acts impose an annual fee for each calendar year beginning on or after January 1, 2011 payable by branded prescription drug manufacturers and importers on branded prescription drugs. The liability for the fee should be estimated and recorded in full upon the first qualifying sale with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation over the calendar year that it is payable. ASU 2010-27 is effective for calendar years beginning on or after December 31, 2010, when the fee initially becomes effective. As the Company does not currently have a commercial product, the effect of this guidance will be limited to future transactions.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05) which is intended to facilitate the convergence of U.S. GAAP and International Financial Reporting Standards (IFRS) as well as to increase the transparency of items reported in other comprehensive income. As a result of ASU 2011-05, all nonowner changes in stockholders' equity are required to be presented in a single continuous statement of comprehensive income or in two separate but consecutive statements. The option to present other comprehensive income in the statement of changes in equity has been eliminated. ASU 2011-05 is effective for fiscal years beginning after December 15, 2011 and should be applied retrospectively. The Company expects to adopt this standard beginning in 2012. As ASU 2011-05 impacts presentation

only, it will have no effect on the Company's consolidated financial statements.

3. Initial Public Offering

In February 2010, the Company completed its initial public offering of Class A common stock pursuant to a registration statement that was declared effective on February 2, 2010. The Company sold 19,166,667 shares of its Class A common stock, which included 2,500,000 shares of the Company's Class A common stock sold pursuant to an over-allotment option granted to the underwriters, at a price to the public of \$11.25 per share. As a result of the initial public offering, the Company raised a total of \$215.6 million in gross proceeds, and approximately \$203.2 million in net proceeds after deducting underwriting discounts and expenses.

Upon the closing of the initial public offering, 69,904,843 shares outstanding of the Company's convertible preferred stock automatically converted into 70,391,620 shares of its Class B common stock.

Table of Contents**Ironwood Pharmaceuticals, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****4. Net Loss Per Share**

Basic and diluted net loss per share is calculated as follows (in thousands, except share and per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Numerator:				
Net loss from continuing operations	\$ (18,844)	\$ (17,165)	\$ (37,245)	\$ (31,646)
Net loss from discontinued operations		(44)		(1,816)
Less: net loss from discontinued operations attributable to noncontrolling interest		73		402
Net income (loss) from discontinued operations attributable to Ironwood Pharmaceuticals, Inc.		29		(1,414)
Net loss attributable to Ironwood Pharmaceuticals, Inc.	\$ (18,844)	\$ (17,136)	\$ (37,245)	\$ (33,060)
Denominator:				
Weighted average number of common shares used in net loss per share attributable to Ironwood Pharmaceuticals, Inc. basic and diluted	99,674,969	97,642,330	99,458,336	80,893,200
Net loss per share associated with continuing operations	\$ (0.19)	\$ (0.18)	\$ (0.37)	\$ (0.39)
Net loss per share associated with discontinued operations attributable to Ironwood Pharmaceuticals, Inc.	\$	\$	\$	\$ (0.02)
Net loss per share attributable to Ironwood Pharmaceuticals, Inc. basic and diluted	\$ (0.19)	\$ (0.18)	\$ (0.37)	\$ (0.41)

The net loss attributable to noncontrolling interest is reflected in the net loss from discontinued operations for purposes of segregating the earnings per share calculation between continuing and discontinued operations.

The following potentially dilutive securities have been excluded from the computation of diluted weighted average shares outstanding as of June 30, 2011 and 2010, as they would be anti-dilutive:

	At June 30,	
	2011	2010
Options to purchase common stock	15,786,758	14,888,833
Shares subject to repurchase	203,201	338,556
	15,989,959	15,227,389

5. Collaboration and License Agreements

Forest Laboratories, Inc.

In September 2007, the Company entered into a collaboration agreement with Forest to jointly develop and commercialize linaclotide, a drug candidate for the treatment of IBS-C, CC and other gastrointestinal conditions, in North America. Under the terms of this collaboration agreement, the Company shares equally with Forest all development costs, as well as potential future profits and losses from the development and sale of linaclotide in the U.S. The Company will receive royalties from Forest for sales in Canada and Mexico. The Company retained the rights to commercialize linaclotide outside of North America. Forest made non-refundable, up-front payments totaling \$70.0 million to the Company in order to obtain rights to linaclotide in North America. Because the license to jointly develop and commercialize linaclotide did not have standalone value without the research and development activities provided by the Company, the Company is recognizing the up-front license fee as revenue on a straight-line basis over 60 months, which is the Company's estimate of the period over which linaclotide will be jointly developed under the collaboration. At June 30, 2011, approximately \$16.9 million of the up-front license fee remains deferred and is being recognized on a straight-line basis over the

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

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remaining estimated development period. The collaboration agreement also includes contingent milestone payments, as well as a contingent equity investment based on the achievement of specific development and commercial milestones. These payments, including the up-front license fee, could total up to \$330.0 million if certain development and sales milestones are achieved for linaclotide. To date, \$100.0 million in license fees and milestone payments has already been received and Forest made the equity investment when it purchased \$25.0 million of the Company's capital stock. Of the remaining milestones, each of which the Company considers substantive, pre-commercial milestone payments could total up to \$20.0 million upon new drug application (NDA) acceptance by the U.S. Food and Drug Administration (FDA) and up to \$85.0 million upon NDA approval. The Company can also achieve up to approximately \$100.0 million in a sales related milestone if certain conditions are met.

The collaboration agreement included a contingent equity investment, in the form of a forward purchase contract, which required Forest to purchase shares of the Company's convertible preferred stock, upon achievement of a specific clinical milestone. Based on the Company's evaluation, this financial instrument was considered an asset or liability, which was required to be carried at fair value. At the inception of the arrangement, the Company valued the contingent equity investment and recorded a \$9.0 million asset and incremental deferred revenue. The \$9.0 million of incremental deferred revenue is being recognized as revenue on a straight-line basis over the period of the Company's continuing involvement, which was estimated to be 60 months from the inception of the arrangement. At June 30, 2011, approximately \$2.2 million of the incremental deferred revenue remains deferred. In July 2009, the Company achieved the clinical milestone triggering the equity investment and reclassified the forward purchase contract as a reduction to convertible preferred stock. The Company issued the 2,083,333 shares to Forest on September 1, 2009.

Additionally, the Company has achieved two of the development milestones under this agreement, both of which the Company determined to be substantive. In September 2008, the Company achieved a clinical milestone which triggered a \$10.0 million milestone payment and in July 2009, the Company achieved a second clinical milestone which triggered a \$20.0 million milestone payment. At June 30, 2011, approximately \$2.4 million and \$4.8 million of the milestone payments, respectively, remain deferred and are being recognized on a straight-line basis over the remaining estimated development period.

The Company recognized revenue from the Forest collaboration agreement totaling approximately \$5.5 million during both the three months ended June 30, 2011 and 2010 and approximately \$10.9 million during both the six months ended June 30, 2011 and 2010.

Further, because the Company shares development costs equally with Forest, payments from Forest with respect to research and development costs incurred by the Company are recorded as a reduction to expense, and not as revenue. As a result of the cost-sharing arrangements under the collaboration, the Company offset approximately \$2.5 million and \$6.9 million during the three and six months ended June 30, 2011, respectively, and approximately \$4.2 million and \$8.3 million during the three and six months ended June 30, 2010, respectively, against research and development expense.

Almirall, S.A.

In April 2009, the Company entered into a license agreement with Almirall for European rights to develop and commercialize linaclotide for the treatment of IBS-C, CC and other gastrointestinal conditions. Under the terms of the license agreement, Almirall is responsible for the expenses associated with the development and commercialization of linaclotide in the European territory. The license agreement requires the Company to participate on a joint development committee over linaclotide's development period. The Company will receive escalating royalties from the sales of linaclotide in the European territory. In May 2009, the Company received a \$38.0 million payment from Almirall representing a \$40.0 million non-refundable up-front payment net of foreign withholding taxes. The Company elected to record the non-refundable up-front payment on a net basis. Because the license to develop and commercialize linaclotide did not have standalone value without the research and development activities provided by the Company, the Company is recognizing the up-front license fee as revenue on a straight-line basis over the development period, the Company's estimate of the period over which linaclotide will be developed under the license agreement for the European territory. In June 2011, the Company revised its estimate of the development period from 50 months to 41 months and adjusted its amortization of the remaining deferred revenue accordingly. At June 30, 2011, approximately \$17.8 million of the up-front license fee remains deferred. The license agreement also includes contingent milestone payments, as well as a contingent equity investment, that could total up to \$55.0 million upon achievement of specific clinical and sales milestones. To date, \$19.0 million, net of foreign withholding taxes, in milestone payments has already been received and Almirall made the equity investment when it purchased \$15.0 million of the Company's capital stock. Remaining pre-commercial milestone payments, each of which the Company considers substantive, consist of \$4.0 million upon the first commercial launch in each of the five major E.U. countries set forth in the agreement.

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The license agreement included a contingent equity investment, in the form of a forward purchase contract, which required Almirall to purchase shares of the Company's convertible preferred stock, upon achievement of a specific clinical milestone. Based on the Company's evaluation, this financial instrument was considered an asset or liability, which was required to be carried at fair value. The contingent equity investment was valued at inception at its fair value. At the inception of the arrangement, the Company valued the contingent equity investment and recorded a \$6.0 million asset and incremental deferred revenue. The \$6.0 million of incremental deferred revenue is being recognized as revenue on a straight-line basis over the period of the Company's continuing involvement, which was originally estimated to be 50 months and was revised in June 2011 to 41 months. The reduction in the development period was recorded as a change in estimate and deferred revenue will be recorded over the revised period on a prospective basis. At June 30, 2011, approximately \$2.8 million of the incremental deferred revenue remains deferred. In November 2009, the Company achieved the clinical milestone triggering the equity investment and reclassified the forward purchase contract as a reduction to convertible preferred stock. On November 13, 2009, the Company received \$15.0 million from Almirall for the purchase of 681,819 shares of convertible preferred stock.

In November 2010, the Company achieved a second development milestone under the Almirall license agreement, that the Company determined to be substantive, which resulted in a \$19.0 million payment, representing a \$20.0 million milestone, net of foreign withholding taxes. The Company recognized revenue of approximately \$7.2 million upon achievement of the milestone. This amount represented the portion of the milestone payment equal to the applicable percentage of the performance period that had elapsed as of the date the milestone was achieved. The remainder of the balance was deferred, and is being recognized on a straight-line basis over the remaining development period. At June 30, 2011, approximately \$8.9 million of the milestone payment remains deferred.

The Company recognized approximately \$4.9 million and \$8.7 million in total revenue from the Almirall license agreement during the three and six months ended June 30, 2011, respectively, including approximately \$0.4 million in each period from the sale of API to Almirall. During the three and six months ended June 30, 2010, the Company recognized approximately \$2.8 million and \$5.7 million, respectively, in total revenue from the Almirall license agreement, including approximately \$0.1 million and \$0.4 million, respectively, from the sale of API to Almirall.

Astellas Pharma Inc.

On November 9, 2009, the Company entered into a license agreement with Astellas. Astellas has the right to develop and commercialize linaclotide for the treatment of IBS-C, CC and other gastrointestinal conditions in Japan, South Korea, Taiwan, Thailand, Philippines and Indonesia. Under the terms of the agreement, Astellas paid the Company an up-front licensing fee of \$30.0 million on November 16, 2009. The license agreement requires the Company to participate on a joint development committee over linaclotide's development period. The agreement includes additional development milestone payments, each of which the Company considers substantive, that could total up to \$45.0 million. These milestone payments consist of \$15.0 million upon initiation of a Phase 3 study for linaclotide in Japan, \$15.0 million upon filing of the Japanese equivalent of an NDA with the relevant regulatory authority in Japan, and \$15.0 million upon approval of such equivalent by the relevant regulatory authority. In addition, the Company will receive escalating royalties on linaclotide sales should Astellas receive approval to market and sell linaclotide in the Asian market. Astellas will be responsible for activities relating to regulatory approval and commercialization. Because the license to develop and commercialize linaclotide did not have standalone value without the research and development activities

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provided by the Company, the Company is recognizing the up-front license fee as revenue on a straight-line basis over 115 months, which is the Company's estimate of the period over which linaclotide will be developed under the license agreement for the Asian market. At June 30, 2011, approximately \$25.8 million of the up-front license fee remains deferred. During the three and six months ended June 30, 2011, the Company recognized approximately \$0.9 million and \$1.9 million, respectively, in revenue from the Astellas license agreement, including approximately \$0.1 million and \$0.3 million, respectively, from the sale of clinical materials to Astellas. During the three and six months ended June 30, 2010, the Company recognized approximately \$1.0 million and \$1.4 million, respectively, in revenue from the Astellas license agreement, including approximately \$0.2 million and \$0.4 million, respectively, from the sale of clinical materials to Astellas.

Protagonist Therapeutics, Inc.

The Company entered into a collaboration agreement with Protagonist Therapeutics, Inc. and Protagonist Pty Ltd. (collectively "Protagonist") in January 2011. Under this agreement, Protagonist will use its proprietary technology platform to discover peptides against certain targets and the Company has the rights to develop and commercialize these peptides. In connection

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with entering into the agreement, the Company made an up-front payment to Protagonist of approximately \$2.8 million. In accordance with the applicable accounting guidance, the Company expensed the up-front payment as research and development expense. The Company also funds full-time equivalents for Protagonist's drug discovery activities, and will make certain milestone and royalty payments pending the achievement of certain development and commercialization milestones. The Company will expense these payments as incurred. During the three and six months ended June 30, 2011, the Company recorded approximately \$0.6 million and \$3.8 million, respectively, in research and development expense, including the up-front payment, associated with the Protagonist agreement.

6. Fair Value of Financial Instruments

The tables below present information about the Company's assets that are measured at fair value on a recurring basis as of June 30, 2011 and December 31, 2010 and indicate the fair value hierarchy of the valuation techniques the Company utilized to determine such fair value. In general, fair values determined by Level 1 inputs utilize observable inputs such as quoted prices in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs utilize data points that are either directly or indirectly observable, such as quoted prices, interest rates and yield curves. Fair values determined by Level 3 inputs utilize unobservable data points in which there is little or no market data, which require the Company to develop its own assumptions for the asset or liability.

The Company's investment portfolio includes many fixed income securities that do not always trade on a daily basis. As a result, the pricing services used by the Company applied other available information as applicable through processes such as benchmark yields, benchmarking of like securities, sector groupings and matrix pricing to prepare evaluations. In addition, model processes were used to assess interest rate impact and develop prepayment scenarios. These models take into consideration relevant credit information, perceived market movements, sector news and economic events. The inputs into these models may include benchmark yields, reported trades, broker-dealer quotes, issuer spreads and other relevant data.

The Company has classified assets measured at fair value on a recurring basis as follows (in thousands):

Description	June 30, 2011	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds (included in cash and cash equivalents)	\$ 43,570	\$ 43,570	\$	\$
U.S. government-sponsored securities	45,171		45,171	

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U.S. Treasury securities		107,741		107,741		
Total	\$	196,482	\$	151,311	\$	45,171

Description	Fair Value Measurements at Reporting Date Using					
	December 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
Money market funds (included in cash and cash equivalents)	\$	36,228	\$	36,228	\$	
U.S. government-sponsored securities (included in cash and cash equivalents)		2,998				2,998
U.S. Treasury securities		116,219		116,219		
U.S. government-sponsored securities		87,487				87,487
Total	\$	242,932	\$	152,447	\$	90,485

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Cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable, accrued expenses and the current portion of capital lease obligations at June 30, 2011 and December 31, 2010 are carried at amounts that approximate fair value due to their short-term maturities.

Capital lease obligations at June 30, 2011 and December 31, 2010 approximate fair value as they bear interest at a rate approximating a market interest rate.

7. Available-for-Sale Investments

The following tables summarize the available-for-sale securities held at June 30, 2011 and December 31, 2010 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2011:				
U.S. government-sponsored securities	\$ 45,181	\$ 10	\$ (20)	\$ 45,171
U.S. Treasury securities	107,679	62		107,741
Total	\$ 152,860	\$ 72	\$ (20)	\$ 152,912

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2010:				
U.S. government-sponsored securities	\$ 87,503	\$ 3	\$ (19)	\$ 87,487
U.S. Treasury securities	116,200	24	(5)	116,219
Total	\$ 203,703	\$ 27	\$ (24)	\$ 203,706

The contractual maturities of all securities held at June 30, 2011 was one year or less. There were five investments in an unrealized loss position at June 30, 2011, none of which had been in an unrealized loss position for more than twelve months. The aggregate fair value of these securities was approximately \$14.7 million. The Company reviews its investments for other-than-temporary impairment whenever the fair value of an investment is less than amortized cost and evidence indicates that an investment's carrying amount is not recoverable within a reasonable period of time. To determine whether an impairment is other-than-temporary, the Company considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. The Company did not hold any securities with an other-than-temporary impairment at June 30, 2011.

Gross realized gains and losses on the sales of investments have not been material to the Company's consolidated results of operations.

8. Commitments and Contingencies

The Company leases its facility and various equipment under leases that expire at varying dates through 2018. Certain of these leases contain renewal options, and require the Company to pay operating costs, including property taxes, insurance and maintenance.

In January 2007, the Company entered into a lease agreement for 113,646 rentable square feet of office and lab space at 301 Binney Street, Cambridge, Massachusetts. The initial term of the lease is eight years expiring in January 2016, and the Company has the right to extend the initial term for two additional terms of five years each. The Company's occupancy of the space occurred in four distinct phases, and rent for each phase commenced at the earlier of a contractually set date or the occupancy date. Base rent for the space ranges from \$49.25 to \$60.50 per rentable square foot per year. Base rent escalates in January 2012 based upon a formula that is tied to the Consumer Price Index. The space was delivered to the Company in September 2007, and rent payments for the initial

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occupancy commenced in January 2008. The rent expense, inclusive of the escalating rent payments and free rent period is recognized on a straight-line basis over the term of the lease agreement. In accordance with the terms of the lease agreement, in the second quarter of 2010, the Company increased the letter of credit securing its obligations under the lease agreement by approximately \$2.3 million.

The Company amended the lease agreement in February 2010, July 2010 and February 2011 (together the Amendments) in order to lease additional space. Pursuant to the Amendments, the Company leases an additional 80,340 rentable square feet of the 301 Binney Street building, comprised of (a) an initial phase of 35,444 rentable square feet (the Initial Phase), (b) a second phase of 21,589 rentable square feet (the Second Phase) and (c) a third phase of 23,307 rentable square feet (the Third Phase). Rent for the Initial Phase commenced on July 1, 2010, rent for the Second Phase commenced on March 1, 2011 and rent for the Third Phase will commence no later than February 15, 2012. Initial base rent for the Initial Phase is \$42.00 per rentable square foot per year and the initial base rent for the Second Phase and Third Phase is \$42.50 per rentable square foot per year. Base rent for the Initial Phase, Second Phase and Third Phase will increase annually by \$0.50 per rentable square foot. The Amendments do not change the expiration date of the lease agreement.

The landlord has reimbursed the Company for its tenant improvements for the space occupied prior to the Amendments at a set rate per rentable square foot. Under the terms of the Amendments, the landlord has or will provide the Company with an allowance for the expansion space, which consists of \$55.00 per rentable square foot for tenant improvements in the Initial Phase and the Second Phase and an allowance of \$40.00 per rentable square foot for the Third Phase. As of June 30, 2011, approximately \$15.9 million has been paid to the Company as reimbursement for tenant improvements under the lease agreement, including the Amendments. The reimbursement amount is recorded as deferred rent on the condensed consolidated balance sheets and is being amortized as a reduction to rent expense over the term of the lease agreement.

The Company, and in some cases, along with its collaboration partner, Forest, has entered into multiple commercial supply agreements for the purchase of linaclotide API and drug product. Some of the agreements contain minimum purchase commitments, the earliest of which commences in 2012. As of June 30, 2011, the Company's minimum purchase requirement across all the agreements is approximately \$44.8 million through 2017.

9. Restricted Stock

In 2009, the Company granted an aggregate of 515,549 shares of common stock to independent members of the board of directors under restricted stock agreements in accordance with the terms of the Company's Amended and Restated 2005 Stock Incentive Plan (2005 Plan) and the Company's director compensation program. 115,549 shares of restricted common stock granted in 2009 vested on December 31, 2009 and the remainder vest ratably over four years beginning in January 2010. In the event that a member of the board ceases to serve on the Company's board prior to December 31, 2013, the member shall forfeit all unvested shares in accordance with the terms of the restricted stock agreement.

A summary of the unvested shares of restricted stock as of June 30, 2011 is presented below:

	Shares	Weighted Average Grant Date Fair Value
Unvested at December 31, 2010	270,000	\$ 5.69
Granted		\$
Vested	(42,500)	\$ 5.70
Forfeited	(27,500)	\$ 5.48
Unvested at June 30, 2011	200,000	\$ 5.72

10. Stock Option Plans

The Company has several share-based compensation plans under which stock options, restricted stock, restricted stock units, and other share-based awards are available for grant to employees, directors and consultants of the Company. At June 30, 2011 and December 31, 2010, options for 3,328,825 and 5,574,857 shares, respectively, were available for future grant under the plans.

Table of Contents**Ironwood Pharmaceuticals, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)**

In calculating share-based compensation costs, the Company estimated the fair value of stock options using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of short-lived, exchange-traded options that have no vesting restrictions and are fully transferable. The Company estimates the number of awards that will be forfeited in calculating compensation costs. Such costs are then recognized over the requisite service period of the awards on a straight-line basis.

Determining the fair value of share-based awards using the Black-Scholes option-pricing model requires the use of highly subjective assumptions, including the expected term of the award and expected stock price volatility. The weighted average assumptions used to estimate the fair value of the stock options using the Black-Scholes option-pricing model were as follows for the three and six months ended June 30, 2011 and 2010:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Expected volatility	48.3%	57.3%	49.6%	57.7%
Expected term (in years)	6.5	6.5	6.5	6.5
Risk-free interest rate	2.6%	3.1%	2.8%	3.1%
Expected dividend yield	%	%	%	%

The following table summarizes the expense recognized for these share-based compensation arrangements in the condensed consolidated statements of operations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Ironwood:				
Employee stock options	\$ 2,759	\$ 1,407	\$ 5,243	\$ 2,865
Restricted stock awards	97	119	215	227
Non-employee stock options	41	46	78	58
ESPP	47		98	
Stock awards	7	93	15	103
	2,951	1,665	5,649	3,253
Microbia Stock Plan (included in discontinued operations)		25		45
	\$ 2,951	\$ 1,690	\$ 5,649	\$ 3,298

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Share-based compensation is reflected in the condensed consolidated statements of operations as follows for the three and six months ended June 30, 2011 and 2010 (in thousands):

	Three Months Ended			Six Months Ended		
	June 30,			June 30,		
	2011	2010	2011	2010	2011	2010
Research and development	\$ 1,465	\$ 1,034	\$ 2,803	\$ 1,756		
General and administrative	1,486	631	2,846	1,497		
Net loss from discontinued operations		25		45		

Table of Contents**Ironwood Pharmaceuticals, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)**

The following table summarizes stock option activity under the share-based compensation plans, including performance-based options:

	Shares of Common Stock Attributable to Options	Weighted Average Exercise Price	Weighted Average Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2010	14,603,229	\$ 4.25	6.44	\$ 91,575
Granted	2,440,050	\$ 11.66		
Exercised	(1,068,688)	\$ 1.62		
Cancelled	(187,833)	\$ 8.17		
Outstanding at June 30, 2011	15,786,758	\$ 5.53	6.61	\$ 160,914
Vested or expected to vest at June 30, 2011	14,330,899	\$ 5.43	6.52	\$ 147,403
Exercisable at June 30, 2011(1)	6,551,243	\$ 2.91	4.96	\$ 83,936

(1) All stock options granted under the 1998 Amended and Restated Stock Option Plan, the Amended and Restated 2002 Stock Incentive Plan and the 2005 Plan contain provisions allowing for the early exercise of such options into restricted stock. The exercisable shares disclosed above represent those that are vested as of June 30, 2011.

The weighted average grant date fair value per share of options granted to employees during the three and six months ended June 30, 2011 was approximately \$7.67 and \$6.10, respectively, and approximately \$7.26 and \$6.69 during the three and six months ended June 30, 2010, respectively. The grant date fair value of the options granted to employees during the three and six months ended June 30, 2011 was approximately \$3.0 million and \$14.9 million, respectively, and approximately \$2.4 million and \$12.5 million during the three and six months ended June 30, 2010, respectively. The total intrinsic value of options exercised during the three and six months ended June 30, 2011 was approximately \$6.6 million and \$12.8 million, respectively, and approximately \$2.0 million and \$8.4 million during the three and six months ended June 30, 2010, respectively.

As of June 30, 2011, there was approximately \$1.1 million and \$24.1 million of unrecognized share-based compensation, net of estimated forfeitures, related to restricted stock awards and unvested stock option grants with time-based vesting, respectively, which are expected to be recognized over a weighted average period of 2.5 years and 3.2 years, respectively. The total unrecognized share-based compensation cost will be adjusted for future changes in estimated forfeitures.

11. Related Party Transactions

The Company has and currently obtains legal services from a law firm that is an investor in the Company. The Company paid approximately \$57,000 and \$95,000 in legal fees to this investor during the three and six months ended June 30, 2011, respectively, and approximately \$41,000 and \$100,000 during the three and six months ended June 30, 2010, respectively.

In September 2009, Forest became a related party when the Company sold to Forest 2,083,333 shares of the Company's convertible preferred stock and in November 2009, Almirall became a related party when the Company sold to Almirall 681,819 shares of the Company's convertible preferred stock (Note 5).

12. Segment Reporting

Prior to the sale of its interest in Microbia in September 2010, the Company had two reportable business segments: human therapeutics and biomanufacturing. The Company has no inter-segment revenues.

Table of Contents**Ironwood Pharmaceuticals, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)**

The following table reports revenue and loss from operations for the Company's reportable segments for the three and six months ended June 30, 2011 and 2010 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Revenue:				
Human therapeutics	\$ 11,262	\$ 9,188	\$ 21,499	\$ 18,026
Bio manufacturing (included in discontinued operations)		1,771		1,985
Total	\$ 11,262	\$ 10,959	\$ 21,499	\$ 20,011
Loss from operations:				
Human therapeutics	\$ (18,952)	\$ (17,310)	\$ (37,494)	\$ (31,806)
Bio manufacturing (included in discontinued operations)		(9)		(1,741)
Total	\$ (18,952)	\$ (17,319)	\$ (37,494)	\$ (33,547)

	June 30,	December 31,
	2011	2010
Total assets:		
Human therapeutics	\$ 249,727	\$ 301,365
Bio manufacturing (included in discontinued operations)		
Total	\$ 249,727	\$ 301,365

At June 30, 2011 and December 31, 2010, all of the Company's accounts receivable related to the human therapeutics segment.

13. State Grant