UNITED THERAPEUTICS Corp
Form 10-Q
July 28, 2016
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

OR

o 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 0-26301

United Therapeutics Corporation

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**52-1984749**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
1040 Spring Street, Silver Spring, MD	**20910**
(Address of Principal Executive Offices)	(Zip Code)

(301) 608-9292

(Registrant s Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

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

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

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

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

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

The number of shares outstanding of the issuer s common stock, par value $.01 per share, as of July 21, 2016 was 43,467,794.

Table of Contents

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. CONSOLIDATED FINANCIAL STATEMENTS

UNITED THERAPEUTICS CORPORATION

CONSOLIDATED BALANCE SHEETS

(In millions, except share data)

	June 30, 2016 (Unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 837.5	$ 831.8
Marketable investments	107.2	122.0
Accounts receivable, net of allowance of none for 2016 and 2015	238.1	192.8
Inventories, net	89.1	81.3
Other current assets	43.5	47.4
Total current assets	1,315.4	1,275.3
Marketable investments	3.9	38.0
Goodwill and other intangible assets, net	34.1	28.4
Property, plant, and equipment, net	490.6	495.8
Deferred tax assets, net	188.1	192.7
Other assets	169.4	154.2
Total assets	$ 2,201.5	$ 2,184.4
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 124.0	$ 103.4
Convertible notes	0.9	5.4
Share tracking awards plan	120.9	274.5
Other current liabilities	46.6	57.4
Total current liabilities	292.4	440.7
Other liabilities	92.0	144.0
Total liabilities	384.4	584.7
Commitments and contingencies		
Temporary equity	10.9	11.1
Stockholders equity:		
Preferred stock, par value $.01, 10,000,000 shares authorized, no shares issued		
Series A junior participating preferred stock, par value $.01, 100,000 shares authorized, no shares issued		
Common stock, par value $.01, 245,000,000 shares authorized, 69,220,268 and 68,987,919 shares issued, and 43,732,565 and 45,760,845 shares outstanding at June 30, 2016 and December 31, 2015, respectively	0.7	0.7
Additional paid-in capital	1,826.7	1,790.6
Accumulated other comprehensive loss	(14.7)	(20.4)
	(2,167.9)	(1,902.1)

Treasury stock, 25,487,703 and 23,227,074 shares at June 30, 2016 and December 31, 2015, respectively				
Retained earnings		2,161.4		1,719.8
Total stockholders equity		1,806.2		1,588.6
Total liabilities and stockholders equity	$	2,201.5	$	2,184.4

See accompanying notes to consolidated financial statements.

Table of Contents

UNITED THERAPEUTICS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except per share data)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
	(Unaudited)		(Unaudited)	
Revenues:				
Net product sales	$ 412.6	$ 345.8	$ 781.6	$ 671.7
Other		1.4		3.0
Total revenues	412.6	347.2	781.6	674.7
Operating expenses:				
Cost of product sales	20.0	16.0	20.7	36.8
Research and development	35.2	49.4	34.8	159.6
Selling, general and administrative	72.2	110.0	77.2	321.3
Total operating expenses	127.4	175.4	132.7	517.7
Operating income	285.2	171.8	648.9	157.0
Other income (expense):				
Interest expense	(0.6)	(1.3)	(1.2)	(3.4)
Other, net	1.1	(2.1)	1.9	(2.0)
Total other income (expense), net	0.5	(3.4)	0.7	(5.4)
Income before income taxes	285.7	168.4	649.6	151.6
Income tax expense	(79.6)	(69.2)	(208.0)	(69.0)
Net income	$ 206.1	$ 99.2	$ 441.6	$ 82.6
Net income per common share:				
Basic	$ 4.65	$ 2.15	$ 9.86	$ 1.78
Diluted	$ 4.39	$ 1.91	$ 9.24	$ 1.57
Weighted average number of common shares outstanding:				
Basic	44.3	46.1	44.8	46.4
Diluted	46.9	51.9	47.8	52.5

See accompanying notes to consolidated financial statements.

Table of Contents

UNITED THERAPEUTICS CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
	(Unaudited)		(Unaudited)	
Net income	$ 206.1	$ 99.2	$ 441.6	$ 82.6
Other comprehensive income (loss):				
Foreign currency translation (loss) gain	(2.2)	1.5	(1.8)	(1.6)
Defined benefit pension plan:				
Actuarial gain (loss) arising during period, net of tax	7.1		7.1	(2.1)
Less: amortization of actuarial gain and prior service cost included in net periodic pension cost, net of tax	0.2	0.2	0.4	0.5
Total defined benefit pension plan, net	7.3	0.2	7.5	(1.6)
Other comprehensive income (loss), net of tax	5.1	1.7	5.7	(3.2)
Comprehensive income	$ 211.2	$ 100.9	$ 447.3	$ 79.4

See accompanying notes to consolidated financial statements.

Table of Contents

UNITED THERAPEUTICS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
	(Unaudited)	
Cash flows from operating activities:		
Net income	$ 441.6	$ 82.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	15.6	16.7
Share-based compensation (benefit) expense	(143.1)	281.8
Amortization of debt discount and debt issue costs	0.1	5.1
Amortization of discount or premium on investments	0.3	1.4
Other	1.1	(4.5)
Excess tax benefits from share-based compensation	(3.5)	(23.5)
Changes in operating assets and liabilities:		
Accounts receivable	(45.3)	(6.9)
Inventories	(8.8)	(1.9)
Accounts payable and accrued expenses	19.8	23.3
Other assets and liabilities	(26.3)	(224.0)
Net cash provided by operating activities	251.5	150.1
Cash flows from investing activities:		
Purchases of property, plant and equipment	(14.2)	(7.8)
Purchases of held-to-maturity investments	(0.8)	(61.3)
Maturities of held-to-maturity investments	49.6	172.8
Purchase of investments under the cost method, net	(7.6)	(4.2)
Purchase of investments under the equity method	(2.1)	
Intangible assets acquired	(5.2)	
Net cash provided by investing activities	19.7	99.5
Cash flows from financing activities:		
Principal payments of debt	(7.9)	(104.3)
Payments of debt issuance costs	(6.8)	
Payments to repurchase common stock	(259.7)	(336.8)
Proceeds from the exercise of stock options	5.0	24.4
Issuance of stock under employee stock purchase plan	2.2	1.9
Excess tax benefits from share-based compensation	3.5	23.5
Net cash used in financing activities	(263.7)	(391.3)
Effect of exchange rate changes on cash and cash equivalents	(1.8)	(1.6)
Net increase (decrease) in cash and cash equivalents	5.7	(143.3)
Cash and cash equivalents, beginning of period	831.8	397.7
Cash and cash equivalents, end of period	$ 837.5	$ 254.4
Supplemental cash flow information:		
Cash paid for interest	$ 0.1	$ 0.7
Cash paid for income taxes	$ 222.0	$ 110.1
Non-cash investing and financing activities:		
Non-cash additions to property, plant and equipment	$ 3.4	$ 1.4

Issuance of common stock upon conversion of convertible notes	$ 6.1	$ 263.3

See accompanying notes to consolidated financial statements.

Table of Contents

UNITED THERAPEUTICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(UNAUDITED)

1. Organization and Business Description

United Therapeutics Corporation is a biotechnology company focused on the development and commercialization of innovative products to address the unmet medical needs of patients with chronic and life-threatening diseases.

We have approval from the U.S. Food and Drug Administration (FDA) to market the following therapies: Remodulin® (treprostinil) Injection (Remodulin), Tyvaso® (treprostinil) Inhalation Solution (Tyvaso), Adcirca® (tadalafil) Tablets (Adcirca), Orenitram® (treprostinil) Extended-Release Tablets (Orenitram) and Unituxin® (dinutuximab) Injection (Unituxin). We commenced commercial sales of Unituxin in the United States during the third quarter of 2015. Remodulin has also been approved in various countries outside the United States, and Unituxin was granted marketing authorization by the European Medicines Agency in August 2015. Tyvaso is also approved in Israel.

As used in these notes to the consolidated financial statements, unless the context otherwise requires, the terms we , us , our , and similar terms refer to United Therapeutics Corporation and its consolidated subsidiaries.

2. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the U.S. Securities and Exchange Commission (SEC) for interim financial information. Accordingly, they do not include all of the information required by U.S. generally accepted accounting principles (GAAP) for complete financial statements. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the accompanying notes to the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the SEC on February 25, 2016.

In our management s opinion, the accompanying consolidated financial statements contain all adjustments, including normal, recurring adjustments, necessary to fairly present our financial position as of June 30, 2016, statements of operations and comprehensive income (loss) for the three-and six-month periods ended June 30, 2016 and June 30, 2015 and cash flows for the six-month periods ended June 30, 2016 and June 30, 2015. Interim results are not necessarily indicative of results for an entire year.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). ASU 2014-09 will eliminate transaction-specific and industry-specific revenue recognition guidance under current GAAP and replace it with a principle-based approach for determining revenue recognition. ASU 2014-09 will require that companies recognize revenue based on the value of transferred goods or services as they occur in the contract. ASU 2014-09 also will require additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. ASU 2014-09 allows for either full retrospective or modified retrospective adoption. On July 9, 2015, the FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606); Deferral of the Effective Date*, which (1) delays the effective date of ASU 2014-09 by one year to annual periods beginning after December 15, 2017; and (2) allows early adoption of the ASU by all entities as of the original effective date for public entities. We are evaluating the transition method we will elect and the effects of the adoption of this ASU on our financial statements.

In July 2015, the FASB issued ASU No. 2015-11, *Simplifying the Measurement of Inventory* (ASU 2015-11), which requires that inventory be measured at the lower of cost or net realizable value for entities using first-in, first-out or average cost methods. ASU 2015-11 should be applied prospectively and will be effective for fiscal years beginning after December 15,

Table of Contents

2016, and for interim periods within those fiscal years, with early adoption permitted. We are evaluating the effect of adoption on our financial statements.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*, which requires equity investments to be measured at fair value through net income. Equity investments that are accounted for under the equity method are not impacted. ASU 2016-01 provides that equity investments without readily determinable fair values can be valued at cost minus impairment with a simplified impairment assessment using qualitative assessments. ASU 2016-01 requires separate presentation of the financial assets and liabilities by category and form. ASU 2016-01 should be applied prospectively and will be effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. Early adoption is not permitted except in limited circumstances. We are evaluating the effect of adoption on our financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (ASU 2016-02), which requires that organizations recognize lease assets and lease liabilities on the balance sheet. ASU 2016-02 also requires additional quantitative and qualitative disclosures that provide the amount, timing, and uncertainty of cash flows relating to lease arrangements. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018 using a modified retrospective approach. The modified retrospective approach requires retrospective application to the earliest period presented in the respective financial statements, provides certain practical expedients related to leases that commenced prior to the effective date and allows the use of hindsight when evaluating lease options. Early adoption is permitted. We are evaluating the effect of adoption on our financial statements.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation Stock Compensation* (ASU 2016-09), which serves to simplify the accounting for share-based payment transactions. ASU 2016-09 includes guidance on several aspects of the accounting for share-based payments, including the income tax consequences, forfeitures and classification on the statement of cash flows. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and for interim periods within those fiscal years. Early adoption is permitted. We are evaluating the effect of adoption on our financial statements.

3. Investments

Marketable Investments

Marketable investments classified as held-to-maturity consist of the following (in millions):

As of June 30, 2016	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Government-sponsored enterprises	$ 44.2	$ 0.1	$	$ 44.3
Corporate notes and bonds	66.9			66.9
Total	$ 111.1	$ 0.1	$	$ 111.2
Reported under the following captions on the consolidated balance sheet:				

Current marketable investments	$	107.2
Noncurrent marketable investments		3.9
	$	111.1

Table of Contents

As of December 31, 2015		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
Government-sponsored enterprises	$	53.3	$		$	(0.2)	$	53.1
Corporate notes and bonds		106.7						106.7
Total	$	160.0	$		$	(0.2)	$	159.8
Reported under the following captions on the consolidated balance sheet:								
Current marketable investments	$	122.0						
Noncurrent marketable investments		38.0						
	$	160.0						

The following table summarizes gross unrealized losses and the length of time marketable investments have been in a continuous unrealized loss position (in millions):

	As of June 30, 2016				As of December 31, 2015			
		Fair Value		Gross Unrealized Loss		Fair Value		Gross Unrealized Loss
Government-sponsored enterprises:								
Continuous unrealized loss position less than one year	$		$		$	48.1	$	(0.2)
Continuous unrealized loss position greater than one year								
						48.1		(0.2)
Corporate notes and bonds:								
Continuous unrealized loss position less than one year		3.0				63.8		
Continuous unrealized loss position greater than one year								
		3.0				63.8		
Total	$	3.0	$		$	111.9	$	(0.2)

We attribute gross unrealized losses pertaining to our held-to-maturity securities as of December 31, 2015 to the variability in related market interest rates. We do not intend to sell these securities, nor is it more likely than not that we will be required to sell them prior to the end of their contractual terms. Furthermore, we do not believe that these securities expose us to undue market risk or counterparty credit risk. As such, we do not consider these securities to be other than temporarily impaired.

The following table summarizes the contractual maturities of held-to-maturity marketable investments (in millions):

	June 30, 2016			
		Amortized Cost		Fair Value
Due in less than one year	$	107.2	$	107.3
Due in one to two years		3.9		3.9
Total	$	111.1	$	111.2

Table of Contents

4. Fair Value Measurements

We account for certain assets and liabilities at fair value and rank these assets within a fair value hierarchy (Level 1, Level 2 or Level 3). Our other current assets and our current liabilities have fair values that approximate their carrying values. Assets and liabilities subject to fair value measurements are as follows (in millions):

	As of June 30, 2016			
	Level 1	Level 2	Level 3	Balance
Assets				
Money market funds(1)	$ 669.0	$	$	$ 669.0
Federally-sponsored and corporate debt securities(2)		111.2		111.2
Total assets	$ 669.0	$ 111.2	$	$ 780.2
Liabilities				
Convertible notes(3)	$ 2.6	$	$	$ 2.6
Contingent consideration(4)			10.3	10.3
Total liabilities	$ 2.6	$	$ 10.3	$ 12.9

	As of December 31, 2015			
	Level 1	Level 2	Level 3	Balance
Assets				
Money market funds(1)	$ 496.4	$	$	$ 496.4
Federally-sponsored and corporate debt securities(2)		159.8		159.8
Total assets	$ 496.4	$ 159.8	$	$ 656.2
Liabilities				
Convertible notes(3)	$ 16.0	$	$	$ 16.0
Contingent consideration(4)			9.4	9.4
Total liabilities	$ 16.0	$	$ 9.4	$ 25.4

(1) Included in cash and cash equivalents on the accompanying consolidated balance sheets.

(2) Included in current and non-current marketable investments on the accompanying consolidated balance sheets. The fair value of these securities is principally measured or corroborated by trade data for identical securities in which related trading activity is not sufficiently frequent to be considered a Level 1 input or comparable securities that are more actively traded.

(3) Included in convertible notes on the accompanying consolidated balance sheets. The fair value of our Convertible Notes is estimated using Level 1 observable inputs since our Convertible Notes are trading with sufficient frequency such that we believe related pricing can be used as the primary basis for measuring their fair value. As of June 30, 2016 and December 31, 2015, the fair value of the Convertible Notes was substantially higher than their book value. This was primarily due to the excess conversion value of the notes compared to the notes par value, and the fact

that any such excess would be paid in shares of our common stock.

(4) Included in other liabilities on the accompanying consolidated balance sheets. The fair value of contingent consideration has been estimated using probability weighted discounted cash flow models (DCF). The DCFs incorporate Level 3 inputs including estimated discount rates that we believe market participants would consider relevant in pricing and the projected timing and amount of cash flows, which are estimated and developed, in part, based on the requirements specific to each acquisition agreement. We analyze and evaluate these fair value measurements quarterly to determine whether valuation inputs continue to be relevant and appropriate or whether current period developments warrant adjustments to valuation inputs and related measurements.

Table of Contents

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses approximate fair value because of their short maturities. The fair values of our marketable investments and our Convertible Notes are reported above within the fair value hierarchy. Refer to Note 3 *Investments Marketable Investments* and Note 8 *Debt Convertible Notes*.

5. Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market (current replacement cost) and consist of the following, net of reserves (in millions):

		June 30, 2016		December 31, 2015
Raw materials	$	24.8	$	23.1
Work-in-progress		27.0		22.5
Finished goods		37.3		35.7
Total inventories	$	89.1	$	81.3

6. Goodwill and Other Intangible Assets

Goodwill and other intangible assets comprise the following (in millions):

	As of June 30, 2016						As of December 31, 2015					
		Gross		Accumulated Amortization		Net		Gross		Accumulated Amortization		Net
Goodwill	$	10.3	$		$	10.3	$	10.3	$		$	10.3
Other intangible assets:												
Technology, patents and trade names		6.5		(4.7)		1.8		6.5		(4.7)		1.8
In-process, research and development		21.5				21.5		15.5				15.5
Customer relationships and non-compete agreements		4.3		(3.8)		0.5		4.3		(3.5)		0.8
Contract-based		1.3		(1.3)				1.3		(1.3)		
Total	$	43.9	$	(9.8)	$	34.1	$	37.9	$	(9.5)	$	28.4

7. Share Tracking Awards Plans

We previously issued awards under the United Therapeutics Corporation Share Tracking Awards Plan, adopted in June 2008 (2008 STAP) and the United Therapeutics Corporation 2011 Share Tracking Awards Plan, adopted in March 2011 (2011 STAP). We refer to the 2008 STAP and the 2011 STAP collectively as the STAP and awards granted and/or outstanding under either of these plans as STAP awards. STAP awards convey the right to receive in cash an amount equal to the appreciation of our common stock, which is measured as the increase in the closing price of our common stock between the dates of grant and exercise. STAP awards expire on the tenth anniversary of the grant date, and in most cases they vest in equal increments on each anniversary of the grant date over a four-year period. The STAP liability includes vested awards and awards that are expected to vest. We recognize expense for awards that are expected to vest during the vesting period. We discontinued the issuance of STAP awards in June 2015, when our shareholders approved the United Therapeutics Corporation 2015 Stock Incentive Plan (the 2015 Plan), a broad-based stock incentive plan enabling us to grant stock options and other forms of equity compensation to our employees. See Note 9 *Stockholders Equity* to these consolidated financial statements for information on the 2015 Plan.

The aggregate STAP liability balance was $161.3 million and $354.7 million at June 30, 2016 and December 31, 2015, respectively, of which $40.4 million and $80.2 million, respectively, has been classified as non-current liabilities under the caption Other liabilities on our consolidated balance sheets based on their vesting terms.

Estimating the fair value of STAP awards requires the use of certain inputs that can materially impact the determination of fair value and the amount of compensation (benefit) expense we recognize. Inputs used in estimating fair value include the price of our common stock, the expected volatility of the price of our common stock, the risk-free interest rate, the expected

Table of Contents

term of STAP awards, the expected forfeiture rate and the expected dividend yield. The fair value of the STAP awards is measured each financial reporting period because the awards are settled in cash.

The table below includes the weighted-average assumptions used to measure the fair value of the outstanding STAP awards:

	June 30, 2016	June 30, 2015
Expected volatility	36.9%	34.4%
Risk-free interest rate	0.7%	1.4%
Expected term of awards (in years)	3.0	4.3
Expected forfeiture rate	10.4%	9.6%
Expected dividend yield	0.0%	0.0%

The closing price of our common stock was $105.92 and $173.95 on June 30, 2016 and June 30, 2015, respectively.

A summary of the activity and status of STAP awards is presented below:

	Number of Awards	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value (in millions)
Outstanding at January 1, 2016	6,845,163	$ 86.86		
Granted				
Exercised	(542,555)	61.77		
Forfeited	(401,962)	86.38		
Outstanding at June 30, 2016	5,900,646	$ 89.20		