

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended: December 31, 2017

**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 001-36150

**SORRENTO THERAPEUTICS, INC.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)  
  
**4955 Directors Place,**  
**San Diego, California**  
(Address of Principal Executive Offices)

**33-0344842**  
(I.R.S. Employer  
Identification No.)

**92121**  
(Zip Code)

**(858) 203-4100**

(Registrant's telephone number, including area code)  
**Securities registered pursuant to Section 12(b) of the Act:**

| Title of each class                        | Name of exchange on which registered |
|--|--------------------------------------|
| Common Stock, par value \$0.0001 per share | The Nasdaq Stock Market LLC          |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.  Yes  No

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 the filing requirements for at least 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 (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

|                         |  |                           |                                     |
|-------------------------|--|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/>   | Accelerated filer         | <input checked="" type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/>            |
| Emerging growth company | <input type="checkbox"/>   |                           |                                     |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of voting stock held by non-affiliates of the registrant is calculated based upon the closing sale price of the common stock on June 30, 2017 (the last trading day of the registrant's second fiscal quarter of 2017), as reported on the Nasdaq Capital Market, was approximately \$153.0 million.

At March 9, 2018, the registrant had 87,434,049 shares of common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of our Proxy Statement for the 2018 Annual Meeting of Stockholders or an amendment to this Annual Report on Form 10-K, to be filed within 120 days of December 31, 2017, are incorporated by reference in Part III.

SORRENTO THERAPEUTICS, INC.  
ANNUAL REPORT ON FORM 10-K  
FISCAL YEAR ENDED DECEMBER 31, 2017

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## FORWARD-LOOKING STATEMENTS

*This Annual Report on Form 10-K, or Form 10-K, contains “forward-looking statements” that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially and adversely from those expressed or implied by such forward-looking statements. The forward-looking statements are contained principally in Item 1—“Business,” Item 1.A—“Risk Factors” and Item 7—“Management’s Discussion and Analysis of Financial Condition and Results of Operations” but appear throughout the Form 10-K. Examples of forward-looking statements include, but are not limited to our expectations, beliefs or intentions regarding our potential product offerings, business, financial condition, results of operations, strategies or prospects and other matters that do not relate strictly to historical facts or statements of assumptions underlying any of the foregoing. These statements are often identified by the use of words such as “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “ongoing,” “opportunity,” “plan,” “potential,” “predicts,” “seek,” “should,” “will,” or “would,” and similar expressions and variations or negatives of these words. These forward-looking statements are based on the expectations, estimates, projections, beliefs and assumptions of our management based on information currently available to management, all of which are subject to change. Such forward-looking statements are subject to risks, uncertainties and other factors that are difficult to predict and could cause our actual results and the timing of certain events to differ materially and adversely from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed under Item 1.A—“Risk Factors” in this Form 10-K. Furthermore, such forward-looking statements speak only as of the date of this Form 10-K. We undertake no obligation to update or revise publicly any forward-looking statements to reflect events or circumstances after the date of such statements for any reason, except as otherwise required by law.*

### PART I

#### **Item 1. Business.**

##### **Overview**

Sorrento Therapeutics, Inc. (Nasdaq: SRNE), together with its subsidiaries (collectively, the “Company”, “we”, “us” and “our”) is a clinical stage biotechnology company focused on delivering clinically meaningful therapies to patients and their families, globally. Our primary focus is to transform cancer into a treatable or chronically manageable disease. We also have programs assessing the use of our technologies and products in auto-immune, inflammatory and neurodegenerative diseases and pain indications with high unmet medical needs.

At our core, we are an antibody-centric company and leverage our proprietary G-MAB™ library and targeted delivery modalities to generate the next generation of cancer therapeutics. Our validated fully human antibodies include PD-1, PD-L1, CD38, CD123, CD47, c-MET, VEGFR2, CCR2, OX40, TIGIT and CD137 among others.

Our vision is to leverage these antibodies in conjunction with proprietary targeted delivery modalities to generate the next generation of cancer therapeutics. These modalities include proprietary antibody drug conjugates (“ADCs”), bispecific approaches, as well as T-Cell Receptor (“TCR”)-like antibodies. With LA Cell, Inc. (“LA Cell”), our joint venture with City of Hope, our objective is to become the global leader in the development of antibodies against intracellular targets such as STAT3, mutant KRAS, MYC, p53 and TAU. Additionally, we have acquired and are assessing the regulatory and strategic path forward for our portfolio of late stage biosimilar/biobetter antibodies based on Erbitux®, Remicade®, Xolair®, and Simulect® as these may represent nearer term commercial opportunities.

With each of our programs, we aim to tailor our therapies to treat specific stages in the evolution of cancer, from elimination, to equilibrium and escape. In addition, our objective is to focus on tumors that are resistant to current treatments and where we can design focused trials based on a genetic signature or biomarker to ensure patients have the best chance of a durable and significant response. We have several immuno-oncology programs that are in or near to entering the clinic. These include cellular therapies, an oncolytic virus and a palliative care program targeted to treat intractable cancer pain. Finally, as part of our global aim to provide a wide range of therapeutic products to meet underserved therapeutic markets, we have made investments and developed a separate pain focused franchise which we believe will serve to provide short term upside to our core thesis.

Our cellular therapy programs focus on Chimeric Antigen Receptor-T Cell (“CAR-T”) for adoptive cellular immunotherapy to treat both solid and liquid tumors. We have reported early data from Phase I trials of our carcinoembryonic antigen (“CEA”) and PSMA directed CAR-T programs. Our CD38 CAR-T is being evaluated in the context of highly resistant

multiple myeloma (“MM”), amyloidosis and graft-versus-host disease (“GvHD”). We are assessing our CD123 CAR-T in the context of highly resistant acute myeloid leukemia (“AML”). Both of the latter programs have successfully demonstrated strong preclinical anti-tumor activity in animal models. Our plan is to submit Investigational New Drug (“IND”) applications with the U.S. Food and Drug Administration (the “FDA”) for at least one of these CAR-T programs in 2018.

Finally, as part of our global aim to provide a wide range of therapeutic products to meet underserved therapeutic markets, we have made investments and developed a separate pain focused franchise which we believe will serve to provide short term upside to our core thesis. Within this franchise, resiniferatoxin (“RTX”) is a non-opioid-based TRPV1 agonist neurotoxin used as an injectable pain treatment. The compound RTX has been granted orphan drug status for the treatment of intractable pain at end-stage cancer and a Phase I trial with the National Institutes of Health (“NIH”) is concluding. Other applications of RTX are expected to start Phase I trials in 2018. Additionally, we have acquired proprietary technologies to responsibly develop next generation, branded pharmaceutical products to better manage critical conditions and maximize the quality of life of patients and healthcare providers. Scilex’s lead product candidate, ZTlido™ (lidocaine topical system 1.8%), is a next-generation lidocaine delivery system recently approved by the FDA for the treatment of postherpetic neuralgia, a severe neuropathic pain condition. ZTlido™ (lidocaine topical system 1.8%) is manufactured by our collaboration partner in their state of the art manufacturing facility.

## **Our Strategy**

Our primary goal is to deliver clinically meaningful therapies to patients and their families, globally. In immuno-oncology, we aim to deliver next generation therapeutics to transform cancer into a treatable or chronically manageable disease. Across all our programs, we are focused on addressing severe unmet medical needs where our therapies can change the natural course of disease or significantly improve a patient’s quality of life.

Our core strategic objectives and resources are focused on:

1. Advancing our lead product candidates through the clinic. These include the initiation of Phase I, Phase II and potentially accelerated approval trials for our cellular therapies, oncolytic virus immunotherapy and RTX in oncology and/or hematology indications.
2. Continuing the development of our preclinical programs with the aim of filing several new INDs over the next 5 years. These include moving our checkpoint inhibitors from our core antibody portfolio into the clinic with several of our strategic partners, while internally focusing on advancing our transformational intracellular targeting antibodies (“iTAbs”), with LA Cell.
3. Collaborating with key opinion leaders and leading clinical and research institutes to enhance our preclinical and clinical development plans. We currently have such agreements in place with the Karolinska Institute, The Scripps Research Institute (“TSRI”), the NIH, City of Hope, Tufts Medical School, and Roger Williams Medical Center, among others.
4. Manufacturing our preclinical and clinical materials in-house. We have established a quality control and quality assurance program, which includes a set of standard operating procedures and specifications designed to ensure that our products are manufactured in accordance with current good manufacturing practices (“cGMPs”), and other applicable domestic and foreign regulations.
5. Exploring strategic relationships to share in the risk reward of our core franchises and to derive near term value from our non-core franchise, such as our pain franchise. Our partnering objectives include generating revenue through license fees, milestone-related development fees and royalties as well as profit shares or joint ventures to generate potential returns from our product candidates and technologies.

## **Segment Information and Financial Information about Geographic Areas**

We have determined that we operate in one operating segment. See Note 3 to the notes to our consolidated financial statements accompanying this Form 10-K for further information. All of our revenues from continuing operations are essentially attributed to the United States. All of our long-lived assets are essentially located within the United States.

## **Pipeline and Product Candidates**

An overview of our core programs is provided in the table below:

|  |   |
|--|---|
| <p><b>CAR-based Immunotherapies</b></p>            | <ul style="list-style-type: none"> <li>&gt; Autologous and allogeneic CAR-T therapies</li> <li>&gt; Targets include CD38 for Multiple Myeloma, CD123 for Acute Myeloid Leukemia, CEA, and PSMA</li> <li>&gt; IND filing expected in 2018</li> </ul>   |
| <p><b>Oncolytic Virus Immunotherapy</b></p>        | <ul style="list-style-type: none"> <li>&gt; Acquired Virttu Biologics on April 27, 2017</li> <li>&gt; Lead product, Seprehvir®, is an HSV-based oncolytic virus for the treatment of mesothelioma for which Phase I studies have been completed.</li> </ul>                                       |
| <p><b>Antibodies</b></p>                           | <ul style="list-style-type: none"> <li>&gt; mAbs generated from proprietary G-MAB library are targeting PD-L1, CD47, VEGFR2, CCR2, etc.</li> <li>&gt; Next-generation antibody drug conjugates with proprietary toxins, lead program targeting CD38-ADC.</li> </ul>                               |
| <p><b>Intracellular Targeting mAbs (iTAbs)</b></p> | <ul style="list-style-type: none"> <li>&gt; Proprietary platform enables modulation of intracellular targets with antibody therapeutics</li> <li>&gt; Greatly increases druggable space</li> <li>&gt; Licensed from City of Hope, lead targets include STAT3, mutant KRAS, and MYC-MAX</li> </ul> |
| <p><b>Biosimilars</b></p>                          | <ul style="list-style-type: none"> <li>&gt; 4 monoclonal antibodies licensed from Mabtech Limited</li> <li>&gt; Cetuximab (Erbix®), infliximab (Remicade®), omalizumab (Xolair®), basiliximab (Simulect®)</li> <li>&gt; All have completed Phase III studies in China</li> </ul>                  |
| <p><b>Pain Management</b></p>                      | <ul style="list-style-type: none"> <li>&gt; TRPV1 agonist neurotoxin for end-stage intractable cancer pain</li> <li>&gt; Novel anhydrous lidocaine patch to treat post-herpetic neuralgia</li> </ul>  |

## Near Term Clinical Programs

### Cellular Therapies

With our cellular therapy subsidiary, TNK Therapeutics, Inc. (“TNK”), we are focusing on the development of Chimeric Antigen Receptor (“CAR”)-based immunotherapies using autologous T-cells.

#### *CD38 Directed CAR-T Program*

Our most advanced cellular therapy is a proprietary, second generation anti-CD38 CAR-T therapy, which we are developing for the treatment of multiple myeloma and for additional potential indications including amyloidosis and graft-versus-host disease. Our anti-CD38 CAR-T is based on a fully human anti-CD38 mAb derived from our G-MAB™ antibody library.

The membrane glycoprotein CD38 is widely found on the surface of lymphoid and myeloid lineages including B, T and NK cells, but absent from most mature resting lymphocytes with the notable exception of terminally differentiated plasma cells. Because CD38 is highly expressed on multiple myeloma cells, it represents a valuable and validated therapeutic target against myeloma. Multiple myeloma (MM) is a hematologic malignancy in which clonal plasma cells accumulate in the bone marrow or extramedullary sites and give rise to clinical complications such as painful, lytic bone lesions, hypercalcemia, renal impairment, cytopenias, and symptomatic plasmacytomas.

The American Cancer Society estimated 30,280 new cases and 12,590 deaths from multiple myeloma in the U.S. during 2017. The anti-CD38 monoclonal antibody DARZALEX® (daratumumab), marketed by Janssen Oncology, was granted accelerated approval by the FDA for the treatment of multiple myeloma on November 16, 2015. Worldwide net sales of DARZALEX® were \$572 million in 2016 and \$1.2 billion in 2017. We are encouraged by the validation of this important target in the market for multiple myeloma therapeutics and its rapid adoption by clinicians in the myeloma community. We believe our CD38 cellular therapy will provide an additional significant advance in the CD38 blockade for multiple myeloma patients that are resistant or have failed current therapies.

Pre-clinically, CD38 has demonstrated specific activation through the anti-CD38 CAR resulting in the production of cytokines and CAR-T proliferation. In vitro models have shown that CD38-expressing multiple myeloma tumor cells were killed efficiently, and completely eradicated tumors in a xenograft mouse model of human myeloma. Importantly, anti-CD38

CAR-T selectively lysed multiple myeloma target cells expressing high levels of CD38 while avoiding the killing of cells with normal or low levels of CD38. We believe this unique characteristic may result in a more tolerable safety profile in humans and enable a more effective manufacturing process of our anti-CD38 CAR-T cells since we do not anticipate requiring a genetic CD38 knock-out or knock-down in our construct.

We believe anti-CD38 CAR-T benefits from 3 key advantages:

1. **Non-Immunogenic:** Anti-CD38 CAR-T is based on a fully human mAb generated from our GMAB® library. This may result in a potentially more tolerable CAR-T regimen, and a more durable long term response.
2. **Selective Lysing of High Expressing CD38 Positive Cells:** Ability to selectively lyse CD38 high expression cells only, may limit on-target / off-tumor toxicity.
3. **Has Not Demonstrated Graft versus Host Disease:** Our anti-CD38 CAR-T cells did not cause GvHD *in vivo*. This could have implications on our ability to apply this therapy in an allogeneic setting.

Our intention is to submit an IND for anti-CD38 CAR-T in 2018, and initiate a Phase I trial shortly thereafter.

### **CD123 Directed CAR-T Program**

CD123 is a proprietary, second generation anti-CD123 CAR-T therapy which we are developing for the treatment of AML, also known as acute myelogenous leukemia or acute non-lymphocytic leukemia, a cancer of the myeloid line of blood cells, characterized by the rapid growth of abnormal white blood cells that accumulate in the bone marrow and interfere with the production of normal blood cells. AML is the most common acute leukemia affecting adults, and its incidence increases with age. The American Cancer Society estimated 21,380 new cases and 10,590 deaths from acute myeloid leukemia in the U.S. for 2017. Our anti-CD123 CAR-T is based on a fully human anti-CD123 mAb derived from our G-MAB™ antibody library.

CD123 is overexpressed in a variety of hematological neoplasms, including AML, blastic plasmacytoid dendritic cell neoplasm (BPDCN), acute lymphoblastic leukemia (“ALL”), chronic myeloid leukemia (“CML”), Hodgkin’s lymphoma and hairy cell leukemia. The overexpression of CD123 has been clinically correlated with a lower survival rate in AML patients and thus, we believe CD123 could provide an important therapy in this disease.

To date, CD123 has demonstrated specific activation resulting in the production of cytokines and CAR-T proliferation. Anti-CD123 CAR-T has selectively lysed CD123-expressing AML tumor cells *in vitro*, and strongly suppressed the growth of established tumors in a xenograft mouse model of human AML. Upon the completion of our preclinical testing of anti-CD123 CAR-T, we will plan to submit an IND for first in human trials in AML.

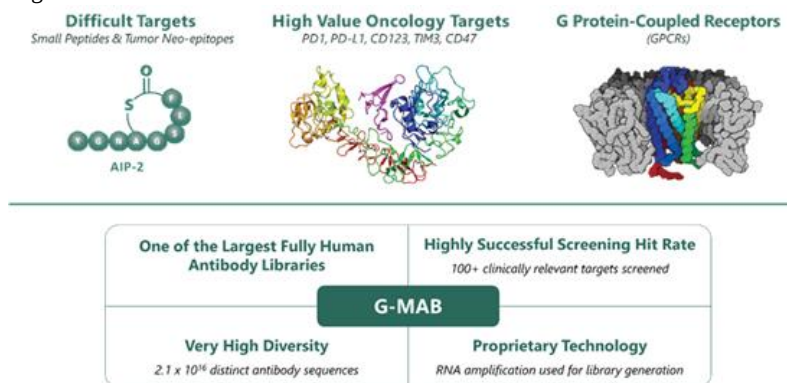
### **Technologies and Preclinical Pipeline**

#### **G-MAB™: Fully Human Antibody Library Platform**

Our G-MAB™ library, which forms the backbone of many of our product candidates, was initially invented by Henry Ji, Ph.D., our co-founder, President and Chief Executive Officer. We believe our proprietary G-MAB™ library is one of the industry’s largest and most diverse fully human antibody libraries, with an estimated one quadrillion unique antibodies available for drug discovery and development. We believe G-MAB™ may offer the following advantages over competing antibody libraries:

- G-MAB™ has been designed to provide a full spectrum of human immunoglobulin gene recombination in fully-human mAbs. Unlike chimeric and humanization technologies, G-MAB™ has allowed the generation of antibodies with fully-human protein sequences without the challenges and limitations of animal-to-human gene transfer procedures.
- Because G-MAB™ represents an *in vitro* human mAb library technology, research suggests that it enables faster and cost-effective *in vitro* screening of a large number of antigens. G-MAB™ is designed so that any antigen of interest can be investigated, with no dependence on the successful induction of a host immune response against the antigen.

The following is a depiction of the types of fully human mAbs that we have derived from G-MAB™. It includes antibodies that bind to a wide range of targets, from small molecular weight antigens to large protein complexes antigens, such as G-Protein Coupled Receptors (“GPCRs”), a difficult class of antigens to raise therapeutic antibodies against.



Our objective is to leverage G-MAB™ to develop first in class or best in class antibody drug candidates that will possess greater efficacy and fewer side effects as compared to existing drugs and develop them as novel monotherapies, ADCs (such as c-MET), components of bispecific antibodies, and as part of our adoptive immunotherapy (CD38, CD123) and intracellular targeting programs (STAT3, mutant KRAS).

To date, we have screened over 100 validated targets and generated a number of fully human antibodies against these targets which are at various stages of development. These include PD-1, PD-L1, CD38, CD123, CD47, c-MET, VEGFR2, CCR2, OX40, TIGIT and CD137 among others. Upon the completion of preclinical studies, our objective is to, independently or in tandem with our strategic collaborators, file INDs for these product candidates.

The following diagrams highlight our key antibody-related strategic partnerships and programs:

| Partner                              | Asset Type       | Partner Background   | Partnership Details   |
|--------------------------------------|------------------|--|---|
| <b>Yuhan Corporation</b>             | Immuno-Oncology  | • Yuhan Corporation is one of the largest Korean pharmaceutical companies founded over 80 years ago  | • Joint Venture named ImmuneOncia Therapeutics, LLC<br>• Focused on developing and commercializing a number of immune checkpoint antibodies for hematological malignancies and solid tumors         |
| <b>Lee's Pharmaceutical Holdings</b> | Immuno-Oncology  | • Lee's Pharm is a public biopharma company with over 20 years of operation in China and currently markets 14 products in the PRC  | • Sorrento has licensed exclusive rights to Lee's Pharma to develop and commercialize the fully human anti-PD-L1 mAb STI-A1014 for the greater Chinese market                                       |
| <b>Morphotek (Eisai)</b>             | ADC              | • Morphotek, a subsidiary of Eisai, Inc., specializes in the development of protein and antibody products through the use of a novel and proprietary gene evolution technology | • Collaboration agreement for Concertis (Sorrento) and Morphotek to generate novel ADCs based on a Morphotek antibody linked to chemotherapeutic agents using Concertis' proprietary ADC technology |
| <b>Celularity</b>                    | Cellular Therapy | • Celularity is a joint venture utilizing TNK's CAR constructs for use in placenta-derived and cord-blood derived cells  | • License of product rights to Celularity in exchange for equity  |

### LA Cell: Intracellular Targeting Antibodies (iTAb)

With LA Cell, our exclusive joint venture with City of Hope, our objective is to become the global leader in the development of modified antibodies and other macromolecules against intracellular targets. Our internal research suggests that LA Cell's platform is highly disruptive in that it uniquely enables the penetration of large molecules such as antibodies, peptides and modified DNA into disease cells.

We are looking to apply this technology to specifically modulate formerly “undruggable” targets known in the evolution of cancer, inflammation, autoimmune diseases, diabetes, central nervous system diseases, cardiovascular diseases and viral infections.

Antibodies and other protein based therapeutics, compared to other drug modalities, have the advantage of specificity, ease of creation and long-lasting effects *in vivo*. Although these therapies have benefited many patients across many solid and hematological malignancies, they are currently constrained in their ability to target solely extracellular proteins, either secreted



or membrane bound. Separately, small molecule drugs are less specific, depend on defined hydrophobic binding pockets and have proven difficult to administer long term given their many off-target toxicities.

In contrast, LA Cell’s proprietary technology and iTabS enable the ability to modulate intracellular targets with modified antibodies derived from our G-MAB™ library. Our lead product candidates focus on key “undruggable” disease targets, such as STAT3, mutant KRAS, MYC and FOXP3 and we have designed constructs which are at various stages of *in vitro* and *in vivo* testing.

**STAT3 iTab**

Our lead iTab is targeted against STAT3 and has demonstrated the inhibition of STAT3 through phosphorylation and downstream gene modulation as well as cytotoxic/cytostatic activity in multiple human cancer cells *in vitro*. STAT3 is a master regulator of genes controlling cell proliferation, survival, migration and immune suppression which is highly upregulated in human cancers. Persistent STAT3 activation has been shown to lead to abnormal survival and tumorigenesis with constitutive STAT3 activation reported in 50-90% of human cancers. This prevalence can be attributed to STAT3’s position as the convergence point of several major oncogenic signaling including EGFR, HER2/Neu, platelet-PDGFR, IL-6R/gp130, c-MET, ABL and Src tyrosine kinases. We believe our STAT3 iTab will be useful in the treatment of severely undertreated cancers such as glioblastoma. STAT3 has emerged as a key initiator and master regulator of mesenchymal transformation in malignant gliomas. We have completed *in vitro* and pharmacokinetic work and are currently conducting *in vivo* validation of this iTab.

**Mutant KRAS iTab**

Our second most advanced iTab is targeted against mutant KRAS. 30% of human cancers possess activating RAS mutations, 85% of which are KRAS mutations which are most frequently present in colorectal, pancreatic and lung cancers. *In vitro*, our KRASG12D iTab has demonstrated specific cytotoxic activity only in KRASG12D-expressing cancer cells but not in wild-type KRAS cells.

**Biosimilar Antibody Portfolio**

In August 2015, we entered into an exclusive licensing agreement with Mabtech Limited to develop and commercialize four, late-stage clinical biosimilar or biobetter antibodies based on Erbitux®, Remicade®, Xolair® and Simulect® for the North American, European and Japanese markets. Each of these four antibody programs has completed Phase 3 clinical trials in China. We are assessing the regulatory and strategic path forward for this portfolio due to the fact that, if we are to follow the biosimilar route, we will be required to perform comparative studies versus the reference products in the U.S. and EU.

**Pain Franchise**

Our pain franchise consists of Scilex Pharmaceuticals Inc. (“Scilex”), a private company which we acquired a majority interest in November 2016, and our RTX program (which was formerly held in our subsidiary, Scintilla Pharmaceuticals, Inc. (“Scintilla”) and is now held by Sorrento) as depicted below:

|                 | RTX<br>(resiniferatoxin)   | ZTlido™<br>(lidocaine patch 1.8%)   |
|-----------------|--|---|
| Asset Overview  | <ul style="list-style-type: none"> <li>Non-opioid-based TRPV1 agonist neurotoxin injectable pain treatment</li> </ul>  | <ul style="list-style-type: none"> <li>Anhydrous, single-layer lidocaine patch based on proprietary technology</li> </ul> |
| Indication      | <ul style="list-style-type: none"> <li>Treatment of intractable pain at end-stage disease (Orphan Status Granted)</li> <li>Phase I trial with NIH</li> </ul> | <ul style="list-style-type: none"> <li>Postherpetic neuralgia (“PHN”)</li> </ul>  |
| Next Milestones | <ul style="list-style-type: none"> <li>Pivotal Phase II study</li> <li>Potential Breakthrough Designation</li> </ul>   | <ul style="list-style-type: none"> <li>FDA approval in 2018</li> <li>MAA approval</li> </ul>                              |



## **RTX**

RTX is a small molecule with a non-opiate mechanism of action that may permanently eliminate intractable cancer pain experienced by end-stage cancer patients. When injected intraspinally or paraspinaly, RTX directly interacts with nerve cells expressing TRPV1 receptors without affecting normal sensation (touch and vibration sense) or muscle function. RTX has been extensively tested in animals and was tested in an investigator-sponsored Phase I clinical trial at the NIH under a Cooperative Research and Development Agreement (CRADA). To date, 12 patients with terminal cancer pain have been treated at the NIH.

More recent studies in animals (translational work from our animal health subsidiary) have unveiled clinical potential of resiniferatoxin intra-articular injections for the control of pain associated with moderate to severe arthritis. Safety studies have been completed and we expect to commence a Phase I clinical trial in humans in the first half of 2018.

The mechanism of action for RTX is well understood and has been validated by extensive data in both animals and humans. In chronic pain states, TRPV1 is upregulated and expressed to a greater degree, resulting in central hypersensitivity and pathological pain states. When the drug is delivered, it targets and binds to TRPV1 receptors expressed by specific neurons in dorsal root ganglia and the superficial layers of the dorsal horn of the spinal column, or to the nerve endings if injected peripherally. RTX binding to TRPV1 results in calcium influx, which initiates programmed cell death (apoptosis) of only the targeted neurons (or axon endings) and, therefore, results in the reduction of pain transmitted by these TRPV1 positive neurons.

We expect to initiate a dose finding study using epidural administration of RTX in the first half of 2018, for the control of pain associated with terminal cancer. Given our prior clinical experience with RTX, we expect that the drug will be well tolerated at all doses and that we will see a dose response. We have hired a contract manufacturer to produce the cGMP drug substance and have sufficient material to complete the clinical development. We have also secured enough raw materials to cover the commercial needs for several years, including the drug product, also produced by a contract manufacturer, for which we have sufficient vials in storage to complete clinical development. Our plan is to conduct Phase I trials for intrathecal application and epidural terminal cancer pain treatment as well as Phase I trials for osteoarthritis in 2018.

### **Scilex Pharmaceuticals: ZTlido™ (lidocaine topical system 1.8%)**

Scilex leverages its core, proprietary technologies to responsibly develop next generation, branded pharmaceutical products to better manage critical conditions and maximize the quality of life of patients and healthcare providers. Scilex's lead product candidate, ZTlido™ (lidocaine topical system 1.8%), is a next-generation lidocaine delivery system recently approved by the FDA for the treatment of postherpetic neuralgia ("PHN"), a severe neuropathic pain condition. ZTlido™ (lidocaine topical system 1.8%) is manufactured by our collaboration partner in their state of the art manufacturing facility.

The elderly population, individuals that have suffered a shingles infection, HIV/AIDS and cancer patients are at highest risk of contracting PHN. In the 2016 Centers for Disease Control and Prevention Guideline for Prescribing Opioids in Chronic Pain, topical lidocaine is recommended for the treatment of neuropathic pain. The prescription lidocaine patch market for all indications totaled almost \$700 million in 2015 in the U.S.

ZTlido™ (lidocaine topical system 1.8%) is based on a novel and proprietary technology that contains only 36 mg of lidocaine versus Endo Pharmaceuticals, Inc.'s Lidoderm® (lidocaine patch 5%), which holds 700 mg of lidocaine per patch. In December 2016 and January 2017, Scilex reported key endpoints were met in the pivotal bioequivalence clinical trials for ZTlido™ (lidocaine topical system 1.8%). The full data package was resubmitted (the first 505(b)(2) new drug application filed in 2015 resulted in a Complete Response Letter from the FDA in May 2016, which meant that the FDA considered the drug application not ready for approval at that time) to the FDA as part of the 505(b)(2) new drug application ("NDA") and accepted by the FDA in September 2017 (setting the Prescription Drug User Fee Act or FDA decision date on the resubmitted 505(b)(2) NDA for February 28, 2018) and filed with the Medicines and Healthcare products Regulatory Agency ("MHRA") in the United Kingdom a hybrid Marketing Authorization Application ("MAA") in November 2017. On February 28, 2018, the FDA approved ZTlido™ (lidocaine topical system 1.8%) for the relief of pain associated with post-herpetic neuralgia. Scilex is currently in preparations for a commercial launch of ZTlido™ (lidocaine topical system 1.8%) and exploring potential partnerships for the product.

See the section entitled "Risk Factors" in this Form 10-K for a discussion of some of the risks relating to the execution of our business strategy.

## **Recent Developments**

### **Termination of Binding Term Sheet Regarding Acquisition of Semnur Pharmaceuticals, Inc.**

On August 15, 2016, our subsidiary, Scintilla, and Semnur Pharmaceuticals, Inc. (“Semnur”) entered into a binding term sheet (the “Semnur Binding Term Sheet”) setting forth the terms and conditions by which Scintilla would, through a subsidiary, purchase all of the issued and outstanding equity of Semnur. On October 6, 2017, the Semnur Binding Term Sheet was terminated without additional consideration, effective immediately.

### **Public Offering of Common Stock**

On April 13, 2017, we entered into an underwriting agreement (the “Underwriting Agreement”) with Cantor Fitzgerald & Co., as representative of the several underwriters named therein (the “Underwriters”), relating to an underwritten public offering (the “Offering”) of 23,625,084 shares of our common stock. The public offering price was \$2.00 per share of our common stock and the Underwriters agreed to purchase the shares of our common stock pursuant to the Underwriting Agreement at a price of \$1.8571 per share.

On April 19, 2017, the Offering was completed and resulted in net proceeds of approximately \$43.5 million, after deducting underwriting discounts and commissions and estimated Offering expenses payable by us.

### **Acquisition of Virttu Biologics Limited**

On April 27, 2017, we entered into a Share Purchase Agreement (the “Virttu Purchase Agreement”) with TNK, Virttu Biologics Limited (“Virttu”), the shareholders of Virttu (the “Virttu Shareholders”) and Dayspring Ventures Limited, as the representative of the Virttu Shareholders, pursuant to which, among other things, TNK acquired from the Virttu Shareholders 100% of the outstanding ordinary shares of Virttu (the “Virttu Acquisition”).

Virttu focuses on the development of oncolytic viruses that infect and selectively multiply in and destroy tumor cells without damaging healthy tissue. Its lead oncolytic virus candidate, Seprehvir, infects and replicates in cancer cells selectively, leaving normal cells unharmed.

Under the Virttu Purchase Agreement, the total amount of the consideration payable to the Virttu Shareholders in the Virttu Acquisition is equal to \$25 million, less Virttu’s net debt (the “Virttu Base Consideration”). An additional \$10 million contingent consideration is payable upon the achievement of certain regulatory milestones (as described below) (the “Regulatory Approval Consideration”).

At the closing of the Virttu Acquisition (the “Closing”), on April 27, 2017, we issued to the Virttu Shareholders consideration valued at approximately \$2.2 million, which consisted primarily of an aggregate of 797,081 shares (the “Virttu Closing Shares”) and approximately \$557,000 in cash (the “Cash Consideration”). The issuance of the Closing Shares and the payment of the Cash Consideration satisfied TNK’s obligation to pay 20% of the Virttu Base Consideration at the Closing. Under the terms of the Virttu Purchase Agreement, we agreed to provide additional consideration to the Virttu Shareholders, as follows:

(1) Upon a financing resulting in gross proceeds (individually or in the aggregate) to TNK of at least \$50.0 million (a “Qualified Financing”), TNK will issue to the Virttu Shareholders an aggregate number of shares of its capital stock (“TNK Capital Stock”) as is equal to the quotient obtained by dividing 80% of the Virttu Base Consideration by the lowest per share price paid by investors in the Qualified Financing (the “TNK Financing Consideration”); provided, however, that 20% of the TNK Financing Consideration shall be held in escrow until April 27, 2018 (the “Financing Due Date”), to be used to, among other things, satisfy the indemnification obligations of the Virttu Shareholders. In the event that a Qualified Financing does not occur, then on the Financing Due Date, we will issue to the Virttu Shareholders an aggregate number of shares of our common stock as is equal to the quotient obtained by dividing 80% of the Virttu Base Consideration, by \$5.55 (as adjusted, as appropriate, to reflect any stock splits or similar events affecting our common stock after the Closing).

(2) Within 45 business days after Virttu becomes aware that certain governmental bodies in the United States, the European Union, the United Kingdom or Japan have approved for commercialization, on or before October 26, 2024, Seprehvir (or any enhancement, combination or derivative thereof) as a monotherapy or in combination with one or more other active components (each of the first two such approvals by a governmental body being a “Regulatory Approval”), TNK shall pay half of the Regulatory Approval Consideration to the Virttu Shareholders, in a combination of (a) up to \$5.0 million in cash (the “Regulatory Approval Cash”) and/or (b) (i) such number of shares of our common stock as is equal to the quotient obtained by dividing \$5.0 million less the Regulatory Approval Cash (the “Regulatory Approval Share Value”) by the 30 Day VWAP (as defined below) of one share of our common stock; (ii) if TNK has completed its first public offering of TNK Capital Stock, the number of shares of TNK Capital Stock as is equal to the quotient obtained by dividing the Regulatory Approval Share Value by the 30 Day VWAP of one share of TNK Capital Stock; or (iii) such number of shares of common stock of a publicly traded company as is equal to the quotient obtained by dividing the Regulatory Approval Share Value by the volume weighted average price of the relevant security, as reported on the Nasdaq Capital Market (or other principal stock exchange or securities market

on which the shares are then listed or quoted) for the thirty trading days immediately following the receipt of Regulatory Approval (the “30 Day VWAP”), with the composition of the Regulatory Approval Consideration to be at TNK’s option. In order for a second regulatory approval to qualify as a Regulatory Approval under the Purchase Agreement, the second approval must be granted by a different governmental body in a different jurisdiction than that which granted the first Regulatory Approval.

### **Celularity Transaction**

On November 1, 2016, we loaned \$5.0 million to Celularity, Inc., a research and development company (“Celularity”), pursuant to a promissory note issued by us to Celularity, as amended (as so amended, the “Celularity Note”), in connection with the entry into a nonbinding term sheet by us, TNK and Celularity. Pursuant to the terms of the Celularity Note, the loan was due and payable in full on the earlier of November 1, 2017 and the occurrence of an event of default under the Celularity Note (the “Maturity Date”). Under the terms of the Celularity Note, in the event that Celularity met certain minimum financing conditions prior to the Maturity Date, all outstanding amounts under the Celularity Note would be forgiven and converted to equity. On May 31, 2017, we loaned an additional \$2.0 million to Celularity pursuant to the terms of the Celularity Note. On June 14, 2017, we loaned an additional \$1.0 million to Celularity. Additionally, on July 7, 2017, we loaned an additional \$2.0 million to Celularity. The loan amounts were forgiven and converted to additional equity investment in Celularity as part of the closing of the Contribution Agreement (as defined below) on June 12, 2017.

On June 12, 2017, we entered into a Contribution Agreement (the “Contribution Agreement”) with TNK and Celularity, pursuant to which, among other things, we and TNK agreed to contribute certain intellectual property rights related to our proprietary chimeric antigen receptor (“CAR”) constructs and related CARs to Celularity in exchange for shares of Celularity’s Series A Preferred Stock equal to 25% of Celularity’s outstanding shares of capital stock, calculated on a fully-diluted basis (the “Celularity Shares”).

On August 15, 2017, the transactions contemplated by the Contribution Agreement closed, the loan amounts were forgiven, and, on such date, among other things, (a) Celularity issued the Celularity Shares to TNK, and (b) we, TNK and Celularity entered into a License and Transfer Agreement (the “License Agreement”). Pursuant to the License Agreement (i) TNK and we agreed to provide to Celularity (1) our CAR constructs and related CARs for use worldwide in combination with placenta-derived cells and/or cord blood-derived cells for the treatment of any disease or disorder except that anti-CD38 CAR constructs and related CARs may also be used in adult cells for the treatment of multiple myeloma unless TNK exercises its termination rights, and (2) our know-how relating to the foregoing, (ii) TNK and we granted to Celularity a limited, perpetual, transferable and sublicensable license and covenant not to sue with respect to certain of their patents and other intellectual property rights, which license is exclusive for a subset of such patents, and (iii) Celularity agreed to pay to TNK 50% of the first \$200 million and 20% thereafter of any upfront and milestone payments that Celularity receives in connection with any sublicense of a combination of anti-CD38 CAR constructs and either placenta-driven cells and/or cord blood-derived cells or adult cells.

### **Termination of Servier License Agreement**

On July 11, 2016, we announced a license and collaboration agreement with Les Laboratoires Servier, SAS, a corporation incorporated under the laws of France, and Institut de Recherches Internationales Servier, a company duly organized and existing under the laws of France (individually and collectively, “Servier”) for the development, manufacture and commercialization of products using our fully human immuno-oncology anti-PD-1mAb STI-A1110 and provided support for Servier’s initial development efforts (the “Servier License Agreement”).

Effective November 6, 2017, the Servier License Agreement was terminated by mutual agreement pursuant to its terms.

### **Private Placement of Convertible Promissory Notes and Warrants**

On December 11, 2017, we entered into a Securities Purchase Agreement (the “Securities Purchase Agreement” or “Note SPA”) with certain accredited investors (collectively, the “Purchasers”). Pursuant to the Securities Purchase Agreement, on December 21, 2017, we issued and sold to the Purchasers, in a private placement transaction (the “Private Placement”), (1) convertible promissory notes in an aggregate principal amount of \$50,000,000 (the “Notes”), which will accrue simple interest at a rate equal to 5.0% per annum and mature upon the earlier to occur of (a) December 21, 2022, and (b) the date of the closing of a change in control (the “Maturity Date”), and (2) warrants (the “Warrants”) to purchase an aggregate of 12,121,210 shares of our common stock.

At any time and from time to time before the Maturity Date, each Purchaser shall have the option to convert any portion of the outstanding principal amount of such Purchaser’s Note that is equal to or greater than the lesser of: (1) \$4,000,000, and

(2) the then-outstanding principal amount of such Purchaser's Note into shares of our common stock at a price per share of \$2.26875, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions. Accrued but unpaid interest on the Notes shall be paid in cash semi-annually in arrears on or prior to the 30th day of June and 31st day of December of each calendar year commencing with the year ending December 31, 2018. If a Purchaser elects to convert any of the principal amount of their Note, then all accrued but unpaid interest on such portion of the principal amount shall become due and payable in cash. The Notes contain restrictive covenants and event of default provisions that are customary for transactions of this type.

Each Warrant has an exercise price of \$2.61 per share, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions, will become exercisable on June 20, 2018, has a term of five and a half years and is exercisable on a cash basis, unless there is not an effective registration statement covering the resale of the shares issuable upon exercise of the Warrants, in which case the Warrants shall also be exercisable on a cashless exercise basis.

## Patents and Other Proprietary Rights

We are able to protect our technology from unauthorized use by third parties only to the extent that it is covered by valid and enforceable patents, is effectively maintained as a trade secret, or is protected by confidentiality agreements. Accordingly, patents and other proprietary rights are essential elements of our business.

We have multiple issued patents and pending patent applications in the U.S. and in selected foreign jurisdictions that cover our G-MAB™ technology, G-MAB™-derived antibodies, other proprietary antibody-centric technologies, and pain management compounds, including, but not limited to, the following:

- 1) The G-MAB™ discovery antibody library technology. Certain aspects of this technology are covered by issued patents and are the subject matter of pending patent applications with potential patent coverage to at least 2023.
- 2) The G-MAB™-derived immuno-oncology antibody candidate portfolio. Certain of these antibody candidates are covered by issued patents and are the subject matter of pending applications and granted patents with potential patent coverage to at least 2033.
- 3) The bispecific antibody technology directed to the combination of one or more different monoclonal antibodies or fragments that can target multiple or different antigens. The bispecific antibody technology is the subject matter of pending applications with potential patent coverage to at least 2035.
- 4) The ADC technology using proprietary conjugation chemistries (called C-Lock and K-Lock), initially developed by ConcorTis Biosystems, Corp. ("ConcorTis"), one of our wholly-owned subsidiaries. This ADC technology is the subject matter of pending patent applications and granted patents with potential patent coverage to at least 2033. Additional pending patent applications directed to different toxin derivatives, are the subject matter of pending applications with potential patent coverage to at least 2035.
- 5) The CAR T-Cell based technology is an immunotherapy platform and is the subject matter of pending patent applications with potential patent coverage to at least 2035. Candidates arising from the platform are the subject matter of pending applications with potential patent coverage to at least 2037.
- 6) The CAR adoptive cellular immunotherapy using T cells and NK immune cells is directed to helping a patient's immune system fight disease, including cancer. We have filed patent applications on the techniques for creating such therapies based on our CAR combination therapies providing with potential patent coverage to at least 2036.
- 7) The intracellular targeting antibody (iTAbs) technology (LA Cell) for targeting intracellular targets for treating disease is the subject matter of pending patent applications with potential patent coverage to at least 2036. We have filed patent applications on improvements to this technology with potential patent coverage to at least 2038.
- 8) The new biosimilar / biobetter antibody technology using manufacture in certain cells (for example, directed to antigen targets such as EGFR or TNF-alpha) is the subject matter of pending patent applications with potential patent coverage to at least 2035.

- 9) The RTX (resiniferatoxin)-based pain management technology. Certain aspects of this technology are covered by an issued patent in the U.S. providing patent protection to at least 2021 and are the subject matter of pending patent applications that will provide potential patent coverage to at least 2036.
- 10) The lidocaine-based pain management technology, obtained by acquisition of Scilex Pharmaceuticals Inc. Certain aspects of this technology are covered by an issued U.S. patent with patent coverage to at least 2031. Additional patent applications to improvements of this technology have been filed with potential patent coverage to at least 2038.

Certain factors can either extend patent terms or provide other forms of exclusivity (e.g., data exclusivity) for varying periods depending on the date of patent filing, date of grant or the legal term of a patent in the various jurisdictions in which patent protection is obtained. The actual protection afforded by a patent, which can vary from country to country, also depends upon the type of patent, the scope of claim coverage and the availability of legal remedies in the particular country.

While trade secret protection is an essential element of our business and we have taken security measures to protect our proprietary information and trade secrets, we cannot guarantee that our unpatented proprietary technology will afford us significant commercial protection. We seek to protect our trade secrets by entering into confidentiality agreements with third parties, employees and consultants. Our employees and consultants also sign agreements requiring that they assign to us their interest in any intellectual property arising from their work for us. All employees sign an agreement not to engage in any conflicting employment or activity during their employment with us and not to disclose or misuse our confidential information. However, it is possible that these agreements may be breached or invalidated and, if so, there may not be an adequate corrective remedy. Accordingly, we cannot guarantee that employees, consultants or third parties will not breach the confidentiality provisions in our contracts, infringe or misappropriate our trade secrets or other proprietary rights, or that measures we are taking to protect our proprietary rights will be adequate.

In the future, third parties may file claims asserting that our technologies or products infringe on their intellectual property. We cannot predict whether third parties will assert such claims against us or against the licensors of technology licensed to us, or whether those claims will harm our business. If we are forced to defend ourselves against such claims, whether they are with or without merit and whether they are resolved in favor of, or against, our licensors or us, we may face costly litigation and the diversion of management's attention and resources. As a result of such disputes, we may have to develop costly non-infringing technology or enter into licensing agreements. These agreements, if necessary, may be unavailable on terms acceptable to us, or at all.

## **Government Regulation**

Government authorities in the U.S. (including federal, state and local authorities) and in other countries extensively regulate, among other things, the manufacturing, research and clinical development, marketing, labeling and packaging, storage, distribution, post-approval monitoring and reporting, advertising and promotion, pricing and export and import of pharmaceutical products, such as those we are developing. The process of obtaining regulatory approvals and the subsequent compliance with appropriate federal, state, local and foreign statutes and regulations require the expenditure of substantial time and financial resources. Moreover, failure to comply with applicable regulatory requirements may result in, among other things, warning letters, clinical holds, civil or criminal penalties, recall or seizure of products, injunction, disbarment, partial or total suspension of production or withdrawal of the product from the market. Any agency or judicial enforcement action could have a material adverse effect on us.

### ***U.S. Government Regulations***

In the U.S., the FDA regulates drugs under the Federal Food, Drug, and Cosmetic Act ("FDCA"), and its implementing regulations. Drugs are also subject to other federal, state and local statutes and regulations. The process required by the FDA before product candidates may be marketed in the U.S. generally involves the following:

- submission to the FDA of an IND, which must become effective before human clinical trials may begin and must be updated annually;
- completion of extensive preclinical laboratory tests and preclinical animal studies, all performed in accordance with the FDA's Good Laboratory Practice ("GLP") regulations. Preclinical testing generally includes evaluation of our product candidates in the laboratory or in animals to characterize the product and determine safety and efficacy;
- performance of adequate and well-controlled human clinical trials to establish the safety and efficacy of the product candidate for each proposed indication;

- submission to the FDA of a Biologics License Application (“BLA”) or an NDA after completion of all pivotal clinical trials;
- a determination by the FDA within 60 days of its receipt of a BLA or an NDA to file the NDA for review;
- satisfactory completion of an FDA pre-approval inspection of the manufacturing facilities at which the active pharmaceutical ingredient (“API”) and finished drug product are produced and tested to assess compliance with cGMP regulations; and
- FDA review and approval of a BLA or an NDA prior to any commercial marketing or sale of the drug in the U.S.

In addition, we are subject to regulation under state, federal, and international laws and regulations regarding occupational safety, laboratory practices, import and export of materials and products, environmental protection and the use and handling of hazardous substance control, and other regulations. Our clinical trial and research and development activities involve the controlled use of hazardous materials and chemical compounds. Although we believe that our safety procedures for handling and disposing of such materials comply with the standards prescribed by state and federal regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event of such an accident, we could be held liable for any damages that result and any such liability could exceed our financial resources. In addition, disposal of radioactive materials used in our clinical trials and research efforts may only be made at approved facilities. We believe that we are in material compliance with all applicable laws and regulations including those relating to the handling and disposal of hazardous and toxic waste.

An IND is a request for authorization from the FDA to administer an investigational drug product to humans. The central focus of an IND submission is on the general investigational plan and the protocol(s) for human studies. The IND also includes results of animal studies or other human studies, as appropriate, as well as manufacturing information, analytical data and any available clinical data or literature to support the use of the investigational new drug. An IND must become effective before human clinical trials may begin. An IND will automatically become effective 30 days after receipt by the FDA, unless before that time the FDA raises concerns or questions related to the proposed clinical trials. In such a case, the IND may be placed on clinical hold and the IND sponsor and the FDA must resolve any outstanding concerns or questions before clinical trials can begin. Accordingly, submission of an IND may or may not result in the FDA allowing clinical trials to commence.

Clinical trials involve the administration of the investigational drug to human subjects under the supervision of qualified investigators in accordance with Good Clinical Practices (“GCPs”), which include the requirement that all research subjects provide their informed consent for their participation in any clinical trial. Clinical trials are conducted under protocols detailing, among other things, the objectives of the study, the parameters to be used in monitoring safety, and the efficacy criteria to be evaluated. A protocol for each clinical trial and any subsequent protocol amendments must be submitted to the FDA as part of the IND. Additionally, approval must also be obtained from each clinical trial site’s institutional review board (“IRB”) before the trials may be initiated, and the IRB must monitor the study until completed. There are also requirements governing the reporting of ongoing clinical trials and clinical trial results to public registries.

The clinical investigation of a drug is generally divided into three phases. Although the phases are usually conducted sequentially, they may overlap or be combined. The three phases of an investigation are as follows:

- *Phase I.* Phase I includes the initial introduction of an investigational new drug into humans. Phase I clinical trials are typically closely monitored and may be conducted in patients with the target disease or condition or in healthy volunteers. These studies are designed to evaluate the safety, dosage tolerance, metabolism and pharmacologic actions of the investigational drug in humans, the side effects associated with increasing doses, and if possible, to gain early evidence on effectiveness. During Phase I clinical trials, sufficient information about the investigational drug’s pharmacokinetics and pharmacological effects may be obtained to permit the design of well-controlled and scientifically valid Phase II clinical trials. The total number of participants included in Phase I clinical trials varies, but is generally in the range of 20 to 80.
- *Phase II.* Phase II includes controlled clinical trials conducted to preliminarily or further evaluate the effectiveness of the investigational drug for a particular indication(s) in patients with the disease or condition under study, to determine dosage tolerance and optimal dosage, and to identify possible adverse side effects and safety risks associated with the drug. Phase II clinical trials are typically well-controlled, closely monitored, and conducted in a limited patient population, usually involving no more than several hundred participants.
- *Phase III.* Phase III clinical trials are generally controlled clinical trials conducted in an expanded patient population generally at geographically dispersed clinical trial sites. They are performed after preliminary evidence suggesting effectiveness of the drug has been obtained, and are intended to further evaluate dosage, clinical effectiveness and safety, to establish the overall benefit-risk relationship of the

investigational drug product, and to provide an adequate basis for product approval. Phase III clinical trials usually involve several hundred to several thousand participants.

A pivotal trial is a clinical trial that adequately meets regulatory agency requirements for the evaluation of a drug candidate's efficacy and safety such that it can be used to justify the approval of the product. Generally, pivotal trials are also Phase III trials but may be Phase II trials if the trial design provides a well-controlled and reliable assessment of clinical benefit, particularly in situations where there is an unmet medical need.

The FDA, the IRB or the clinical trial sponsor may suspend or terminate a clinical trial at any time on various grounds, including a finding that the research subjects are being exposed to an unacceptable health risk. Additionally, some clinical trials are overseen by an independent group of qualified experts organized by the clinical trial sponsor, known as a data safety monitoring board or committee. This group provides authorization for whether or not a trial may move forward at designated check points based on access to certain data from the study. We may also suspend or terminate a clinical trial based on evolving business objectives and/or competitive climate.

Assuming successful completion of all required testing in accordance with all applicable regulatory requirements, detailed investigational drug product information is submitted to the FDA in the form of an NDA requesting approval to market the product for one or more indications.

The application includes all relevant data available from pertinent preclinical and clinical trials, including negative or ambiguous results as well as positive findings, together with detailed information relating to the product's chemistry, manufacturing, controls and proposed labeling, among other things. Data can come from company-sponsored clinical trials intended to test the safety and effectiveness of a use of a product, or from a number of alternative sources, including studies initiated by investigators. To support marketing approval, the data submitted must be sufficient in quality and quantity to establish the safety and effectiveness of the investigational drug product to the satisfaction of the FDA.

Once the NDA submission has been accepted for filing, the FDA's goal is to review applications within ten months of submission or, if the application relates to an unmet medical need in a serious or life-threatening indication, six months from submission. The review process is often significantly extended by FDA requests for additional information or clarification. The FDA may refer the application to an advisory committee for review, evaluation and recommendation as to whether the application should be approved. The FDA is not bound by the recommendation of an advisory committee, but it typically follows such recommendations.

After the FDA evaluates the NDA and conducts inspections of manufacturing facilities where the drug product and/or its API will be produced, it may issue an approval letter or a Complete Response Letter. An approval letter authorizes commercial marketing of the drug with specific prescribing information for specific indications. A Complete Response Letter indicates that the review cycle of the application is complete and the application is not ready for approval. A Complete Response Letter may require additional clinical data, an additional pivotal Phase III clinical trial(s), and/or other significant, expensive and time-consuming requirements related to clinical trials, preclinical studies or manufacturing. Even if such additional information is submitted, the FDA may ultimately decide that the NDA does not satisfy the criteria for approval. The FDA could also approve the NDA with a Risk Evaluation and Mitigation Strategies ("REMS") plan to mitigate risks, which could include medication guides, physician communication plans, or elements to assure safe use, such as restricted distribution methods, patient registries and other risk minimization tools. The FDA also may condition approval on, among other things, changes to proposed labeling, development of adequate controls and specifications, or a commitment to conduct one or more post-market studies or clinical trials. Such post-market testing may include Phase IV clinical trials and surveillance to further assess and monitor the product's safety and effectiveness after commercialization. Regulatory approval of oncology products often requires that patients in clinical trials be followed for long periods to determine the overall survival benefit of the drug.

After regulatory approval of a drug product is obtained, we are required to comply with a number of post-approval requirements. As a holder of an approved NDA, we would be required to report, among other things, certain adverse reactions and production problems to the FDA, to provide updated safety and efficacy information, and to comply with requirements concerning advertising and promotional labeling for any of our products. Also, quality control and manufacturing procedures must continue to conform to cGMP after approval to ensure and preserve the long term stability of the drug product. The FDA periodically inspects manufacturing facilities to assess compliance with cGMP, which imposes extensive procedural, substantive and record keeping requirements. In addition, changes to the manufacturing process are strictly regulated, and, depending on the significance of the change, may require prior FDA approval before being implemented. FDA regulations also require investigation and correction of any deviations from cGMP and impose reporting and documentation requirements upon us and any third-party manufacturers that we may decide to use. Accordingly, manufacturers must continue to expend time,



money and effort in the area of production and quality control to maintain compliance with cGMP and other aspects of regulatory compliance.

We rely, and expect to continue to rely, on third parties for the production, distribution, shipping and storage of clinical and commercial quantities of our product candidates. Future FDA and state inspections may identify compliance issues at our facilities or at the facilities of our contract manufacturers that may disrupt production or distribution, or require substantial resources to correct. In addition, discovery of previously unknown problems with a product or the failure to comply with applicable requirements may result in restrictions on a product, manufacturer or holder of an approved NDA, including withdrawal or recall of the product from the market or other voluntary, FDA-initiated or judicial action that could delay or prohibit further marketing. Newly discovered or developed safety or effectiveness data may require changes to a product's approved labeling, including the addition of new warnings and contraindications, and also may require the implementation of other risk management measures. Also, new government requirements, including those resulting from new legislation, may be established, or the FDA's policies may change, which could delay or prevent regulatory approval of our product candidates under development.

### ***Europe/Rest of World Government Regulations***

In addition to regulations in the U.S., we will be subject to a variety of regulations in other jurisdictions governing, among other things, clinical trials and any commercial sales and distribution of our products.

Whether or not we obtain FDA approval for a product, we must obtain the requisite approvals from regulatory authorities in foreign countries prior to the commencement of clinical trials or marketing of the product in those countries. Certain countries outside of the U.S. have a similar process that requires the submission of a clinical trial application much like the IND prior to the commencement of human clinical trials. In Europe, for example, a clinical trial application ("CTA") must be submitted to each country's national health authority and an independent ethics committee, much like the FDA and IRB, respectively. Once the CTA is approved in accordance with a country's requirements, clinical trial development may proceed.

The requirements and process governing the conduct of clinical trials, product licensing, pricing and reimbursement vary from country to country. In all cases, the clinical trials are conducted in accordance with GCP and the applicable regulatory requirements and the ethical principles that have their origin in the Declaration of Helsinki.

To obtain regulatory approval of an investigational drug under European Union regulatory systems, we must submit a marketing authorization application. The application used to file the NDA in the U.S. is similar to that required in Europe, with the exception of, among other things, country-specific document requirements. For other countries outside of the European Union, such as countries in Eastern Europe, Latin America or Asia, the requirements governing the conduct of clinical trials, product licensing, pricing and reimbursement vary from country to country. In all cases, again, the clinical trials are conducted in accordance with GCP and the applicable regulatory requirements and the ethical principles that have their origin in the Declaration of Helsinki.

If we fail to comply with applicable foreign regulatory requirements, we may be subject to, among other things, fines, suspension or withdrawal of regulatory approvals, product recalls, seizure of products, operating restrictions and criminal prosecution.

### ***Available Special Regulatory Procedures***

#### ***Formal Meetings***

We are encouraged to engage and seek guidance from health authorities relating to the development and review of investigational drugs, as well as marketing applications. In the U.S., there are different types of official meetings that may occur between us and the FDA. Each meeting type is subject to different procedures. Conclusions and agreements from each of these meetings are captured in the official final meeting minutes issued by the FDA.

The European Medicines Agency ("EMA") also provides the opportunity for dialogue with us. This is usually done in the form of Scientific Advice, which is given by the Scientific Advice Working Party of the Committee for Medicinal Products for Human Use ("CHMP"). A fee is incurred with each Scientific Advice meeting.

Advice from either the FDA or EMA is typically provided based on questions concerning, for example, quality (chemistry, manufacturing and controls testing), nonclinical testing and clinical trials and pharmaco-vigilance plans and risk-management programs. Such advice is not legally binding on the sponsor. To obtain binding commitments from health

authorities in the U.S. and the European Union, Special Protocol Assessment (“SPA”) or Protocol Assistance procedures are available. An SPA is an evaluation by the FDA of a protocol with the goal of reaching an agreement with the sponsor that the protocol design, clinical endpoints and statistical analyses are acceptable to support regulatory approval of the product candidate with respect to effectiveness in the indication studied. The FDA’s agreement to an SPA is binding upon the FDA except in limited circumstances, such as if the FDA identifies a substantial scientific issue essential to determining the safety or effectiveness of the product after clinical trials begin, or if the trial sponsor fails to follow the protocol that was agreed upon with the FDA. There is no guarantee that a trial will ultimately be adequate to support an approval even if the trial is subject to an SPA.

### *Orphan Drug Designation*

The FDA may grant orphan drug designation to drugs intended to treat a rare disease or condition that affects fewer than 200,000 individuals in the U.S., or if it affects more than 200,000 individuals in the U.S., there is no reasonable expectation that the cost of developing and making the drug for this type of disease or condition will be recovered from sales in the U.S. In the European Union, the EMA’s Committee for Orphan Medicinal Products (“COMP”) grants orphan drug designation to promote the development of products that are intended for the diagnosis, prevention or treatment of a life-threatening or chronically debilitating condition affecting not more than 5 in 10,000 persons in the European Union Community. Additionally, designation is granted for products intended for the diagnosis, prevention or treatment of a life-threatening, seriously debilitating or serious and chronic condition and when, without incentives, it is unlikely that sales of the drug in the European Union would be sufficient to justify the necessary investment in developing the drug or biological product.

In the U.S., orphan drug designation entitles a party to financial incentives such as opportunities for grant funding towards clinical trial costs, tax advantages and user-fee waivers. In addition, if a product receives the first FDA approval for the indication for which it has orphan designation, the product is entitled to orphan drug exclusivity, which means the FDA may not approve any other application to market the same drug for the same indication for a period of 7 years, except in limited circumstances, such as a showing of clinical superiority over the product with orphan exclusivity.

In the European Union, orphan drug designation also entitles a party to financial incentives such as reduction of fees or fee waivers and 10 years of market exclusivity is granted following drug or biological product approval. This period may be reduced to 6 years if the orphan drug designation criteria are no longer met, including where it is shown that the product is sufficiently profitable not to justify maintenance of market exclusivity.

Orphan drug designation must be requested before submitting an application for marketing approval. Orphan drug designation does not convey any advantage in, or shorten the duration of, the regulatory review and approval process.

### *Authorization Procedures in the European Union*

Medicines can be authorized in the European Union by using either the centralized authorization procedure or national authorization procedures.

- *Centralized procedure.* The EMA implemented the centralized procedure for the approval of human medicines to facilitate marketing authorizations that are valid throughout the European Union. This procedure results in a single marketing authorization issued by the EMA that is valid across the European Union, as well as Iceland, Liechtenstein and Norway. The centralized procedure is compulsory for human medicines that are: derived from biotechnology processes, such as genetic engineering, contain a new active substance indicated for the treatment of certain diseases, such as HIV/AIDS, cancer, diabetes, neurodegenerative disorders or autoimmune diseases and other immune dysfunctions, and officially designated orphan medicines.
- For medicines that do not fall within these categories, an applicant has the option of submitting an application for a centralized marketing authorization to the EMA, as long as the medicine concerned is a significant therapeutic, scientific or technical innovation, or if its authorization would be in the interest of public health.
- *National authorization procedures.* There are also two other possible routes to authorize medicinal products in several countries, which are available for investigational drug products that fall outside the scope of the centralized procedure:
- *Decentralized procedure.* Using the decentralized procedure, an applicant may apply for simultaneous authorization in more than one European Union country of medicinal products that have not yet been authorized in any European Union country and that do not fall within the mandatory scope of the centralized procedure.

- *Mutual recognition procedure.* In the mutual recognition procedure, a medicine is first authorized in one European Union Member State, in accordance with the national procedures of that country. Following this, further marketing authorizations can be sought from other European Union countries in a procedure whereby the countries concerned agree to recognize the validity of the original, national marketing authorization.

#### *Priority Review/Standard Review (U.S.) and Accelerated Review (European Union)*

Based on results of the Phase III clinical trial(s) submitted in an NDA, upon the request of an applicant, the FDA may grant the NDA a priority review designation, which sets the target date for FDA action on the application at six months. Priority review is granted where preliminary estimates indicate that a product, if approved, has the potential to provide a safe and effective therapy where no satisfactory alternative therapy exists, or a significant improvement compared to marketed products is possible. If criteria are not met for priority review, the NDA is subject to the standard FDA review period of 10 months. Priority review designation does not change the scientific/medical standard for approval or the quality of evidence necessary to support approval.

Under the Centralized Procedure in the European Union, the maximum timeframe for the evaluation of a marketing authorization application is 210 days (excluding clock stops, when additional written or oral information is to be provided by the applicant in response to questions asked by the CHMP). Accelerated evaluation might be granted by the CHMP in exceptional cases, when a medicinal product is expected to be of a major public health interest, defined by three cumulative criteria: the seriousness of the disease (e.g., heavy disabling or life-threatening diseases) to be treated; the absence or insufficiency of an appropriate alternative therapeutic approach; and anticipation of high therapeutic benefit. In this circumstance, EMA ensures that the opinion of the CHMP is given within 150 days, excluding clock stops.

There can be no assurance that we or any of our partners would be able to satisfy one or more of these requirements to conduct preclinical or clinical trials or receive any regulatory approvals.

#### *Pharmaceutical Coverage, Pricing and Reimbursement*

Significant uncertainty exists as to the coverage and reimbursement status of any drug products for which we obtain regulatory approval. In the U.S. and markets in other countries, sales of any products for which we receive regulatory approval for commercial sale will depend in part on the availability of reimbursement from third-party payors. Third-party payors include government health administrative authorities, managed care providers, private health insurers and other organizations. The process for determining whether a payor will provide coverage for a drug product may be separate from the process for setting the price or reimbursement rate that the payor will pay for the drug product. Third-party payors may limit coverage to specific drug products on an approved list, or formulary, which might not include all of the FDA-approved drugs for a particular indication. Third-party payors are increasingly challenging the price and examining the medical necessity and cost-effectiveness of medical products and services, in addition to their safety and efficacy. We may need to conduct expensive pharmacoeconomic studies in order to demonstrate the medical necessity and cost-effectiveness of our products, in addition to the costs required to obtain FDA approvals. Our product candidates may not be considered medically necessary or cost-effective. A payor's decision to provide coverage for a drug product does not imply that an adequate reimbursement rate will be approved. Adequate third-party reimbursement may not be available to enable us to maintain price levels sufficient to realize an appropriate return on our investment in product development.

In 2003, the U.S. government enacted legislation providing a partial prescription drug benefit for Medicare beneficiaries, which became effective at the beginning of 2006. Government payment for some of the costs of prescription drugs may increase demand for any products for which we receive marketing approval. However, to obtain payments under this program, we would be required to sell products to Medicare recipients through prescription drug plans operating pursuant to this legislation. These plans will likely negotiate discounted prices for our products. Further, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act (collectively, the "Healthcare Reform Law"), substantially changed the way healthcare is financed in the U.S. by both government and private insurers. Among other cost containment measures, the Healthcare Reform Law established:

- An annual, nondeductible fee on any entity that manufactures or imports certain branded prescription drugs and biologic agents;
- A new Medicare Part D coverage gap discount program, in which pharmaceutical manufacturers who wish to have their drugs covered under Part D must offer discounts to eligible beneficiaries during their coverage gap period (the "donut hole"); and
- A new formula that increases the rebates a manufacturer must pay under the Medicaid Drug Rebate Program.

We expect that federal, state and local governments in the U.S. will continue to consider legislation to limit the growth of healthcare costs, including the cost of prescription drugs. Future legislation could limit payments for pharmaceuticals such as the drug candidates that we are developing.

Different pricing and reimbursement schemes exist in other countries. In the European Union, governments influence the price of pharmaceutical products through their pricing and reimbursement rules and control of national health care systems that fund a large part of the cost of those products to consumers. Some jurisdictions operate positive and negative list systems under which products may only be marketed once a reimbursement price has been agreed. To obtain reimbursement or pricing approval, some of these countries may require the completion of clinical trials that compare the cost-effectiveness of a particular product candidate to currently available therapies. Other member states allow companies to fix their own prices for medicines, but monitor and control company profits. The downward pressure on health care costs in general, particularly prescription drugs, has become very intense. As a result, increasingly high barriers are being erected to the entry of new products. In addition, in some countries, cross-border imports from low-priced markets exert a commercial pressure on pricing within a country.

The marketability of any products for which we receive regulatory approval for commercial sale may suffer if the government and third-party payors fail to provide adequate coverage and reimbursement. In addition, an increasing emphasis on managed care in the U.S. has increased and we expect will continue to increase the pressure on pharmaceutical pricing. Coverage policies and third-party reimbursement rates may change at any time. Even if favorable coverage and reimbursement status is attained for one or more products for which we receive regulatory approval, less favorable coverage policies and reimbursement rates may be implemented in the future.

#### *Other Healthcare Laws and Compliance Requirements*

If we obtain regulatory approval for any of our product candidates, we may be subject to various federal and state laws targeting fraud and abuse in the healthcare industry. For example, in the U.S., there are federal and state anti-kickback laws that prohibit the payment or receipt of kickbacks, bribes or other remuneration intended to induce the purchase or recommendation of healthcare products and services or reward past purchases or recommendations. Violations of these laws can lead to civil and criminal penalties, including fines, imprisonment and exclusion from participation in federal healthcare programs.

The federal Anti-Kickback Statute prohibits persons from knowingly and willfully soliciting, receiving, offering or paying remuneration, directly or indirectly, to induce either the referral of an individual, or the furnishing, recommending, or arranging for a good or service, for which payment may be made under a federal healthcare program, such as the Medicare and Medicaid programs. The reach of the Anti-Kickback Statute was broadened by the Healthcare Reform Law, which, among other things, amended the intent requirement of the federal Anti-Kickback Statute and the applicable criminal healthcare fraud statutes contained within 42 U.S.C. § 1320a-7b, effective March 23, 2010. Pursuant to the statutory amendment, a person or entity no longer needs to have actual knowledge of this statute or specific intent to violate it in order to have committed a violation. In addition, the government may assert that a claim including items or services resulting from a violation of the federal Anti-Kickback Statute constitutes a false or fraudulent claim for purposes of the civil False Claims Act (discussed below) or the civil monetary penalties statute. Many states have adopted laws similar to the federal Anti-Kickback Statute, some of which apply to the referral of patients for healthcare items or services reimbursed by any source, not only the Medicare and Medicaid programs.

The federal False Claims Act imposes liability on any person who, among other things, knowingly presents, or causes to be presented, a false or fraudulent claim for payment by a federal healthcare program. The “qui tam” provisions of the False Claims Act allow a private individual to bring civil actions on behalf of the federal government alleging that the defendant has submitted a false claim to the federal government, and to share in any monetary recovery. In addition, various states have enacted false claims laws analogous to the False Claims Act. Many of these state laws apply where a claim is submitted to any third-party payer and not merely a federal healthcare program. When an entity is determined to have violated the False Claims Act, it may be required to pay up to three times the actual damages sustained by the government, plus civil penalties of \$5,500 to \$11,000 for each separate false claim.

Also, the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”) created several new federal crimes, including healthcare fraud, and false statements relating to healthcare matters. The health care fraud statute prohibits knowingly and willfully executing a scheme to defraud any health care benefit program, including private third-party payers. The false statements statute prohibits knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false, fictitious or fraudulent statement in connection with the delivery of or payment for health care benefits, items or services.

In addition, we may be subject to, or our marketing activities may be limited by HIPAA, as amended by the Health Information Technology for Economic and Clinical Health Act and its implementing regulations, which established uniform standards for certain “covered entities” (healthcare providers, health plans and healthcare clearinghouses) and their business associates governing the conduct of certain electronic healthcare transactions and protecting the security and privacy of protected health information.

### **Antibody Clinical Development**

We currently focus our research efforts primarily in the identification and isolation of human antibody drug candidates and further characterize these antibody candidates in *in vitro* and *in vivo* functional testing. Due to our limited financial resources, we intend to actively seek product development and commercialization partners from the biopharmaceuticals industry to help us advance the clinical development of select product candidates.

### **Marketing and Sales**

With the exception of our subsidiary, Scilex (which is in the process of preparing for a potential commercial launch for ZTlido™ (lidocaine topical system 1.8%)), we currently do not have any sales capabilities. We intend to license to, or enter into strategic alliances with, larger companies in the biopharmaceutical businesses or use the services of contract sales organizations (“CROs”), which are equipped to, market and/or sell our products, if any, through their well-developed marketing and sales teams and distribution networks. We intend to license some or all of our worldwide patent rights to more than one third party to achieve the fullest development, marketing and distribution of any products we develop.

### **Manufacturing and Raw Materials**

We currently manufacture the majority of our preclinical and clinical materials in-house, and use contract manufacturers for the manufacture of some of our product candidates. We may or may not manufacture the products we develop, if any. Our internal manufacturing and contract manufacturers are subject to extensive governmental regulation. Regulatory authorities in our markets require that pharmaceutical products be manufactured, packaged and labeled in conformity with cGMPs. We have established a quality control and quality assurance program, which includes a set of standard operating procedures and specifications designed to ensure that our products are manufactured in accordance with cGMPs, and other applicable domestic and foreign regulations.

### **Employees**

As of December 31, 2017, we had 162 employees and 19 consultants and advisors. A significant number of our management and our other employees and consultants have worked or consulted with pharmaceutical, biotechnology or medical product companies. While we have been successful in attracting skilled and experienced scientific personnel, there can be no assurance that we will be able to attract or retain the necessary qualified employees and/or consultants in the future.

None of our employees are covered by collective bargaining agreements and we consider relations with our employees to be good.

### **Research and Development**

Our research and development expenses, excluding acquired in-process research and development expenses, totaled \$55.5 million and \$42.2 million in the years ended December 31, 2017 and 2016, respectively.

### **Corporate Information**

On September 21, 2009, QuikByte Software, Inc., a Colorado corporation and shell company (“QuikByte”), consummated its acquisition of Sorrento Therapeutics, Inc., a Delaware corporation and private concern (“STI”), in a reverse merger (the “Merger”). Pursuant to the Merger, all of the issued and outstanding shares of STI common stock were converted into an aggregate of 6,775,032 shares of QuikByte common stock and STI became a wholly owned subsidiary of QuikByte. The holders of QuikByte’s common stock immediately prior to the Merger held an aggregate of 2,228,333 shares of QuikByte’s common stock immediately following the Merger.

We were originally incorporated as San Diego Antibody Company in California in 2006 and were renamed “Sorrento Therapeutics, Inc.” and reincorporated in Delaware in 2009, prior to the Merger. QuikByte was originally incorporated in Colorado in 1989. Following the Merger, on December 4, 2009, QuikByte reincorporated under the laws of the State of

Delaware (the "Reincorporation"). Immediately following the Reincorporation, on December 4, 2009, we merged with and into QuikByte, the separate corporate existence of STI ceased and QuikByte continued as the surviving corporation (the "Roll-Up Merger"). Pursuant to the certificate of merger filed in connection with the Roll-Up Merger, QuikByte's name was changed from "QuikByte Software, Inc." to "Sorrento Therapeutics, Inc."

## **Address**

Our principal executive offices are located at 4955 Directors Place, San Diego, CA 92121, and our telephone number at that address is (858) 203-4100. Our website is [www.sorrentotherapeutics.com](http://www.sorrentotherapeutics.com). Any information contained on, or that can be accessed through, our website is not incorporated by reference into, nor is it in any way part of this Form 10-K.

## **Available Information**

We file electronically with the U.S. Securities and Exchange Commission (the "SEC") our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and reports filed pursuant to Section 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended. We make available on our website at [www.sorrentotherapeutics.com](http://www.sorrentotherapeutics.com), free of charge, copies of these reports, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Copies of our annual report to stockholders will also be made available, free of charge, upon written request.

The public may read and copy any materials filed by us with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>. The contents of these websites are not incorporated into this filing. Further, our references to the URLs for these websites are intended to be inactive textual references only.

## **Item 1A. Risk Factors.**

### **Risks Related to Our Financial Position and Capital Requirements**

***We are a clinical stage company subject to significant risks and uncertainties, including the risk that we or our partners may never develop, obtain regulatory approval or market any of our product candidates or generate product related revenues.***

We are primarily a clinical stage biotechnology company that began operating and commenced research and development activities in 2009. Pharmaceutical product development is a highly speculative undertaking and involves a substantial degree of risk. There is no assurance that our libraries of fully-human mAbs or any of our other product candidates in development will be suitable for diagnostic or therapeutic use, or that we will be able to identify and isolate therapeutics product candidates, or develop, market and commercialize these candidates. We do not expect any of our product candidates in development, including, but not limited to, our fully-human mAbs, biosimilars/biobetters, fully human anti-PD-L1 and anti-PD-1 checkpoint inhibitors derived from our proprietary G-MAB™ library platform, antibody drug conjugates ("ADCs"), BsAbs, as well as Chimeric Antigen Receptor-T Cell ("CAR-T") for adoptive cellular immunotherapy and resiniferatoxin ("RTX") to be commercially available for a few years, if at all. Even if we are able to commercialize our product candidates, there is no assurance that these candidates would generate revenues or that any revenues generated would be sufficient for us to become profitable or thereafter maintain profitability.

***We do not have many products that are approved for commercial sale and therefore do not expect to generate any revenues from product sales from most of our product candidates in the foreseeable future, if ever.***

We have not generated any product related revenues to date, and, with the exception of our ZTlido™ (lidocaine topical system 1.8%), do not expect to generate any such revenues for at least the next several years, if at all. To obtain revenues from sales of our product candidates, we must succeed, either alone or with third parties, in developing, obtaining regulatory approval for, manufacturing and marketing products with commercial potential. We may never succeed in these activities, and we may not generate sufficient revenues to continue our business operations or achieve profitability.

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

As of December 31, 2017 and December 31, 2016, we had an accumulated deficit of \$165.1 million and \$174.3 million, respectively. We continue to incur significant research and development and other expenses related to our ongoing operations.

We have incurred operating losses since our inception, expect to continue to incur significant operating losses for the foreseeable future, and we expect these losses to increase as we: (i) advance RTX and our other product candidates into clinical trials and pursue other development, acquire, develop and manufacture clinical trial materials and increase other regulatory operating activities, (ii) incur incremental expenses associated with our efforts to further advance a number of potential product candidates into preclinical development activities, (iii) continue to identify and advance a number of fully human therapeutic antibody and ADC preclinical product candidates, (iv) incur higher salary, lab supply and infrastructure costs incurred in connection with supporting all of our programs, (v) invest in our joint ventures, collaborations or other third party agreements, (vi) incur expenses in conjunction with defending and enforcing our rights in various litigation matters, (vii) expand our corporate, development and manufacturing infrastructure, and (viii) support our subsidiaries, such as Scilex Pharmaceuticals Inc. (“Scilex”), in their commercialization efforts. As such, we are subject to all risks incidental to the development of new biopharmaceutical products and related companion diagnostics, and we may encounter unforeseen expenses, difficulties, complications, delays and other unknown factors that may adversely affect our business. Our prior losses, combined with expected future losses, have had and will continue to have an adverse effect on our stockholders’ equity and working capital.

***We will require substantial additional funding, which may not be available to us on acceptable terms, or at all. If we fail to raise the necessary additional capital, we may be unable to complete the development and commercialization of our product candidates, or continue our development programs.***

Our operations have consumed substantial amounts of cash since inception. We expect to significantly increase our spending to advance the preclinical and clinical development of our product candidates and launch and commercialize any product candidates for which we receive regulatory approval, including building our own commercial organizations to address certain markets. We will require additional capital for the further development and commercialization of our product candidates, as well as to fund our other operating expenses and capital expenditures.

As a result of our recurring losses from operations and stockholders’ capital deficiency, there is uncertainty regarding our ability to maintain liquidity sufficient to operate our business effectively, which raises substantial doubt about our ability to continue as a going concern. If we are unsuccessful in our efforts to raise outside financing, we may be required to significantly reduce or cease operations. The report of our independent registered public accounting firm on our audited financial statements for the year ended December 31, 2017 included a “going concern” explanatory paragraph indicating that our recurring losses from operations and availability of working capital raise substantial doubt about our ability to continue as a going concern.

We cannot be certain that additional funding will be available on acceptable terms, or at all. If we are unable to raise additional capital in sufficient amounts or on terms acceptable to us we may have to significantly delay, scale back or discontinue the development or commercialization of one or more of our product candidates. We may also seek collaborators for one or more of our current or future product candidates at an earlier stage than otherwise would be desirable or on terms that are less favorable than might otherwise be available. Any of these events could significantly harm our business, financial condition and prospects.

Our future capital requirements will depend on many factors, including:

- the progress of the development of our fully-human mAbs, including biosimilars/biobetters, fully human anti-PD-L1 and anti-PD-1 checkpoint inhibitors derived from our proprietary G-MAB™ library platform, ADCs, BsAbs, as well as CAR-T for adoptive cellular immunotherapy and RTX;
- the number of product candidates we pursue;
- the time and costs involved in obtaining regulatory approvals;
- the costs involved in filing and prosecuting patent applications and enforcing or defending patent claims;
- our plans to establish sales, marketing and/or manufacturing capabilities;
- the effect of competing technological and market developments;
- the terms and timing of any collaborative, licensing and other arrangements that we may establish;
- general market conditions for offerings from biopharmaceutical companies;
- our ability to establish, enforce and maintain selected strategic alliances and activities required for product commercialization; and
- our revenues, if any, from successful development and commercialization of our product candidates.

In order to carry out our business plan and implement our strategy, we anticipate that we will need to obtain additional financing from time to time and may choose to raise additional funds through strategic collaborations, licensing arrangements, joint ventures, public or private equity or debt financing, bank lines of credit, asset sales, government grants or other arrangements. We cannot be sure that any additional funding, if needed, will be available on terms favorable to us or at all. Furthermore, any additional equity or equity-related financing may be dilutive to our stockholders, and debt or equity financing, if available, may subject us to restrictive covenants and significant interest costs. If we obtain funding through a

strategic collaboration or licensing arrangement, we may be required to relinquish our rights to certain of our product candidates or marketing territories.

Further, there is uncertainty related to future National Institutes of Health (“NIH”) grant funding, and the NIH’s plans for new grants or cooperative agreements may be re-scoped, delayed, or canceled depending on the nature of the work and the availability of resources. As a result, we cannot assure you that we will receive any additional funding under our existing NIH grants, and we may not be successful in securing additional grants from the NIH in the future.

Our inability to raise capital when needed would harm our business, financial condition and results of operations, and could cause our stock price to decline or require that we wind down our operations altogether.

### **Risks Related to Our Business and Industry**

***We are heavily dependent on the success of our technologies and product candidates, and we cannot give any assurance that our product candidates will receive regulatory approval, which is necessary before they can be commercialized.***

To date, we have invested a significant portion of our efforts and financial resources in the acquisition and development of our product candidates. We have not demonstrated our ability to perform the functions necessary for the successful acquisition, development or commercialization of the technologies we are seeking to develop. As an early stage company, we have limited experience and have not yet demonstrated an ability to successfully overcome many of the risks and uncertainties frequently encountered by companies in new and rapidly evolving fields, particularly in the biopharmaceutical area. Our future success is substantially dependent on our ability to successfully develop, obtain regulatory approval for, and then successfully commercialize such product candidates. Other than ZTlido™ (lidocaine topical system 1.8%), our product candidates are currently in preclinical development or in clinical trials. Our business depends entirely on the successful development and commercialization of our product candidates, which may never occur. We currently generate no revenues from sales of any drugs, and we may never be able to develop or commercialize a marketable drug.

The successful development, and any commercialization, of our technologies and any product candidates would require us to successfully perform a variety of functions, including:

- developing our technology platform;
- seeking and obtaining intellectual property and/or proprietary rights to our technology and/or the technology of others;
- identifying, developing, manufacturing and commercializing product candidates;
- entering into successful licensing and other arrangements with product development partners;
- participating in regulatory approval processes;
- formulating and manufacturing products; and
- conducting sales and marketing activities.

Our operations have been limited to organizing our company, acquiring, developing and securing our proprietary technology and identifying and obtaining early preclinical data or clinical data for various product candidates. These operations provide a limited basis for you to assess our ability to continue to develop our technology, identify product candidates, develop and commercialize any product candidates we are able to identify and enter into successful collaborative arrangements with other companies, as well as for you to assess the advisability of investing in our securities. Each of these requirements will require substantial time, effort and financial resources.

Each of our product candidates will require additional preclinical or clinical development, management of preclinical, clinical and manufacturing activities, regulatory approval in multiple jurisdictions, obtaining manufacturing supply, building of a commercial organization, and significant marketing efforts before we generate any revenues from product sales. We are not permitted to market or promote any of our product candidates before we receive regulatory approval from the U.S. Food and Drug Administration (the “FDA”), the United Kingdom’s Medicines and Healthcare Products Regulatory Agency (the “MHRA”), the European Medicines Agency (“EMA”) or comparable foreign regulatory authorities, and we may never receive such regulatory approval for any of our product candidates. In addition, our product development programs contemplate the development of companion diagnostics by our third-party collaborators. Companion diagnostics are subject to regulation as medical devices and must themselves be approved for marketing by the FDA, the MHRA, the EMA or certain other foreign regulatory agencies before we may commercialize our product candidates.

***Drug development involves a lengthy and expensive process with an uncertain outcome, and results of earlier studies and trials may not be predictive of future trial results.***



Clinical testing is expensive and can take many years to complete, and its outcome is risky and uncertain. Failure can occur at any time during the clinical trial process. The results of preclinical studies and early clinical trials of our product candidates may not be predictive of the results of later-stage clinical trials. Product candidates in later stages of clinical trials may fail to show the desired safety and efficacy traits despite having progressed through preclinical studies and initial clinical trials. It is not uncommon for companies in the pharmaceutical industry to suffer significant setbacks in advanced clinical trials due to lack of efficacy or adverse safety profiles, notwithstanding promising results in earlier trials. Our future clinical trial results may not be successful.

This drug candidate development risk is heightened by any changes in the planned clinical trials compared to the completed clinical trials. As product candidates are developed through preclinical to early and late stage clinical trials towards approval and commercialization, it is customary that various aspects of the development program, such as manufacturing and methods of administration, are altered along the way in an effort to optimize processes and results. While these types of changes are common and are intended to optimize the product candidates for late stage clinical trials, approval and commercialization, such changes do carry the risk that they will not achieve these intended objectives.

Other than with respect to ZTlido™ (lidocaine topical system 1.8%), we have not previously initiated or completed a corporate-sponsored clinical trial. Consequently, we may not have the necessary capabilities, including adequate staffing, to successfully manage the execution and completion of any clinical trials we initiate, including our planned clinical trials of RTX, CAR-T, our biosimilar/biobetters antibodies and other product candidates, in a way that leads to our obtaining marketing approval for our product candidates in a timely manner, or at all.

In the event we are able to conduct a pivotal clinical trial of a product candidate, the results of such trial may not be adequate to support marketing approval. Because our product candidates are intended for use in life-threatening diseases, in some cases we ultimately intend to seek marketing approval for each product candidate based on the results of a single pivotal clinical trial. As a result, these trials may receive enhanced scrutiny from the FDA. For any such pivotal trial, if the FDA disagrees with our choice of primary endpoint or the results for the primary endpoint are not robust or significant relative to control, are subject to confounding factors, or are not adequately supported by other study endpoints, including possibly overall survival or complete response rate, the FDA may refuse to approve a New Drug Application (“NDA”), Biologics License Application (“BLA”) or other application for marketing based on such pivotal trial. The FDA may require additional clinical trials as a condition for approving our product candidates.

***Delays in clinical testing could result in increased costs to us and delay our ability to generate revenue.***

Although we are planning for certain clinical trials relating to RTX, CAR-T, and biosimilar/biobetter antibodies and other product candidates, there can be no assurance that the FDA will accept our proposed trial designs. We may experience delays in our clinical trials and we do not know whether planned clinical trials will begin on time, need to be redesigned, enroll patients on time or be completed on schedule, if at all. Clinical trials can be delayed for a variety of reasons, including delays related to:

- obtaining regulatory approval to commence a trial;
- reaching agreement on acceptable terms with prospective contract research organizations (“CROs”) and clinical trial sites, the terms of which can be subject to extensive negotiation and may vary significantly among different CROs and trial sites;
- obtaining institutional review board (“IRB”) approval at each site;
- recruiting suitable patients to participate in a trial;
- clinical sites deviating from trial protocol or dropping out of a trial;
- having patients complete a trial or return for post-treatment follow-up;
- developing and validating companion diagnostics on a timely basis, if required;
- adding new clinical trial sites; or
- manufacturing sufficient quantities of product candidate for use in clinical trials.

Patient enrollment, a significant factor in the timing of clinical trials, is affected by many factors, including the size and nature of the patient population, the proximity of patients to clinical sites, the eligibility criteria for the trial, the design of the clinical trial, competing clinical trials and clinicians’ and patients’ perceptions as to the potential advantages of the drug being studied in relation to other available therapies, including any new drugs that may be approved for the indications we are investigating. Furthermore, we intend to rely on CROs and clinical trial sites to ensure the proper and timely conduct of our clinical trials and we intend to have agreements governing their committed activities, but we will have limited influence over their actual performance.

We could encounter delays if a clinical trial is suspended or terminated by us, by the IRBs of the institutions in which such trials are being conducted, by the Data Safety Monitoring Board for such trial or by the FDA or other regulatory authorities. Such authorities may impose such a suspension or termination due to a number of factors, including failure to conduct the clinical trial in accordance with regulatory requirements or our clinical protocols, inspection of the clinical trial operations or trial site by the FDA or other regulatory authorities resulting in the imposition of a clinical hold, unforeseen safety issues or adverse side effects, failure to demonstrate a benefit from using a drug, changes in governmental regulations or administrative actions or lack of adequate funding to continue the clinical trial.

If we experience delays in the completion of, or termination of, any clinical trial of our product candidates, the commercial prospects of our product candidates will be harmed, and our ability to generate product revenues from any of these product candidates will be delayed. In addition, any delays in completing our clinical trials will increase our costs, slow down our product candidate development and approval process and jeopardize our ability to commence product sales and generate revenues. Any of these occurrences may harm our business, financial condition and prospects significantly. In addition, many of the factors that cause, or lead to, a delay in the commencement or completion of clinical trials may also ultimately lead to the denial of regulatory approval of our product candidates.

***Competition for patients in conducting clinical trials may prevent or delay product development and strain our limited financial resources.***

Many pharmaceutical companies are conducting clinical trials in patients with the disease indications that our potential drug products target. As a result, we must compete with them for clinical sites, physicians and the limited number of patients who fulfill the stringent requirements for participation in clinical trials. Also, due to the confidential nature of clinical trials, we do not know how many of the eligible patients may be enrolled in competing studies and who are consequently not available to us for our clinical trials. Our clinical trials may be delayed or terminated due to the inability to enroll enough patients. Patient enrollment depends on many factors, including the size of the patient population, the nature of the trial protocol, the proximity of patients to clinical sites and the eligibility criteria for the study. The delay or inability to meet planned patient enrollment may result in increased costs and delays or termination of the trial, which could have a harmful effect on our ability to develop products.

***The regulatory approval processes of the FDA, the MHRA, the EMA and comparable foreign authorities are lengthy, time consuming and inherently unpredictable, and if we are ultimately unable to obtain regulatory approval for our product candidates, our business will be substantially harmed.***

The time required to obtain approval from the FDA, the MHRA, the EMA and comparable foreign authorities is unpredictable but typically takes many years following the commencement of clinical trials and depends upon numerous factors, including the substantial discretion of the regulatory authorities. In addition, approval policies, regulations, or the type and amount of clinical data necessary to gain approval may change during the course of a product candidate's clinical development and may vary among jurisdictions. Other than ZTlido™ (lidocaine topical system 1.8%), we have not obtained regulatory approval for any product candidate and it is possible that none of our existing product candidates or any product candidates we may seek to develop in the future will ever obtain regulatory approval.

We may fail to receive regulatory approval for our product candidates for many reasons, including the following:

- the FDA, the MHRA, the EMA or comparable foreign regulatory authorities may disagree with the design or implementation of our clinical trials;
- we may be unable to demonstrate to the satisfaction of the FDA, the MHRA, the EMA or comparable foreign regulatory authorities that a product candidate is safe and effective for its proposed indication;
- the results of clinical trials may not meet the level of statistical significance required for approval by the FDA, the MHRA, the EMA or comparable foreign regulatory authorities;
- the FDA, the MHRA, the EMA or comparable foreign regulatory authorities may disagree with our interpretation of data from preclinical studies or clinical trials;
- the data collected from clinical trials of our product candidates may not be sufficient to support the submission of an NDA, a marketing authorization application (“MAA”) or other submission or to obtain regulatory approval in the U.S., the United Kingdom, the European Union or elsewhere;
- the FDA, the MHRA, the EMA or comparable foreign regulatory authorities may fail to approve the manufacturing processes or facilities of third-party manufacturers with which we contract for clinical and commercial supplies;
- the FDA, the MHRA, the EMA or comparable foreign regulatory authorities may fail to approve the companion diagnostics we contemplate developing with partners; and
- the approval policies or regulations of the FDA, the MHRA, the EMA or comparable foreign regulatory authorities may significantly change in a manner rendering our clinical data insufficient for approval.

This lengthy approval process as well as the unpredictability of future clinical trial results may result in our failing to obtain regulatory approval to market our product candidates, which would significantly harm our business, results of operations and prospects.

In addition, even if we were to obtain approval, regulatory authorities may approve any of our product candidates for fewer or more limited indications than we request, may not approve the price we intend to charge for our products, may grant approval contingent on the performance of costly post-marketing clinical trials, or may approve a product candidate with a label that does not include the labeling claims necessary or desirable for the successful commercialization of that product candidate. Any of the foregoing scenarios could materially harm the commercial prospects for our product candidates.

Other than a new drug application submitted by Scilex for Scilex's lead product candidate, ZTlido™ (lidocaine topical system 1.8%), we have not previously submitted a BLA or an NDA to the FDA, an MAA to the MHRA or the EMA or similar drug approval filings to comparable foreign authorities, for any product candidate, and we cannot be certain that any of our product candidates will be successful in clinical trials or receive regulatory approval. Further, our product candidates may not receive regulatory approval even if our clinical trials are successful. If we do not receive regulatory approvals for our product candidates, we may not be able to continue our operations. Even if we successfully obtain regulatory approvals to market one or more of our product candidates, our revenues will be dependent, in some instances, upon our collaborators' ability to obtain regulatory approval of the companion diagnostics to be used with our product candidates, as well as the size of the markets in the territories for which we gain regulatory approval and have commercial rights. If the markets for patients that we are targeting for our product candidates are not as significant as we estimate, we may not generate significant revenues from sales of such products, if approved.

We plan to seek regulatory approval to commercialize our product candidates in the U.S., the United Kingdom, the European Union and in additional foreign countries. While the scope of regulatory approval is similar in other countries, to obtain separate regulatory approval in many other countries we must comply with numerous and varying regulatory requirements of such countries regarding safety and efficacy and governing, among other things, clinical trials and commercial sales, pricing and distribution of our product candidates, and we cannot predict success in these jurisdictions. Further, the United Kingdom has voted to withdraw from the European Union. We cannot predict what consequences the withdrawal of the United Kingdom from the European Union might have on the regulatory frameworks of the United Kingdom or the European Union, or on our future operations, if any, in these jurisdictions.

***Our approach to the discovery and development of product candidates that target ADCs or iTAbs is unproven, and we do not know whether we will be able to develop any products of commercial value.***

ADCs and intracellular targeting antibodies ("iTAb") are emerging technologies and, consequently, it is conceivable that such technologies may ultimately fail to identify commercially viable products to treat human patients with cancer or other diseases. Due to the unproven nature of ADCs and iTAbs, significant further research and development activities will be required. We may incur substantial costs in connection with such research and development activities and there is no guarantee that these activities will lead to the identification of commercially viable products.

***Our product candidates may cause undesirable side effects or have other properties that could delay or prevent their regulatory approval, limit the commercial profile of an approved label, or result in significant negative consequences following marketing approval, if any.***

Undesirable side effects caused by our product candidates could cause us or regulatory authorities to interrupt, delay or halt clinical trials and could result in a more restrictive label or the delay or denial of regulatory approval by the FDA or other comparable foreign authorities. Results of our trials could reveal a high and unacceptable severity and prevalence of these or other side effects. In such an event, our trials could be suspended or terminated and the FDA or comparable foreign regulatory authorities could order us to cease further development of or deny approval of our product candidates for any or all targeted indications. The drug-related side effects could affect patient recruitment or the ability of enrolled patients to complete the trial or result in potential product liability claims. Any of these occurrences may harm our business, financial condition and prospects significantly.

Additionally, if we receive marketing approval for one or more of our product candidates, and we or others later identify undesirable side effects caused by such products, a number of potentially significant negative consequences could result, including:

- regulatory authorities may withdraw approvals of such products;
- regulatory authorities may require additional warnings on the label;

- we may be required to create a medication guide outlining the risks of such side effects for distribution to patients;
- we could be sued and held liable for harm caused to patients; and
- our reputation may suffer.

Any of these events could prevent us from achieving or maintaining market acceptance of the particular product candidate or for particular indications of a product candidate, if approved, and could significantly harm our business, results of operations and prospects.

***We rely on third parties to conduct our preclinical and clinical trials. If these third parties do not successfully perform their contractual legal and regulatory duties or meet expected deadlines, we may not be able to obtain regulatory approval for or commercialize our product candidates and our business could be substantially harmed.***

We have relied upon and plan to continue to rely upon third-party CROs to monitor and manage data for our ongoing preclinical and clinical programs. We rely on these parties for execution of our preclinical and clinical trials, and control only certain aspects of their activities. Nevertheless, we are responsible for ensuring that each of our studies is conducted in accordance with the applicable protocol, legal, regulatory and scientific standards, and our reliance on the CROs does not relieve us of our regulatory responsibilities. We and our CROs are required to comply with current good clinical practices (“cGCP”), which are regulations and guidelines enforced by the FDA, the Competent Authorities of the Member States of the European Economic Area, and comparable foreign regulatory authorities for all of our product candidates in clinical development.

Regulatory authorities enforce these cGCPs through periodic inspections of trial sponsors, principal investigators and trial sites. If we or any of our CROs fail to comply with applicable cGCPs, the clinical data generated in our clinical trials may be deemed unreliable and the FDA, the MHRA, the EMA or comparable foreign regulatory authorities may require us to perform additional clinical trials before approving our marketing applications or may not approve our marketing applications. We cannot assure you that upon inspection by a given regulatory authority, such regulatory authority will determine that any of our clinical trials comply with cGCP regulations. In addition, our clinical trials must be conducted with product produced under current good manufacturing practices (“cGMP”) regulations. Our failure to comply with these regulations may require us to repeat clinical trials, which would delay the regulatory approval process.

If any of our relationships with these third-party CROs terminate, we may not be able to enter into arrangements with alternative CROs or to do so on commercially reasonable terms. In addition, our CROs are not our employees, and except for remedies available to us under our agreements with such CROs, we cannot control whether or not they devote sufficient time and resources to our on-going clinical, nonclinical and preclinical programs. If CROs do not successfully carry out their contractual duties or obligations or meet expected deadlines, if they need to be replaced or if the quality or accuracy of the clinical data they obtain is compromised due to the failure to adhere to our clinical protocols, regulatory requirements or for other reasons, our clinical trials may be extended, delayed or terminated and we may not be able to obtain regulatory approval for or successfully commercialize our product candidates. As a result, our results of operations and the commercial prospects for our product candidates would be harmed, our costs could increase and our ability to generate revenues could be delayed.

Switching or adding additional CROs involves additional cost and requires management time and focus. In addition, there is a natural transition period when a new CRO commences work. As a result, delays occur, which can materially impact our ability to meet our desired clinical development timelines. Though we carefully manage our relationships with our CROs, there can be no assurance that we will not encounter similar challenges or delays in the future or that these delays or challenges will not have a material adverse impact on our business, financial condition and prospects.

***If we fail to comply with manufacturing regulations, our financial results and financial condition will be adversely affected.***

We currently manufacture our preclinical and clinical materials in-house. However, we only recently began manufacturing such materials and do not have significant prior experience manufacturing preclinical or clinical materials or product candidates. Before we can begin commercial manufacture of our product candidates, regulatory authorities must approve marketing applications that identify manufacturing facilities operated by us or our contract manufacturers that have passed regulatory inspection and manufacturing processes that are acceptable to the regulatory authorities. In addition, our pharmaceutical manufacturing facilities are continuously subject to scheduled and unannounced inspection by the FDA and international regulatory authorities, before and after product approval, to monitor and ensure compliance with cGMP and other regulations. Additionally, we may use contract manufacturers for the manufacture of our product candidates from time to time based on capacity needs. Although we are not involved in the day-to-day operations of our contract manufacturers, we are ultimately responsible for ensuring that our products are manufactured in accordance with cGMP regulations.

Due to the complexity of the processes used to manufacture our product candidates, we may be unable to continue to pass or initially pass federal or international regulatory inspections in a cost-effective manner. For the same reason, any potential third-party manufacturer of our product candidates may be unable to comply with cGMP regulations in a cost-effective manner and may be unable to initially or continue to pass a federal or international regulatory inspection.

If we, or third-party manufacturers with whom we contract, are unable to comply with manufacturing regulations, we may be subject to delay of approval of our product candidates, warning or untitled letters, fines, unanticipated compliance expenses, recall or seizure of our products, total or partial suspension of production and/or enforcement actions, including injunctions, and criminal or civil prosecution. These possible sanctions would adversely affect our financial results and financial condition.

***Material necessary to manufacture our product candidates may not be available on commercially reasonable terms, or at all, which may delay the development and commercialization of our product candidates.***

There are a limited number of suppliers for raw materials that we use to manufacture our drugs and there may be a need to assess alternate suppliers to prevent a possible disruption of the manufacture of the materials necessary to produce our product candidates for our clinical trials, and if approved, ultimately for commercial sale. We do not have any control over the process or timing of the acquisition of these raw materials by us. We typically do not have any agreements for the commercial production of these raw materials. Any significant delay in the supply of a product candidate, or the raw material components thereof, for an ongoing clinical trial due to the need to obtain or replace a third-party manufacturer could considerably delay completion of our clinical trials, product testing and potential regulatory approval of our product candidates. If we are unable to purchase these raw materials after regulatory approval has been obtained for our product candidates, the commercial launch of our product candidates would be delayed or there would be a shortage in supply, which would impair our ability to generate revenues from the sale of our product candidates.

***We may not be able to manufacture our product candidates in commercial quantities, which would prevent us from commercializing our product candidates.***

We are largely dependent on our third party manufacturers to conduct process development and scale-up work necessary to support greater clinical development and commercialization requirements for our product candidates. Carrying out these activities in a timely manner, and on commercially reasonable terms, is critical to the successful development and commercialization of our product candidates. We expect our third-party manufacturers are capable of providing sufficient quantities of our product candidates to meet anticipated clinical and full-scale commercial demands, however if third parties with whom we currently work are unable to meet our supply requirements, we will need to secure alternate suppliers or face potential delays or shortages. While we believe that there are other contract manufacturers with the technical capabilities to manufacture our product candidates, we cannot be certain that identifying and establishing relationships with such sources would not result in significant delay or material additional costs.

***The complexities and regulations related to our manufacturing and development services businesses subject us to potential risks.***

Through certain subsidiaries, we offer development (e.g., conjugation) and manufacturing services that are highly complex, due in part to strict regulatory requirements. A failure of our quality control systems in our facilities could cause problems to arise in connection with facility operations for a variety of reasons, including equipment malfunction, contamination, failure to follow specific manufacturing instructions, protocols and standard operating procedures, problems with raw materials or environmental factors. Such problems could affect production of a single manufacturing run or a series of runs, requiring the destruction of products, or could halt manufacturing operations altogether. In addition, our failure to meet required quality standards may result in our failure to timely deliver products to our customers, which in turn could damage our reputation for quality and service. Any such incident could, among other things, lead to increased costs, lost revenue, reimbursement to customers for lost drug substance, damage to and possibly termination of existing customer relationships, time and expense spent investigating the cause and, depending on the cause, similar losses with respect to other manufacturing runs. With respect to our commercial manufacturing, if problems are not discovered before the product is released to the market, we may be subject to regulatory actions, including product recalls, product seizures, injunctions to halt manufacture and distribution, restrictions on our operations, civil sanctions, including monetary sanctions, and criminal actions. In addition, such issues could subject us to litigation and/or liability for damages, the cost of which could be significant.

Regulatory agencies may periodically inspect our manufacturing facilities to ensure compliance with applicable legal, regulatory and local requirements, such as cGMP requirements. Failure to comply with these requirements may subject us to possible legal or regulatory actions, such as suspension of manufacturing, seizure of product or voluntary recall of a product.

***We currently have no sales and marketing organization. If we are unable to establish a direct sales force in the U.S. to promote our products, the commercial opportunity for our products may be diminished.***

With the exception of Scilex (which is in the process of preparing for a potential commercial launch for ZTlido™ (lidocaine topical system 1.8%) and intends to utilize a contract sales organization to conduct its primary sales activities), we currently have no sales and marketing organization. If any of our product candidates are approved by the FDA, we intend to market that product through our own sales force. We will incur significant additional expenses and commit significant additional management resources to establish our sales force. We may not be able to establish these capabilities despite these additional expenditures. We will also have to compete with other pharmaceutical and biotechnology companies to recruit, hire and train sales and marketing personnel. If we elect to rely on third parties to sell our product candidates in the U.S., we may receive less revenue than if we sold our products directly. In addition, although we would intend to use due diligence in monitoring their activities, we may have little or no control over the sales efforts of those third parties. In the event we are unable to develop our own sales force or collaborate with a third party to sell our product candidates, we may not be able to commercialize our product candidates which would negatively impact our ability to generate revenue.

Specifically relating to Scilex, Scilex only has a limited commercial infrastructure and has limited experience in the commercialization, sale, marketing or distribution of pharmaceutical products, like ZTlido™ (lidocaine topical system 1.8%). To achieve commercial success for any approved product, including ZTlido™ (lidocaine topical system 1.8%), Scilex must either develop a sales and marketing organization or outsource these functions to third parties. Scilex expects that the primary focus of its commercialization efforts will be in the United States. In this regard, Scilex intends to commercialize ZTlido™ (lidocaine topical system 1.8%) through the use of its own sales force, a contract sales organization, or through partnership agreements with a pharmaceutical company. Commercialization of ZTlido™ (lidocaine topical system 1.8%) and other future product candidates outside of the United States, to the extent pursued, is likely to require collaboration with one or more third parties.

***We may need others to market and commercialize our product candidates in international markets.***

In the future, if appropriate regulatory approvals are obtained, we may commercialize our product candidates in international markets. However, we have not decided how to commercialize our product candidates in those markets. We may decide to build our own sales force or sell our products through third parties. If we decide to sell our product candidates in international markets through a third party, we may not be able to enter into any marketing arrangements on favorable terms or at all. In addition, these arrangements could result in lower levels of income to us than if we marketed our product candidates entirely on our own. If we are unable to enter into a marketing arrangement for our product candidates in international markets, we may not be able to develop an effective international sales force to successfully commercialize those products in international markets. If we fail to enter into marketing arrangements for our products and are unable to develop an effective international sales force, our ability to generate revenue would be limited.

***With respect to ZTlido™ (lidocaine topical system 1.8%) and any of our product candidates for which we may receive regulatory approvals, we will be subject to ongoing obligations and continued regulatory review, which may result in significant additional expense. Additionally, our product candidates, if approved, could be subject to labeling and other restrictions and market withdrawal and we may be subject to penalties if we fail to comply with regulatory requirements or experience unanticipated problems with our products.***

Our FDA approval for ZTlido™ (lidocaine topical system 1.8%) and any other regulatory approvals that we may receive for our product candidates may be subject to limitations on the approved indicated uses for which the product may be marketed or to the conditions of approval, or contain requirements for potentially costly post-marketing testing, including Phase IV clinical trials, and surveillance to monitor the safety and efficacy of the product candidate. In addition, if the FDA or a comparable foreign regulatory authority approves any of our product candidates, the manufacturing processes, labeling, packaging, distribution, adverse event reporting, storage, advertising, promotion and recordkeeping for the product will be subject to extensive and ongoing regulatory requirements. These requirements include submissions of safety and other post-marketing information and reports, registration, as well as continued compliance with cGMPs and cGCPs for any clinical trials that we conduct post-approval. The future discovery of previously unknown problems with a product, including adverse events of unanticipated severity or frequency, or with our third-party manufacturers or manufacturing processes, or failure to comply with regulatory requirements, may result in, among other things:

- restrictions on the marketing or manufacturing of the product, withdrawal of the product from the market, or voluntary or mandatory product recalls;
- fines, warning letters or holds on clinical trials;
- refusal by the FDA to approve pending applications or supplements to approved applications filed by us, or suspension or revocation of product license approvals;
- product seizure or detention, or refusal to permit the import or export of products; and

- injunctions or the imposition of civil or criminal penalties.

The FDA's policies may change and additional government regulations may be enacted that could prevent, limit or delay regulatory approval of our product candidates. If we are slow or unable to adapt to changes in existing requirements or the adoption of new requirements or policies, or if we are not able to maintain regulatory compliance, we may lose any marketing approval that we may have obtained, which would adversely affect our business, prospects and ability to achieve or sustain profitability.

***We will need to obtain FDA approval of any proposed product brand names, and any failure or delay associated with such approval may adversely impact our business.***

A pharmaceutical product cannot be marketed in the U.S. or other countries until we have completed rigorous and extensive regulatory review processes, including approval of a brand name. Any brand names we intend to use for our product candidates will require approval from the FDA regardless of whether we have secured a formal trademark registration from the U.S. Patent and Trademark Office (the "PTO"). The FDA typically conducts a review of proposed product brand names, including an evaluation of potential for confusion with other product names. The FDA may also object to a product brand name if it believes the name inappropriately implies medical claims. If the FDA objects to any of our proposed product brand names, we may be required to adopt an alternative brand name for our product candidates. If we adopt an alternative brand name, we would lose the benefit of our existing trademark applications for such product candidate and may be required to expend significant additional resources in an effort to identify a suitable product brand name that would qualify under applicable trademark laws, not infringe the existing rights of third parties and be acceptable to the FDA. We may be unable to build a successful brand identity for a new trademark in a timely manner or at all, which would limit our ability to commercialize our product candidates.

***Our failure to successfully discover, acquire, develop and market additional product candidates or approved products would impair our ability to grow.***

As part of our growth strategy, we intend to develop and market additional products and product candidates. We are pursuing various therapeutic opportunities through our product pipeline. We may spend several years completing our development of any particular current or future internal product candidate, and failure can occur at any stage. The product candidates to which we allocate our resources may not end up being successful. In addition, because our internal research capabilities are limited, we may be dependent upon pharmaceutical and biotechnology companies, academic scientists and other researchers to sell or license products or technology to us. The success of this strategy depends partly upon our ability to identify, select, discover and acquire promising pharmaceutical product candidates and products. Failure of this strategy would impair our ability to grow.

The process of proposing, negotiating and implementing a license or acquisition of a product candidate or approved product is lengthy and complex. Other companies, including some with substantially greater financial, marketing and sales resources, may compete with us for the license or acquisition of product candidates and approved products. We have limited resources to identify and execute the acquisition or in-licensing of third-party products, businesses and technologies and integrate them into our current infrastructure. Moreover, we may devote resources to potential acquisitions or in-licensing opportunities that are never completed, or we may fail to realize the anticipated benefits of such efforts. We may not be able to acquire the rights to additional product candidates on terms that we find acceptable, or at all.

In addition, future acquisitions may entail numerous operational and financial risks, including:

- disruption of our business and diversion of our management's time and attention to develop acquired products or technologies;
- incurrence of substantial debt, dilutive issuances of securities or depletion of cash to pay for acquisitions;
- higher than expected acquisition and integration costs;
- difficulty in combining the operations and personnel of any acquired businesses with our operations and personnel;
- increased amortization expenses;
- impairment of relationships with key suppliers or customers of any acquired businesses due to changes in management and ownership;
- impairment of our ability to obtain intellectual property rights or rights to commercialize additional product candidates, or increased cost to obtain such rights;
- inability to motivate key employees of any acquired businesses; and
- assumption of known and unknown liabilities.

Further, any product candidate that we acquire may require additional development efforts prior to commercial sale, including extensive clinical testing and approval by the FDA and applicable foreign regulatory authorities. All product candidates are prone to risks of failure typical of pharmaceutical product development, including the possibility that a product candidate will not be shown to be sufficiently safe and effective for approval by regulatory authorities.

***Our commercial success depends upon us attaining significant market acceptance of our product candidates, if approved for sale, among physicians, patients, healthcare payors and major operators of cancer and other clinics.***

Even if we obtain regulatory approval for our product candidates, the product may not gain market acceptance among physicians, health care payors, patients and the medical community, which are critical to commercial success. Market acceptance of any product candidate for which we receive approval depends on a number of factors, including:

- the efficacy and safety as demonstrated in clinical trials;
- the timing of market introduction of such product candidate as well as competitive products;
- the clinical indications for which the drug is approved;
- acceptance by physicians, major operators of cancer clinics and patients of the drug as a safe and effective treatment;
- the safety of such product candidate seen in a broader patient group, including its use outside the approved indications;
- the availability, cost and potential advantages of alternative treatments, including less expensive generic drugs;
- the availability of adequate reimbursement and pricing by third-party payors and government authorities;
- the product labeling or product insert required by the FDA or regulatory authority in other countries;
- the approval, availability, market acceptance and reimbursement for a companion diagnostic, if any;
- the prevalence and severity of adverse side effects; and
- the effectiveness of our sales and marketing efforts.

If any product candidate that we develop does not provide a treatment regimen that is as beneficial as, or is perceived as being as beneficial as, the current standard of care or otherwise does not provide patient benefit, that product candidate, if approved for commercial sale by the FDA or other regulatory authorities, likely will not achieve market acceptance. Our ability to effectively promote and sell any approved products will also depend on pricing and cost-effectiveness, including our ability to produce a product at a competitive price and our ability to obtain sufficient third-party coverage or reimbursement. If any product candidate is approved but does not achieve an adequate level of acceptance by physicians, patients and third-party payors, our ability to generate revenues from that product would be substantially reduced. In addition, our efforts to educate the medical community and third-party payors on the benefits of our product candidates may require significant resources, may be constrained by FDA rules and policies on product promotion, and may never be successful.

***If we cannot compete successfully against other biotechnology and pharmaceutical companies, we may not be successful in developing and commercializing our technology and our business will suffer.***

The biotechnology and pharmaceutical industries are characterized by intense competition and rapid technological advances, both in the U.S. and internationally. In addition, the competition in the oncology and pain management markets, and other relevant markets, is intense. Even if we are able to develop our product candidates, proprietary platform technology and/or additional antibody libraries, each will compete with a number of existing and future technologies and product candidates developed, manufactured and marketed by others. Specifically, we will compete against fully integrated pharmaceutical companies and smaller companies that are collaborating with larger pharmaceutical companies, academic institutions, government agencies and other public and private research organizations. Many of these competitors have validated technologies with products already FDA-approved or in various stages of development. In addition, many of these competitors, either alone or together with their collaborative partners, operate larger research and development programs and have substantially greater financial resources than we do, as well as significantly greater experience in:

- developing product candidates and technologies generally;
- undertaking preclinical testing and clinical trials;
- obtaining FDA and other regulatory approvals of product candidates;
- formulating and manufacturing product candidates; and
- launching, marketing and selling product candidates.

Many of our competitors have substantially greater financial, technical and other resources, such as larger research and development staff and experienced marketing and manufacturing organizations. Additional mergers and acquisitions in the biotechnology and pharmaceutical industries may result in even more resources being concentrated in our competitors. As a result, these companies may obtain regulatory approval more rapidly than we are able and may be more effective in selling and



marketing their products as well. Smaller or early-stage companies or generic or biosimilar pharmaceutical manufacturers may also prove to be significant competitors, particularly through collaborative arrangements with large, established companies. Competition may increase further as a result of advances in the commercial applicability of technologies and greater availability of capital for investment in these industries. Our competitors may succeed in developing, acquiring or licensing on an exclusive basis drug products that are more effective or less costly than any drug candidate that we are currently developing or that we may develop. If approved, our product candidates will face competition from commercially available drugs as well as drugs that are in the development pipelines of our competitors and later enter the market.

Established pharmaceutical companies may invest heavily to accelerate discovery and development of novel compounds or to in-license novel compounds that could make our product candidates less competitive. In addition, any new product that competes with an approved product must demonstrate compelling advantages in efficacy, convenience, tolerability and safety in order to overcome price competition and to be commercially successful. Accordingly, our competitors may succeed in obtaining patent protection, receiving FDA, the MHRA, the EMA or other regulatory approval or discovering, developing and commercializing medicines before we do, which would have a material adverse impact on our business. If our technologies fail to compete effectively against third party technologies, our business will be adversely impacted.

We expect that our ability to compete effectively will depend upon our ability to:

- successfully and efficiently complete clinical trials and submit for and obtain all requisite regulatory approvals in a cost-effective manner;
- obtain and maintain a proprietary position for our products and manufacturing processes and other related product technology;
- attract and retain key personnel;
- develop relationships with physicians prescribing these products; and
- build an adequate sales and marketing infrastructure for our product candidates.

Because we will be competing against significantly larger companies with established track records, we will have to demonstrate that, based on experience, clinical data, side-effect profiles and other factors, our product candidates, if approved, are competitive with other products.

***Reimbursement may be limited or unavailable in certain market segments for our product candidates, which could make it difficult for us to sell our products profitably.***

There is significant uncertainty related to the third-party coverage and reimbursement of newly approved drugs. We intend to seek approval to market our product candidates in the U.S., Europe and other selected foreign jurisdictions. Market acceptance and sales of our product candidates in both domestic and international markets will depend significantly on the availability of adequate coverage and reimbursement from third-party payors for any of our product candidates and may be affected by existing and future health care reform measures. Government and other third-party payors are increasingly attempting to contain healthcare costs by limiting both coverage and the level of reimbursement for new drugs and, as a result, they may not cover or provide adequate payment for our product candidates. These payors may conclude that our product candidates are less safe, less effective or less cost-effective than existing or future introduced products, and third-party payors may not approve our product candidates for coverage and reimbursement or may cease providing coverage and reimbursement for these product candidates.

Obtaining coverage and reimbursement approval for a product from a government or other third-party payor is a time consuming and costly process that could require us to provide to the payor supporting scientific, clinical and cost-effectiveness data for the use of our products. We may not be able to provide data sufficient to gain acceptance with respect to coverage and reimbursement. If reimbursement of our future products is unavailable or limited in scope or amount, or if pricing is set at unsatisfactory levels, we may be unable to achieve or sustain profitability.

In some foreign countries, particularly in the European Union, the pricing of prescription pharmaceuticals is subject to governmental control. In these countries, pricing negotiations with governmental authorities can take considerable time after the receipt of marketing approval for a product candidate. To obtain reimbursement or pricing approval in some countries, we may be required to conduct additional clinical trials that compare the cost-effectiveness of our product candidates to other available therapies. If reimbursement of our product candidates is unavailable or limited in scope or amount in a particular country, or if pricing is set at unsatisfactory levels, we may be unable to achieve or sustain profitability of our products in such country.

***Healthcare reform measures could hinder or prevent our product candidates' commercial success.***

In both the U.S. and certain foreign jurisdictions, there have been and we expect there will continue to be a number of legislative and regulatory changes to the health care system that could impact our ability to sell our products profitably. The U.S. government and other governments have shown significant interest in pursuing healthcare reform. In particular, the Medicare Modernization Act of 2003 revised the payment methodology for many products under the Medicare program in the U.S. This has resulted in lower rates of reimbursement. In 2010, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act (collectively, the “Healthcare Reform Law”), was enacted. The Healthcare Reform Law substantially changed the way healthcare is financed by both governmental and private insurers. Such government-adopted reform measures may adversely impact the pricing of healthcare products and services in the U.S. or internationally and the amount of reimbursement available from governmental agencies or other third-party payors.

There have been, and likely will continue to be, legislative and regulatory proposals at the federal and state levels directed at broadening the availability of healthcare and containing or lowering the cost of healthcare. For example, there have been recent public announcements by members of the U.S. Congress, President Trump and his administration regarding their plans to repeal and replace the Healthcare Reform Law and Medicare. Although we cannot predict the ultimate content or timing of any healthcare reform legislation, potential changes resulting from any amendment, repeal or replacement of these programs, including any reduction in the future availability of healthcare insurance benefits, could adversely affect our business and future results of operations. The continuing efforts of the government, insurance companies, managed care organizations and other payors of healthcare services to contain or reduce costs of healthcare may adversely affect the demand for any drug products for which we may obtain regulatory approval, as well as our ability to set satisfactory prices for our products, to generate revenues, and to achieve and maintain profitability.

***Failure to successfully validate, develop and obtain regulatory approval for companion diagnostics could harm our long-term drug development strategy.***

As one of the key elements of our clinical development strategy, we seek to identify patients within a disease category or indication who may derive selective and meaningful benefit from the product candidates we are developing. In collaboration with partners, we plan to develop companion diagnostics to help us to more accurately identify patients within a particular category or indication, both during our clinical trials and in connection with the commercialization of certain of our product candidates. Companion diagnostics are subject to regulation by the FDA and comparable foreign regulatory authorities as medical devices and require separate regulatory approval prior to commercialization. We typically do not develop companion diagnostics internally and thus we are dependent on the sustained cooperation and effort of our third-party collaborators in developing and obtaining approval for these companion diagnostics. We and our collaborators may encounter difficulties in developing and obtaining approval for the companion diagnostics, including issues relating to selectivity/specificity, analytical validation, reproducibility or clinical validation. Any delay or failure by our collaborators to develop or obtain regulatory approval of the companion diagnostics could delay or prevent approval of our product candidates. In addition, our collaborators may encounter production difficulties that could constrain the supply of the companion diagnostics, and both they and we may have difficulties gaining acceptance of the use of the companion diagnostics in the clinical community. If such companion diagnostics fail to gain market acceptance, it would have an adverse effect on our ability to derive revenues from sales of our products. In addition, any diagnostic company with whom we contract may decide to discontinue selling or manufacturing the companion diagnostic that we anticipate using in connection with development and commercialization of our product candidates or our relationship with such diagnostic company may otherwise terminate. In such instances, we may not be able to enter into arrangements with another diagnostic company to obtain supplies of an alternative diagnostic test for use in connection with the development and commercialization of our product candidates or do so on commercially reasonable terms, which could adversely affect and/or delay the development or commercialization of our product candidates.

***Our collaborations depend upon the efforts of third parties to fund and manage the development of many of our potential product candidates, and failure of those third party collaborators to assist or share in the costs of product development could materially harm our business, financial condition and results of operations.***

Our strategy for the development and commercialization of our proprietary product candidates has included the formation of joint ventures and collaborative arrangements with third parties. Potential third parties include biopharmaceutical, pharmaceutical and biotechnology companies, academic institutions and other entities. Third-party collaborators may assist us in:

- funding research, preclinical development, clinical trials and manufacturing;
- seeking and obtaining regulatory approvals;
- seeking and obtaining intellectual property and/or other proprietary rights to technology; and
- successfully commercializing any future product candidates.

Our collaborations limit our ability to control the efforts devoted to many of our product candidates in such arrangements and our earlier stage pipeline is dependent upon identifying new potential collaborators. For example, our most recent joint ventures require us to conduct research and provide potential product candidates in addition to making capital contributions to continue the further development of those products. We generally do not have control over the management of the joint ventures and are minority holders in most of those ventures, which may result in limitations on our ability to successfully develop product candidates, obtain intellectual property and/or other proprietary rights and fund clinical trials through those joint ventures.

In addition, if we are not able to establish further collaboration agreements, we may be required to undertake product development and commercialization at our own expense. Such an undertaking may limit the number of product candidates that we will be able to develop, significantly increase our capital requirements and place additional strain on our internal resources.

Our failure to enter into additional collaborations could materially harm our business, financial condition and results of operations.

In addition, our dependence on licensing, collaboration and other agreements with third parties may subject us to a number of risks. These agreements may not be on terms that prove favorable to us and may require us to relinquish certain rights in our product candidates. To the extent we agree to work exclusively with one collaborator in a given area, our opportunities to collaborate with other entities could be curtailed. Lengthy negotiations with potential new collaborators may lead to delays in the research, development or commercialization of product candidates. The decision by our collaborators to pursue alternative technologies or the failure of our collaborators to develop or commercialize successfully any product candidate to which they have obtained rights from us could materially harm our business, financial condition and results of operations.

***Because our development activities are expected to rely heavily on sensitive and personal information, an area which is highly regulated by privacy laws, we may not be able to generate, maintain or access essential patient samples or data to continue our research and development efforts in the future on reasonable terms and conditions, which may adversely affect our business.***

Although we are not subject to the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”), as we are neither a Covered Entity nor Business Associate (as defined in HIPAA and the Health Information Technology and Clinical Health Act (the “HITECH Act”)), we may have access to very sensitive data regarding patients whose tissue samples are used in our studies. This data will contain information that is personal in nature. The maintenance of this data is subject to certain privacy-related laws, which impose upon us administrative and financial burdens, and litigation risks. In the United States, numerous federal and state laws and regulations, including state data breach notification laws, state health information privacy laws and federal and state consumer protection laws govern the collection, use, disclosure and protection of health-related and other personal information. For instance, the rules promulgated by the Department of Health and Human Services under HIPAA create national standards to protect patients’ medical records and other personal information in the U.S. These rules require that healthcare providers and other covered entities obtain written authorizations from patients prior to disclosing protected health care information of the patient to companies. If the patient fails to execute an authorization or the authorization fails to contain all required provisions, then we will not be allowed access to the patient’s information and our research efforts can be substantially delayed. Furthermore, use of protected health information that is provided to us pursuant to a valid patient authorization is subject to the limits set forth in the authorization (i.e., for use in research and in submissions to regulatory authorities for product approvals). As such, we are required to implement policies, procedures and reasonable and appropriate security measures to protect individually identifiable health information we receive from covered entities, and to ensure such information is used only as authorized by the patient. Any violations of these rules by us could subject us to civil and criminal penalties and adverse publicity, and could harm our ability to initiate and complete clinical trials required to support regulatory applications for our product candidates. In addition, HIPAA does not replace federal, state, or other laws that may grant individuals even greater privacy protections.

International data protection laws and regulations may also apply to some or all of our clinical data obtained outside of the U.S. For example, in April 2016, the EU approved a new data protection regulation, known as the General Data Protection Regulation (the “GDPR”), which will become effective in May 2018. The GDPR will include new operational requirements for companies that receive or process personal data of EU residents, as well as significant penalties for non-compliance. Complying with the GDPR may cause us to incur substantial operational costs or require us to change our business practices.

Failure to comply with data protection laws and regulations could result in government enforcement actions, which may involve civil and criminal penalties, private litigation and/or adverse publicity and could negatively affect our operating results and business. Claims that we have violated individuals’ privacy rights or breached our contractual obligations, even if we are

not found liable, could be expensive and time-consuming to defend and could result in adverse publicity that could harm our business.

We can provide no assurance that future legislation will not prevent us from generating or maintaining personal data or that patients will consent to the use of their personal information, either of which may prevent us from undertaking or publishing essential research. These burdens or risks may prove too great for us to reasonably bear, and may adversely affect our ability to achieve profitability or maintain profitably in the future.

***Our therapeutic product candidates for which we intend to seek approval as biological products may face competition sooner than expected.***

With the enactment of the Biologics Price Competition and Innovation Act of 2009 (“BPCIA”) as part of the Health Care Reform Law, an abbreviated pathway for the approval of biosimilar and interchangeable biological products was created. The new abbreviated regulatory pathway establishes legal authority for the FDA to review and approve biosimilar biologics, including the possible designation of a biosimilar as “interchangeable.” The FDA defines an interchangeable biosimilar as a product that, in terms of safety or diminished efficacy, presents no greater risk when switching between the biosimilar and its reference product than the risk of using the reference product alone. Under the BPCIA, an application for a biosimilar product cannot be submitted to the FDA until four years, or approved by the FDA until 12 years, after the original brand product identified as the reference product was approved under a BLA. The new law is complex and is only beginning to be interpreted by the FDA. As a result, its ultimate impact, implementation and meaning are subject to uncertainty. While it is uncertain when any such processes may be fully adopted by the FDA, any such processes could have a material adverse effect on the future commercial prospects for our biological products.

Although we believe that if any of our product candidates were to be approved as biological products under a BLA, such approved products should qualify for the 12-year period of exclusivity, there is a risk that the U.S. Congress could amend the BPCIA to significantly shorten this exclusivity period, potentially creating the opportunity for generic competition sooner than anticipated. Moreover, the extent to which a biosimilar, once approved, will be substituted for any one of our reference products in a way that is similar to traditional generic substitution for non-biological products is not yet clear, and will depend on a number of marketplace and regulatory factors that are still developing. In addition, a competitor could decide to forego the biosimilar route and submit a full BLA after completing its own preclinical studies and clinical trials. In such cases, any exclusivity to which we may be eligible under the BPCIA would not prevent the competitor from marketing its product as soon as it is approved.

***The regulatory path forward for biosimilar/biobetter product candidates is not clear.***

We have acquired and are assessing the regulatory and strategic path forward for our portfolio of late stage biosimilar/biobetter antibodies based on Erbitux®, Remicade®, Xolair® and Simulect®. While the enactment of the BPCIA created an abbreviated pathway for the approval of biosimilar and interchangeable biological products, there is still considerable uncertainty with respect to the FDA’s approval process. While applications based on biosimilarity may not be required to duplicate the entirety of preclinical and clinical testing used to establish the underlying safety and effectiveness of the reference product, the FDA may refuse to approve an application if there is insufficient information to show that the active ingredients are the same or to demonstrate that any impurities or differences in active ingredients do not affect the safety, purity or potency of the product. In addition, applications based on biosimilarity will not be approved unless the product is manufactured in facilities designed to assure and preserve the biological product’s safety, purity and potency. Due to the uncertainty surrounding the approval of biosimilar/biobetter products, as well as other risk factors identified in this Form 10-K, our portfolio of late stage biosimilar/biobetter antibodies may never result in commercially viable products.

***We may be exposed to liability claims associated with the use of hazardous materials and chemicals.***

Our research and development activities may involve the controlled use of hazardous materials and chemicals. Although we believe that our safety procedures for using, storing, handling and disposing of these materials comply with federal, state and local laws and regulations, we cannot completely eliminate the risk of accidental injury or contamination from these materials. In the event of such an accident, we could be held liable for any resulting damages and any liability could materially adversely affect our business, financial condition and results of operations. We do not currently maintain hazardous materials insurance coverage. In addition, the federal, state and local laws and regulations governing the use, manufacture, storage, handling and disposal of hazardous or radioactive materials and waste products may require us to incur substantial compliance costs that could materially harm our business.

***If we are unable to retain and recruit qualified scientists and advisors, or if any of our key executives, key employees or key consultants discontinues his or her employment or consulting relationship with us, it may delay our development efforts or otherwise harm our business.***

We may not be able to attract or retain qualified management and scientific and clinical personnel in the future due to the intense competition for qualified personnel among biotechnology, pharmaceutical and other businesses, particularly in the San Diego, California area. Our industry has experienced a high rate of turnover of management personnel in recent years. If we are not able to attract, retain and motivate necessary personnel to accomplish our business objectives, we may experience constraints that will significantly impede the successful development of any product candidates, our ability to raise additional capital and our ability to implement our overall business strategy.

We are highly dependent on key members of our management and scientific staff, especially Henry Ji, Ph.D., Chief Executive Officer and President, George Ng, Executive Vice President, and Jerry Zeldis, President of Clinical Research and Regulatory. Our success also depends on our ability to continue to attract, retain and motivate highly skilled junior, mid-level and senior managers as well as junior, mid-level and senior scientific and medical personnel. The loss of any of our executive officers, key employees or key consultants and our inability to find suitable replacements could impede the achievement of our research and development objectives, and potentially harm our business, financial condition and prospects. Furthermore, recruiting and retaining qualified scientific personnel to perform research and development work in the future is critical to our success. We may be unable to attract and retain personnel on acceptable terms given the competition among biotechnology, biopharmaceutical and health care companies, universities and non-profit research institutions for experienced scientists. Certain of our current officers, directors, scientific advisors and/or consultants or certain of the officers, directors, scientific advisors and/or consultants hereafter appointed may from time to time serve as officers, directors, scientific advisors and/or consultants of other biopharmaceutical or biotechnology companies. We do not maintain “key man” insurance policies on any of our officers or employees. All of our employees are employed “at will” and, therefore, each employee may leave our employment at any time.

We may not be able to attract or retain qualified management and scientific personnel in the future due to the intense competition for a limited number of qualified personnel among biopharmaceutical, biotechnology, pharmaceutical and other businesses. Many of the other pharmaceutical companies that we compete against for qualified personnel have greater financial and other resources, different risk profiles and a longer history in the industry than we do. They also may provide more diverse opportunities and better chances for career advancement. Some of these characteristics may be more appealing to high quality candidates than what we have to offer. If we are unable to continue to attract and retain high quality personnel, the rate and success at which we can develop and commercialize product candidates will be limited.

We plan to grant stock options or other forms of equity awards in the future as a method of attracting and retaining employees, motivating performance and aligning the interests of employees with those of our stockholders. If we are unable to implement and maintain equity compensation arrangements that provide sufficient incentives, we may be unable to retain our existing employees and attract additional qualified candidates. If we are unable to retain our existing employees, including qualified scientific personnel, and attract additional qualified candidates, our business and results of operations could be adversely affected.

***Our employees may engage in misconduct or other improper activities, including noncompliance with regulatory standards and requirements, which could have a material adverse effect on our business.***

We are exposed to the risk of employee fraud or other misconduct. Misconduct by employees could include intentional failures to comply with FDA regulations, provide accurate information to the FDA, comply with manufacturing standards we have established, comply with federal and state health-care fraud and abuse laws and regulations, comply with laws and regulations (including, but not limited to the Foreign Corrupt Practices Act of 1977, as amended, 15 U.S.C. §§ 78dd-1 (“FCPA”)) and internal policies restricting payments to government agencies and representatives, report financial information or data accurately or disclose unauthorized activities to us. In particular, sales, marketing and business arrangements in the healthcare industry are subject to extensive laws and regulations intended to prevent fraud, kickbacks, self-dealing and other abusive practices. These laws and regulations may restrict or prohibit a wide range of pricing, discounting, marketing and promotion, sales commission, customer incentive programs and other business arrangements. Employee misconduct could also involve the improper use of information obtained in the course of clinical trials, which could result in regulatory sanctions and serious harm to our reputation. We have adopted a Code of Business Conduct and Ethics, but it is not always possible to identify and deter employee misconduct, and the precautions we take to detect and prevent this activity may not be effective in controlling unknown or unmanaged risks or losses or in protecting us from governmental investigations or other actions or lawsuits stemming from a failure to be in compliance with such laws or regulations. If any such actions are instituted against us,

and we are not successful in defending ourselves or asserting our rights, those actions could have a significant impact on our business and results of operations, including the imposition of significant fines or other sanctions.

***We may be subject, directly or indirectly, to federal and state healthcare fraud and abuse laws, false claims laws and health information privacy and security laws. If we are unable to comply, or have not fully complied, with such laws, we could face substantial penalties.***

If we obtain FDA approval for any of our product candidates, as we have with ZTlido™ (lidocaine topical system 1.8%) through our subsidiary, Scilex, and begin commercializing those products in the U.S., our operations may be directly, or indirectly through our customers, subject to various federal and state fraud and abuse laws, including, without limitation, the federal Anti-Kickback Statute and the federal False Claims Act. These laws may impact, among other things, our proposed sales, marketing and education programs. In addition, we may be subject to patient privacy regulation by both the federal government and the states in which we conduct our business. The laws that may affect our ability to operate include:

- the federal Anti-Kickback Statute, which prohibits, among other things, persons from knowingly and willfully soliciting, receiving, offering or paying remuneration, directly or indirectly, to induce, or in return for, the purchase or recommendation of an item or service reimbursable under a federal healthcare program, such as the Medicare and Medicaid programs;
- federal civil and criminal false claims laws and civil monetary penalty laws, which prohibit, among other things, individuals or entities from knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid, or other third-party payers that are false or fraudulent;
- HIPAA, which created new federal criminal statutes that prohibit executing a scheme to defraud any healthcare benefit program and making false statements relating to healthcare matters;
- HIPAA, as amended by the HITECH Act, and its implementing regulations, which imposes certain requirements relating to the privacy, security and transmission of individually identifiable health information; and
- state law equivalents of each of the above federal laws, such as anti-kickback and false claims laws which may apply to items or services reimbursed by any third-party payer, including commercial insurers, and state laws governing the privacy and security of health information in certain circumstances, many of which differ from each other in significant ways and may not have the same effect, thus complicating compliance efforts.

If our operations are found to be in violation of any of the laws described above or any other governmental regulations that apply to us, we may be subject to penalties, including civil and criminal penalties, damages, fines and the curtailment or restructuring of our operations, any of which could adversely affect our ability to operate our business and our results of operations.

***If product liability lawsuits are brought against us, we may incur substantial liabilities and may be required to limit commercialization of our product candidates.***

We face an inherent risk of product liability as a result of the clinical testing of our product candidates and will face an even greater risk for the commercialization of any products, including ZTlido™ (lidocaine topical system 1.8%), which may be marketed and sold through our subsidiary, Scilex. For example, we may be sued if any product we develop allegedly causes injury or is found to be otherwise unsuitable during product testing, manufacturing, marketing or sale. Any such product liability claims may include allegations of defects in manufacturing, defects in design, a failure to warn of dangers inherent in the product, negligence, strict liability, and a breach of warranties. Claims could also be asserted under state consumer protection acts. If we cannot successfully defend ourselves against product liability claims, we may incur substantial liabilities or be required to limit commercialization of our product candidates, if approved. Even successful defense would require significant financial and management resources. Regardless of the merits or eventual outcome, liability claims may result in:

- decreased demand for our product candidates or products that we may develop;
- injury to our reputation;
- withdrawal of clinical trial participants;
- initiation of investigations by regulators;

- restrictions on the marketing or manufacturing of the product, withdrawal of the product from the market or voluntary or mandatory product recalls;
- costs to defend the related litigation;
- a diversion of management’s time and our resources;
- substantial monetary awards to trial participants or patients;
- product recalls, withdrawals or labeling, marketing or promotional restrictions;
- loss of revenues from product sales; and
- the inability to commercialize our product candidates.

Our inability to obtain and retain sufficient product liability insurance at an acceptable cost to protect against potential product liability claims could prevent or inhibit the commercialization of products we develop.

***We are subject to the U.S. Foreign Corrupt Practices Act and other anti-corruption laws, as well as export control laws, customs laws, sanctions laws and other laws governing our operations. If we fail to comply with these laws, we could be subject to civil or criminal penalties, other remedial measures, and legal expenses, which could adversely affect our business, results of operations and financial condition.***

Our operations are subject to certain anti-corruption laws, including the FCPA, and other anti-corruption laws that apply in countries where we do business. The FCPA and other anti-corruption laws generally prohibit us and our employees and intermediaries from bribing, being bribed or making other prohibited payments to government officials or other persons to obtain or retain business or gain some other business advantage. We and our commercial partners operate in a number of jurisdictions that pose a high risk of potential FCPA violations and we participate in collaborations and relationships with third parties whose actions could potentially subject us to liability under the FCPA or local anti-corruption laws. In addition, we cannot predict the nature, scope or effect of future regulatory requirements to which our international operations might be subject or the manner in which existing laws might be administered or interpreted.

We are also subject to other laws and regulations governing our international operations, including regulations administered in the U.S. and in the EU, including applicable import and export control regulations such as those regulations under the Convention on International Trade in Endangered Species of Wild Fauna and Flora, also known as the Washington Convention (“CITES”), economic sanctions on countries and persons, customs requirements and currency exchange regulations (collectively, “Trade Control Laws”).

There can be no assurance that we will be completely effective in ensuring our compliance with all applicable anticorruption laws, including the FCPA or other legal requirements, such as Trade Control Laws. Any investigation of potential violations of the FCPA, other anti-corruption laws or Trade Control Laws by U.S., EU or other authorities could have an adverse impact on our reputation, our business, results of operations and financial condition. Furthermore, should we be found not to be in compliance with the FCPA, other anti-corruption laws or Trade Control Laws, we may be subject to criminal and civil penalties, disgorgement and other sanctions and remedial measures, as well as the accompanying legal expenses, any of which could have a material adverse effect on our reputation and liquidity, as well as on our business, results of operations and financial condition.

***We will need to increase the size of our company and may not effectively manage our growth.***

Our success will depend upon growing our business and our employee base. Over the next 12 months, we plan to add additional employees to assist us with research and development and in Scilex with potential commercialization efforts. Our future growth, if any, may cause a significant strain on our management, and our operational, financial and other resources. Our ability to manage our growth effectively will require us to implement and improve our operational, financial and management systems and to expand, train, manage and motivate our employees. These demands may require the hiring of additional management personnel and the development of additional expertise by management. Any increase in resources devoted to research and product development without a corresponding increase in our operational, financial and management systems could have a material adverse effect on our business, financial condition, and results of operations.

***Any disruption in our research and development facilities could adversely affect our business, financial condition and results of operations.***

Our principal executive offices, which house our research and development programs, are located in San Diego, California. Our facilities may be affected by natural or man-made disasters. Earthquakes are of particular significance since our facilities are located in an earthquake-prone area. We are also vulnerable to damage from other types of disasters, including power loss, attacks from extremist organizations, fires, floods and similar events. In the event that our facilities were affected

by a natural or man-made disaster, we may be forced to curtail our operations and/or rely on third-parties to perform some or all of our research and development activities. Although we believe we possess adequate insurance for damage to our property and the disruption of our business from casualties, such insurance may not be sufficient to cover all of our potential losses and may not continue to be available to us on acceptable terms, or at all. In the future, we may choose to expand our operations in either our existing facilities or in new facilities. If we expand our worldwide manufacturing locations, there can be no assurance that this expansion will occur without implementation difficulties, or at all.

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

Despite the implementation of security measures, our internal computer systems and those of our CROs and other contractors and consultants are vulnerable to damage from computer viruses, unauthorized access, cybersecurity attacks or hacking, natural disasters, terrorism, war and telecommunication and electrical failures. While we have not experienced any such system failure, accident or security breach to date, if such an event were to occur and cause interruptions in our operations, it could result in a material disruption of our drug development programs. For example, the loss of clinical trial data from completed or ongoing or planned clinical trials could result in delays in our regulatory approval efforts and significantly increase our costs to recover or reproduce the data. To the extent that any disruption or security breach was to result in a loss of or damage to our data or applications, or inappropriate disclosure of confidential or proprietary information, we could incur material legal claims and liability, damage to our reputation, suffer loss or harm to our intellectual property rights and the further research, development and commercial efforts of our products and product candidates could be delayed.

Further, a cybersecurity attack, data breach or privacy violation that leads to disclosure or modification of, or prevents access to, patient information, including personally identifiable information or protected health information, could harm our reputation, compel us to comply with federal and/or state breach notification laws and foreign law equivalents, subject us to mandatory corrective action, require us to verify the correctness of database contents and otherwise subject us to liability under laws and regulations that protect personal data, resulting in increased costs or loss of revenue. If we are unable to prevent such cybersecurity attacks, data security breaches or privacy violations or implement satisfactory remedial measures, our operations could be disrupted, and we may suffer loss of reputation, financial loss and other regulatory penalties because of lost or misappropriated information, including sensitive patient data. In addition, these breaches and other inappropriate access can be difficult to detect, and any delay in identifying them may lead to increased harm of the type described above.

***The terms of our outstanding convertible promissory notes place restrictions on our operating and financial flexibility. If we raise additional capital through debt financing, the terms of any new debt could further restrict our ability to operate our business.***

On December 21, 2017, we issued and sold convertible promissory notes in an aggregate principal amount of \$50 million (the “Convertible Notes”) to certain accredited investors pursuant to a Securities Purchase Agreement (the “Securities Purchase Agreement” or “Note SPA”). The Convertible Notes accrue interest at a rate equal to 5.0% per annum and mature upon the earlier to occur of December 21, 2022 and the date of the closing of a change of control (the “Maturity Date”). At any time and from time to time before the Maturity Date, the holders of the Convertible Notes have the option to convert any portion of the outstanding principal amount of the Convertible Notes that is equal to or greater than the lesser of: (1) \$4,000,000, and (2) the then-outstanding principal amount of the Convertible Note being converted into shares of Common Stock at a price per share of \$2.26875, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions. Any conversion of the Convertible Notes could result in material dilution to the Company’s existing stockholders. Accrued but unpaid interest on the Convertible Notes shall be paid in cash semi-annually in arrears on or prior to the 30th day of June and 31st day of December of each calendar year commencing with the year ending December 31, 2018. If a holder elects to convert any of the principal amount of their Convertible Note, then all accrued but unpaid interest on such portion of the principal amount shall become due and payable in cash. The Note SPA and the Convertible Notes contain customary restrictive covenants, which will remain in effect so long as the aggregate outstanding principal amount of the Convertible Notes is at least \$25 million, including significant limitations on incurring additional indebtedness, liens, declaring cash dividends or making cash distributions and dispositions of our assets, in each case subject to customary exceptions. The breach of such covenants or the occurrence of certain other events would result in the occurrence of an event of default. Upon the occurrence of an event of default and following any applicable cure periods, the interest rate under the Convertible Notes will automatically increase to 12.0% per annum, effective until the day after such default is cured, and the holders of the Convertible Notes may declare all outstanding obligations immediately due and payable and take such other actions as set forth in the Convertible Notes, potentially requiring us to renegotiate our agreement on terms less favorable to us or to immediately cease operations. Any declaration by the holders of the Convertible Notes of an event of default could significantly harm our business and prospects and could cause the price of our common stock to decline. If we raise any additional debt financing, the terms of such additional debt could further restrict our operating and financial flexibility.



***Our ability to utilize our net operating loss and tax credit carryforwards may be limited.***

Section 382 of the Internal Revenue Code of 1986, as amended, and the rules and regulations thereunder (“Section 382”) limit a corporation’s ability to utilize existing net operating loss and tax credit carryforwards once the corporation experiences an ownership change as defined in Section 382. We have undergone an ownership change for purposes of Section 382 in a prior year. For the year ended December 31, 2017, there was no impact of such limitations on our income tax provision. Future equity offerings or acquisitions that have equity as a component of the purchase price could constitute an ownership change under Section 382. If and when any other ownership change occurs, utilization of our net operating loss and tax credit carryforwards may be limited by Section 382, which could potentially result in increased future tax liability to us.

***Our operations in China subject us to risks and uncertainties relating to the laws and regulations of China.***

Certain of our operations are currently based in China. Under its current leadership, the government of China has been pursuing economic reform policies, including by encouraging foreign trade and investment. However, there is no assurance that the Chinese government will continue to pursue such policies, that such policies will be successfully implemented, that such policies will not be significantly altered, or that such policies will be beneficial to our operations in China. China’s system of laws can be unpredictable, especially with respect to foreign investment and foreign trade. The promulgation of new laws and regulations and changes to existing laws and regulations may adversely affect foreign investors and foreign entities with operations in China.

Additionally, the biopharmaceutical industry in particular in China is strictly regulated by the Chinese government. Changes to Chinese regulations affecting biopharmaceutical companies are unpredictable and may have a material adverse effect on our Chinese operations and on our business and financial condition.

***Our global operations are exposed to political and economic risks, commercial volatility and events beyond our control in the countries in which we operate, some of which may be enhanced by our recent acquisition of Virttu Biologics Limited.***

On April 27, 2017, we acquired Virttu Biologics Limited, which is based in the United Kingdom. In addition to challenges specific to the United States, our operations, including but not limited to our operations outside of the United States, are subject to a variety of political and economic risks, including risks arising from:

- unexpected changes in international or domestic legal, regulatory or governmental requirements or regulations, including related to intellectual property or the biopharmaceutical industry;
- unexpected increases in taxes or tariffs;
- trade protection measures or import or export licensing requirements;
- the inability to obtain necessary foreign regulatory or pricing approvals of products in a timely manner;
- fluctuations in foreign currency exchange rates;
- difficulties in staffing and managing international operations;
- less favorable intellectual property or other applicable laws;
- the effects of the implementation of the United Kingdom’s decision to voluntarily depart from the European Union;
- currency controls that restrict or prohibit the payment of funds or the repatriation of earnings to the United States;
- increased costs of compliance with general business and tax regulations in these countries or regions;
- divergent legal systems and regulatory frameworks; and
- political and economic instability or corruption.

These risks and others may have a material adverse effect on our global operations and on our business and financial condition.

**Risks Related to Acquisitions**

***We have and plan to continue to acquire businesses and technologies and may fail to realize the anticipated benefits of the acquisitions, and acquisitions can be costly and dilutive.***

We have and plan to continue to expand our business and intellectual property portfolio through the acquisition of new businesses and technologies. For example, we recently acquired approximately 72% of the outstanding capital stock of Scilex Pharmaceuticals Inc., which remains a stand-alone company. We also acquired Virttu Biologics Limited in 2017 and we are in the process of integrating this company and its operations with ours. The success of any acquisitions depend on, among other things, our ability to combine our business with the acquired business in a manner that does not materially disrupt existing relationships and that allows us to achieve development and operational synergies. If we are unable to achieve these objectives,

the anticipated benefits of the acquisition may not be realized fully or at all or may take longer to realize than expected. In particular, the acquisition may not be accretive to our stock value or development pipeline in the near or long term.

It is possible that the integration process could result in the loss of key employees; the disruption of our ongoing business or the ongoing business of the acquired companies; or inconsistencies in standards, controls, procedures or policies that could adversely affect our ability to maintain relationships with third parties and employees or to achieve the anticipated benefits of the acquisition. Integration efforts between us and the acquired company will also divert management's attention from our core business and other opportunities that could have been beneficial to our stockholders. An inability to realize the full extent of, or any of, the anticipated benefits of the acquisition, as well as any delays encountered in the integration process, could have an adverse effect on our business and results of operations, which may affect the value of the shares of our common stock after the completion of the acquisition. If we are unable to achieve these objectives, the anticipated benefits of the acquisition may not be realized fully or at all or may take longer to realize than expected. In particular, the acquisition may not be accretive to our stock value or development pipeline in the near or long term.

We expect to incur additional costs integrating the operations of any companies we acquire, higher development and regulatory costs, and personnel, which cannot be estimated accurately at this time. If the total costs of the integration of our companies and advancement of acquired product candidates and technologies exceed the anticipated benefits of the acquisition, our financial results could be adversely affected.

***If we acquire companies or technologies in the future, they could prove difficult to integrate, disrupt our business, dilute stockholder value, and adversely affect our operating results and the value of our common stock.***

As part of our business strategy, we may continue to acquire, enter into joint ventures with, or make investments in complementary or synergistic companies, services, and technologies in the future. Acquisitions and investments involve numerous risks, including:

- difficulties in identifying and acquiring products, technologies, proprietary rights or businesses that will help our business;
- difficulties in integrating operations, technologies, services, and personnel;
- diversion of financial and managerial resources from existing operations;
- the risk of entering new development activities and markets in which we have little to no experience;
- risks related to the assumption of known and unknown liabilities; and
- risks related to our ability to raise sufficient capital to fund additional operating activities.

As a result, if we fail to properly evaluate acquisitions or investments, we may not achieve the anticipated benefits of any such acquisitions, we may incur costs in excess of what we anticipate, and management resources and attention may be diverted from other necessary or valuable activities.

***Any acquisitions we make could disrupt our business and seriously harm our financial condition.***

We have in the past made (and may, from time to time, consider) acquisitions of complementary companies, products or technologies. Acquisitions involve numerous risks, including difficulties in the assimilation of the acquired businesses, the diversion of our management's attention from other business concerns and potential adverse effects on existing business relationships. In addition, any acquisitions could involve the incurrence of substantial additional indebtedness. We cannot assure you that we will be able to successfully integrate any acquisitions that we pursue or that such acquisitions will perform as planned or prove to be beneficial to our operations and cash flow. Any such failure could seriously harm our business, financial condition and results of operations.

### **Risks Related to Our Intellectual Property**

***Our ability to protect our intellectual property rights will be critically important to the success of our business, and we may not be able to protect these rights in the U.S. or abroad.***

Our success, competitive position and future revenues will depend in part on our ability to obtain and maintain patent protection for our product candidates, methods, processes and other technologies, to prevent third parties from infringing on our proprietary rights, exclude others from using our technology and to operate without infringing upon the proprietary rights of third parties. We will be able to protect our proprietary rights from unauthorized use by third parties only to the extent that our proprietary rights are covered by valid and enforceable patents or are effectively maintained as trade secrets. We attempt to protect our proprietary position by maintaining trade secrets and by filing U.S. and foreign patent applications related to our proprietary technology, inventions and improvements that are important to the development of our business. The first of the

antibody family patent applications was issued in 2014, and we continue to file additional patent applications for our product candidates and technology.

We have commenced generating a patent portfolio to protect each product candidate in our pipeline. However, the patent position of biopharmaceutical companies involves complex legal and factual questions, and therefore we cannot predict with certainty whether any patent applications that we have filed or that we may file in the future will be approved will cover our products or product candidates or that any resulting patents will be enforced. In addition, third parties may challenge, seek to invalidate, limit the scope of or circumvent any of our patents, once they are issued. Thus, any patents that we own or license from third parties or joint venture or development partners may not provide any protection against competitors. Any patent applications that we have filed or that we may file in the future, or those we may license from third parties or joint venture or development partners, may not result in patents being issued. Moreover, disputes between our licensing or joint development partners and us may arise over license scope, or ownership, assignment, inventorship and/or rights to use or commercialize patent or other proprietary rights, which may adversely impact our ability to obtain and protect our proprietary technology and products. Also, patent rights may not provide us with adequate proprietary protection or competitive advantages against competitors with similar technologies or products.

In addition, the laws of certain foreign countries do not protect our intellectual property rights to the same extent as do the laws of the U.S. If we fail to apply for intellectual property protection or if we cannot adequately protect our intellectual property rights in these foreign countries, our competitors may be able to compete more effectively against us, which could adversely affect our competitive position, as well as our business, financial condition and results of operations.

***Our long-term success depends on intellectual property protection; if our intellectual property rights are invalidated or circumvented, our business will be adversely affected.***

Our long-term success depends on our ability to continually discover, develop, and commercialize innovative new pharmaceutical products. Without strong intellectual property protection, we would be unable to generate the returns necessary to support the enormous investments in research and development and capital as well as other expenditures required to bring new drugs to the market and for commercialization.

Intellectual property protection varies throughout the world and is subject to change over time. In the U.S., for small molecule drug products, such as ZTlido™ (lidocaine topical system 1.8%) (which is held by our subsidiary, Scilex), the Hatch-Waxman Act provides generic companies powerful incentives to seek to invalidate our pharmaceutical patents. As a result, we expect that our U.S. patents on major pharmaceutical products will be routinely challenged, and there can be no assurance that our patents will be upheld. We face generic manufacturer challenges to our patents outside the U.S. as well. In addition, competitors or other third parties may claim that our activities infringe patents or other intellectual property rights held by them. If successful, such claims could result in our being unable to market a product in a particular territory or being required to pay damages for past infringement or royalties on future sales.

***If any of our trade secrets, know-how or other proprietary information is disclosed, the value of our trade secrets, know-how and other proprietary rights would be significantly impaired and our business and competitive position would suffer.***

Our success also depends upon the skills, knowledge and experience of our scientific and technical personnel and our consultants and advisors, as well as our licensors. To help protect our proprietary know-how and our inventions for which patents may be unobtainable or difficult to obtain, or prior to seeking patent protection, we rely on trade secret protection and confidentiality agreements. Unlike some of our competitors, in addition to certain manufacturing processes, we maintain our proprietary libraries for ourselves as trade secrets. To this end, we require all of our employees, consultants, advisors and contractors to enter into agreements which prohibit the disclosure of confidential information and, where applicable, require disclosure and assignment to us of the ideas, developments, discoveries and inventions important to our business. These agreements may not provide adequate protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use or disclosure or the lawful development by others of such information. If any of our trade secrets, know-how or other proprietary information is disclosed, the value of our trade secrets, know-how and other proprietary rights would be significantly impaired and our business and competitive position would suffer. Moreover, our third party licensing partners may retain rights in some of our proprietary or joint trade secrets, know-how, patented inventions or other proprietary information, including rights to sublicense and rights of publication, which may adversely impact our ability to obtain patents and protect trade secrets, know-how or other proprietary information. In addition, the U.S. government may retain rights in some of our patents or other proprietary information.

Third party competitors may seek to challenge the validity of our patents, thereby rendering them unenforceable or we may seek to challenge third party competitor patents if such third parties seek to interpret or enforce a claim scope going well beyond the actual enabled invention.

***Claims that we infringe upon the rights of third parties may give rise to costly and lengthy litigation, and we could be prevented from selling products, forced to pay damages, and defend against litigation.***

Third parties may assert patent or other intellectual property infringement claims against us or our strategic partners or licensees with respect to our technologies and product candidates or potential product candidates. If our products, methods, processes and other technologies infringe upon the proprietary rights of other parties, we could incur substantial costs and we may have to:

- obtain licenses, which may not be available on commercially reasonable terms, if at all, and may be non-exclusive, thereby giving our competitors access to the same intellectual property licensed to us;
- redesign our products or processes to avoid infringement;
- stop using the subject matter validly claimed in the patents held by others;
- pay damages; and
- defend litigation or administrative proceedings which may be costly whether we win or lose, and which could result in a substantial diversion of our valuable management resources.

Even if we were to prevail, any litigation could be costly and time-consuming and would divert the attention of our management and key personnel from our business operations. Furthermore, as a result of a patent infringement suit brought against us or our strategic partners or licensees, we or our strategic partners or licensees may be forced to stop or delay developing, manufacturing or selling technologies, product candidates or potential products that are claimed to infringe a third party's intellectual property unless that party grants us or our strategic partners' or licensees' rights to use its intellectual property. Ultimately, we may be unable to develop some of our technologies or potential products or may have to discontinue development of a product candidate or cease some of our business operations as a result of patent infringement claims, which could severely harm our business.

***Our position as a relatively small company may cause us to be at a significant disadvantage in defending our intellectual property rights and in defending against infringement claims by third parties.***

Litigation relating to the ownership and use of intellectual property is expensive, and our position as a relatively small company in an industry dominated by very large companies may cause us to be at a significant disadvantage in defending our intellectual property rights and in defending against claims that our technology infringes or misappropriates third party intellectual property rights. However, we may seek to use various post-grant administrative proceedings, including new procedures created under the America Invents Act, to invalidate potentially overly-broad third party rights. Even if we are able to defend our position, the cost of doing so may adversely affect our ability to grow, generate revenue or become profitable. We were recently named as a defendant in the U.S. District Court for the District of New Jersey in a suit brought by Immunomedics, Inc. ("Immunomedics") alleging, among other things, patent infringement, improper use and sharing of research material, and breach of contract for failure to provide Immunomedics with the right of first refusal to an exclusive license to certain technologies. This case was dismissed against us for lack of personal jurisdiction but may still pose a risk to our intellectual property and/or licensing rights in certain technologies. In the course of the ongoing litigation or any future additional litigation to which we may be subject, we may not be able to protect our intellectual property at a reasonable cost, or at all. The outcome of litigation is always uncertain, and in some cases could include judgments against us that require us to pay damages, enjoin us from certain activities or otherwise affect our legal, contractual or intellectual property rights, which could have a significant adverse effect on our business.

***Third-party claims of intellectual property infringement may prevent or delay our drug discovery and development efforts.***

Our commercial success depends in part on our avoiding infringement of the patents and proprietary rights of third parties. There is a substantial amount of litigation involving patent and other intellectual property rights in the biotechnology and pharmaceutical industries, including PTO administrative proceedings, such as inter partes reviews, and reexamination proceedings before the PTO or oppositions and revocations and other comparable proceedings in foreign jurisdictions. Numerous U.S. and foreign issued patents and pending patent applications, which are owned by third parties, exist in the fields in which we are developing product candidates. As the biotechnology and pharmaceutical industries expand and more patents are issued, the risk increases that our product candidates may give rise to claims of infringement of the patent rights of others.

Despite safe harbor provisions, third parties may assert that we are employing their proprietary technology without authorization. There may be third-party patents, of which we are currently unaware, with claims to materials, formulations, methods of doing research or library screening, methods of manufacture or methods for treatment related to the use or manufacture of our product candidates. Because patent applications can take many years to issue, there may be currently pending patent published applications which may later result in issued patents that our product candidates may infringe. In addition, third parties may obtain patents in the future and claim that use of our technologies infringes upon these patents. If

any third-party patents were held by a court of competent jurisdiction to cover the manufacturing process of any of our product candidates, any molecules formed during the manufacturing process or any final product itself, the holders of any such patents may be able to block our ability to commercialize such product candidate unless we obtain a license under the applicable patents, or until such patents expire or they are finally determined to be held invalid or unenforceable. Similarly, if any third-party patent were held by a court of competent jurisdiction to cover aspects of our formulations, processes for manufacture or methods of use, including combination therapy or patient selection methods, the holders of any such patent may be able to block our ability to develop and commercialize the applicable product candidate unless we obtain a license, limit our uses, or until such patent expires or is finally determined to be held invalid or unenforceable. In either case, such a license may not be available on commercially reasonable terms or at all.

Parties making claims against us may obtain injunctive or other equitable relief, which could effectively block our ability to further develop and commercialize one or more of our product candidates. Defense of these claims, regardless of their merit, would involve substantial litigation expense and would be a substantial diversion of employee resources from our business. In the event of a successful claim of infringement against us, we may have to pay substantial damages, including treble damages and attorneys' fees for willful infringement, obtain one or more licenses from third parties, cease marketing our products or developing our product candidates, limit our uses, pay royalties or redesign our infringing product candidates, which may be impossible or require substantial time and monetary expenditure. We cannot predict whether any such license would be available at all or whether it would be available on commercially reasonable terms. Furthermore, even in the absence of litigation, we may need to obtain licenses from third parties to advance our research or allow commercialization of our product candidates. We may fail to obtain any of these licenses at a reasonable cost or on reasonable terms, if at all. In that event, we would be unable to further develop and commercialize one or more of our product candidates, which could harm our business significantly.

***We may not be able to protect our intellectual property rights throughout the world.***

Filing, prosecuting and defending patents on all of our product candidates throughout the world would be prohibitively expensive. Competitors may use our technologies in jurisdictions where we have not obtained patent protection to develop their own products and further, may export otherwise infringing products to territories where we have patent protection, but enforcement is not as strong as that in the U.S. These products may compete with our products in jurisdictions where we do not have any issued patents and our patent claims or other intellectual property rights may not be effective or sufficient to prevent them from so competing.

Many companies have encountered significant problems in protecting and defending intellectual property rights in foreign jurisdictions. The legal systems of certain countries, particularly certain developing countries, do not favor the enforcement of patents and other intellectual property protection, particularly those relating to biopharmaceuticals, which could make it difficult for us to stop the infringement of our patents or marketing of competing products in violation of our proprietary rights generally. Proceedings to enforce our patent rights in foreign jurisdictions could result in substantial cost and divert our efforts and attention from other aspects of our business.

***Confidentiality agreements with employees and others may not adequately prevent disclosure of our trade secrets and other proprietary information and may not adequately protect our intellectual property, which could limit our ability to compete.***

Because we operate in the highly technical field of research and development of biologics and small molecule drugs, we rely in part on trade secret protection in order to protect our proprietary trade secrets and unpatented know-how. However, trade secrets are difficult to protect, and we cannot be certain that others will not develop the same or similar technologies on their own. We have taken steps, including entering into confidentiality agreements with our employees, consultants, outside scientific collaborators, sponsored researchers and other advisors, to protect our trade secrets and unpatented know-how. These agreements generally require that the other party keep confidential and not disclose to third parties all confidential information developed by the party or made known to the party by us during the course of the party's relationship with us. We also typically obtain agreements from these parties which provide that inventions conceived by the party in the course of rendering services to us will be our exclusive property. However, these agreements may not be honored and may not effectively assign intellectual property rights to us. Enforcing a claim that a party illegally obtained and is using our trade secrets or know-how is difficult, expensive and time consuming, and the outcome is unpredictable. In addition, courts outside the U.S. may be less willing to protect trade secrets or know-how. The failure to obtain or maintain trade secret protection could adversely affect our competitive position.

***If we breach any of the agreements under which we license commercialization rights to our product candidates from third parties, we could lose license rights that are important to our business.***

We license the use, development and commercialization rights for all of our product candidates, and may enter into similar licenses in the future. Under each of our existing license agreements we are subject to commercialization and development, diligence obligations, milestone payment obligations, royalty payments and other obligations. If we fail to comply with any of these obligations or otherwise breach our license agreements, our licensing partners may have the right to terminate the license in whole or in part.

For example, certain of our joint development and/or licensing agreements, including but not limited to our agreement with City of Hope, set forth diligence milestones including timelines in which certain clinical trials should be initiated. Due to the uncertainty of drug development and clinical trials as set forth above, we may not be able to meet these diligence milestones, which could result in loss of exclusivity or loss of our rights to develop certain products or services pursuant to those agreements.

Generally, the loss of any one of our current licenses or other licenses in the future could materially harm our business, prospects, financial condition and results of operations.

***Intellectual property rights do not necessarily address all potential threats to our competitive advantage.***

The degree of future protection afforded by our intellectual property rights is uncertain because intellectual property rights have limitations, and may not adequately protect our business, or permit us to maintain our competitive advantage. The following examples are illustrative:

- Others may be able to make compounds that are similar to our product candidates but that are not covered by the claims of the patents that we own or have exclusively licensed;
- We or our licensors or strategic partners might not have been the first to make the inventions covered by the issued patent or pending patent application that we own or have exclusively licensed;
- We or our licensors or strategic partners might not have been the first to file patent applications covering certain of our inventions;
- Others may independently develop similar or alternative technologies or duplicate any of our technologies without infringing our intellectual property rights;
- Our pending patent applications may not lead to issued patents;
- Issued patents that we own or have exclusively licensed may not provide us with any competitive advantages, or may be held invalid or unenforceable, as a result of legal challenges by our competitors;
- Our competitors might conduct research and development activities in countries where we do not have patent rights and then use the information learned from such activities to develop competitive products for sale in our major commercial markets;
- We may not develop additional proprietary technologies that are patentable; and
- The patents of others may have an adverse effect on our business.

Should any of these events occur, they could significantly harm our business, results of operations and prospects.

***From time to time we may need to license patents, intellectual property and proprietary technologies from third parties, which may be difficult or expensive to obtain.***

We may need to obtain licenses to patents and other proprietary rights held by third parties to successfully develop, manufacture and market our drug products. As an example, it may be necessary to use a third party's proprietary technology to reformulate one of our drug products in order to improve upon the capabilities of the drug product. If we are unable to timely obtain these licenses on reasonable terms, our ability to commercially exploit our drug products may be inhibited or prevented.

***We remain responsible for payments of all milestone and license fees to Samyang Biopharmaceuticals Corporation pursuant to our agreement with NantPharma.***

As a result of our acquisition of IgDraSol, Inc. in September 2013, we became a party to an Exclusive Distribution Agreement, as amended, with Samyang Biopharmaceuticals Corporation ("SAMYANG") in connection with our development of Cynviloq™ which contained various milestone and license fees to be paid to SAMYANG. On May 14, 2015, we sold all of our equity interests in IgDraSol, Inc. to NantPharma, LLC ("NantPharma"). As part of the sale, we agreed with NantPharma to be responsible for and pay all milestone and license fees required to be paid to SAMYANG under the Exclusive Distribution Agreement following notification from NantPharma when such milestone and license fees become due and payable. If such milestone or license fees become due and payable, the payment thereof could materially harm our business and financial condition.

## Risks Related to Ownership of Our Common Stock

***The market price of our common stock may fluctuate significantly, and investors in our common stock may lose all or a part of their investment.***

The market prices for securities of biotechnology and pharmaceutical companies have historically been highly volatile, and the market has from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. For example, from January 2, 2017 to December 29, 2017, our closing stock price ranged from \$1.525 to \$6.00 per share. The market price of our common stock may fluctuate significantly in response to numerous factors, some of which are beyond our control, such as:

- actual or anticipated adverse results or delays in our clinical trials;
- our failure to commercialize our product candidates, if approved;
- unanticipated serious safety concerns related to the use of any of our product candidates;
- adverse regulatory decisions;
- changes in laws or regulations applicable to our product candidates, including but not limited to clinical trial requirements for approvals;
- legal disputes or other developments relating to proprietary rights, including patents, litigation matters and our ability to obtain patent protection for our product candidates, government investigations and the results of any proceedings or lawsuits, including, but not limited to, patent or stockholder litigation;
- our decision to initiate a clinical trial, not initiate a clinical trial or to terminate an existing clinical trial;
- our dependence on third parties, including CROs;
- announcements of the introduction of new products by our competitors;
- market conditions in the pharmaceutical and biotechnology sectors;
- announcements concerning product development results or intellectual property rights of others;
- future issuances of common stock or other securities;
- the addition or departure of key personnel;
- failure to meet or exceed any financial guidance or expectations regarding development milestones that we may provide to the public;
- actual or anticipated variations in quarterly operating results;
- our failure to meet or exceed the estimates and projections of the investment community;
- overall performance of the equity markets and other factors that may be unrelated to our operating performance or the operating performance of our competitors, including changes in market valuations of similar companies;
- conditions or trends in the biotechnology and biopharmaceutical industries;
- introduction of new products offered by us or our competitors;
- announcements of significant acquisitions, strategic partnerships, joint ventures or capital commitments by us or our competitors;
- issuances of debt or equity securities;
- sales of our common stock by us or our stockholders in the future;
- trading volume of our common stock;
- ineffectiveness of our internal controls;
- publication of research reports about us or our industry or positive or negative recommendations or withdrawal of research coverage by securities analysts;
- failure to effectively integrate the acquired companies' operations;
- general political and economic conditions;
- effects of natural or man-made catastrophic events; and
- other events or factors, many of which are beyond our control.

Further, the equity markets in general have recently experienced extreme price and volume fluctuations. Continued market fluctuations could result in extreme volatility in the price of our common stock, which could cause a decline in the value of our common stock. Price volatility of our common stock might worsen if the trading volume of our common stock is low. The realization of any of the above risks or any of a broad range of other risks, including those described in these "Risk Factors," could have a dramatic and material adverse impact on the market price of our common stock.

***We have not paid cash dividends in the past and do not expect to pay cash dividends in the foreseeable future. Any return on investment may be limited to the value of our common stock.***

We have never paid cash dividends on our common stock and do not anticipate paying cash dividends on our common stock in the foreseeable future. Pursuant to our outstanding convertible notes issued in December 2017, so long as the outstanding principal amount under all such notes is at least \$25,000,000, we are prohibited from paying any dividends without

the prior written consent of the holders of such notes. The payment of dividends on our capital stock will depend on our earnings, financial condition and other business and economic factors affecting us at such time as the board of directors may consider relevant. If we do not pay dividends, our common stock may be less valuable because a return on your investment will only occur if the common stock price appreciates.

***Our strategic investments may result in losses.***

We periodically make strategic investments in various public and private companies with businesses or technologies that may complement our business. The market values of these strategic investments may fluctuate due to market conditions and other conditions over which we have no control. Other-than-temporary declines in the market price and valuations of the securities that we hold in other companies would require us to record losses related to our investment. This could result in future charges to our earnings. It is uncertain whether or not we will realize any long-term benefits associated with these strategic investments.

***A sale of a substantial number of shares of the common stock may cause the price of our common stock to decline.***

If our stockholders sell, or the market perceives that our stockholders intend to sell for various reasons, substantial amounts of our common stock in the public market, including shares issued in connection with the exercise of outstanding options or warrants, the market price of our common stock could fall. Sales of a substantial number of shares of our common stock may make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem reasonable or appropriate. We may become involved in securities class action litigation that could divert management's attention and harm our business.

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

***Our quarterly operating results may fluctuate significantly.***

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

- variations in the level of expenses related to our development programs;
- the addition or termination of clinical trials;
- any intellectual property infringement lawsuit in which we may become involved;
- regulatory developments affecting our product candidates; and
- our execution of any collaborative, licensing or similar arrangements, and the timing of payments we may make or receive under these arrangements.

If our quarterly operating results fall below the expectations of investors or securities analysts, the price of our common stock could decline substantially. Furthermore, any quarterly fluctuations in our operating results may, in turn, cause the price of our common stock to fluctuate substantially.

***Existing stockholders' interest in us may be diluted by additional issuances of equity securities and raising funds through acquisitions, lending and licensing arrangements may restrict our operations or require us to relinquish proprietary rights.***

We may issue additional equity securities to fund future expansion and pursuant to equity incentive or employee benefit plans. We may also issue additional equity for other purposes. These securities may have the same rights as our common stock or, alternatively, may have dividend, liquidation or other preferences to our common stock. The issuance of additional equity securities will dilute the holdings of existing stockholders and may reduce the share price of our common stock.

If we raise additional funds through collaboration, licensing or other similar arrangements, it may be necessary to relinquish potentially valuable rights to our product candidates, potential products or proprietary technologies, or grant licenses on terms that may not be favorable to us. If adequate funds are not available, our ability to achieve profitability or to respond to competitive pressures would be significantly limited and we may be required to delay, significantly curtail or eliminate the development of our product candidates.



***Directors, executive officers, principal stockholders and affiliated entities own a significant percentage of our capital stock, and they may make decisions that you do not consider to be in your best interests or those of our other stockholders.***

As of December 31, 2017, our directors and executive officers beneficially owned, in the aggregate, approximately 5% of our outstanding voting securities. As a result, if some or all of them acted together, they would have the ability to exert significant influence over the election of our board of directors and the outcome of issues requiring approval by our stockholders. This concentration of ownership may also have the effect of delaying or preventing a change in control of our company that may be favored by other stockholders. This could prevent transactions in which stockholders might otherwise recover a premium for their shares over current market prices.

***Our ability to use our net operating loss carry forwards may be subject to limitation.***

Generally, a change of more than 50% in the ownership of a company's stock, by value, over a three-year period constitutes an ownership change for U.S. federal income tax purposes. An ownership change may limit our ability to use our net operating loss carryforwards attributable to the period prior to the change. As a result, if we earn net taxable income, our ability to use our pre-change net operating loss carryforwards to offset U.S. federal taxable income may become subject to limitations, which could potentially result in increased future tax liability for us.

***Our certificate of incorporation, as amended, and bylaws provide for indemnification of officers and directors at our expense and limits their liability, which may result in a major cost to us and hurt the interests of our stockholders because corporate resources may be expended for the benefit of our officers and/or directors.***

Our certificate of incorporation, as amended, bylaws and applicable Delaware law provide for the indemnification of our directors, officers, employees, and agents, under certain circumstances, against attorney's fees and other expenses incurred by them in any litigation to which they become a party arising from their association with or activities on our behalf. We will also bear the expenses of such litigation for any of our directors, officers, employees, or agents, upon such person's promise to repay us, therefore if it is ultimately determined that any such person shall not have been entitled to indemnification. This indemnification policy could result in substantial expenditures by us, which we will be unable to recover.

***Our corporate documents and Delaware law contain provisions that could discourage, delay or prevent a change in control of our company, prevent attempts to replace or remove current management and reduce the market price of our common stock.***

Provisions in our certificate of incorporation, as amended, and bylaws may discourage, delay or prevent a merger or acquisition involving us that our stockholders may consider favorable. For example, our certificate of incorporation, as amended, authorizes our board of directors to issue up to 100,000,000 shares of "blank check" preferred stock. As a result, without further stockholder approval, the board of directors has the authority to attach special rights, including voting and dividend rights, to this preferred stock. With these rights, preferred stockholders could make it more difficult for a third party to acquire us.

We are also subject to the anti-takeover provisions of the General Corporation Law of the State of Delaware. Under these provisions, if anyone becomes an "interested stockholder," we may not enter into a "business combination" with that person for three years without special approval, which could discourage a third party from making a takeover offer and could delay or prevent a change in control of us. An "interested stockholder" means, generally, someone owning 15% or more of our outstanding voting stock or an affiliate of ours that owned 15% or more of our outstanding voting stock within the past three years, subject to certain exceptions as described in the General Corporation Law of the State of Delaware.

We have adopted a shareholder rights plan, the purpose of which is, among other things, to enhance our board of directors' ability to protect shareholder interests and to ensure that stockholders receive fair treatment in the event any coercive takeover attempt of our company is made in the future. The shareholder rights plan could make it more difficult for a third party to acquire, or could discourage a third party from acquiring, our company or a large block of our common stock.

***Compliance with changing regulations concerning corporate governance and public disclosure may result in additional expenses.***

There have been changing laws, regulations and standards relating to corporate governance and public disclosure, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), new regulations promulgated by the U.S. Securities and Exchange Commission (the "SEC") and rules promulgated by the national securities exchanges. The Dodd-Frank Act, enacted in July 2010, expanded federal regulation

of corporate governance matters and imposes requirements on public companies to, among other things, provides stockholders with a periodic advisory vote on executive compensation and also adds compensation committee reforms and enhanced pay-for-performance disclosures. While some provisions of the Dodd-Frank Act were effective upon enactment, others have been and will be implemented upon the SEC's adoption of related rules and regulations. The scope and timing of the adoption of such rules and regulations is uncertain and, accordingly, the cost of compliance with the Dodd-Frank Act is also uncertain. Additionally, while campaigning, President Trump made statements suggesting he may seek to adopt legislation that could significantly affect the regulation of United States financial markets. Areas subject to potential change, amendment or repeal include the Dodd-Frank Act, including § 619 (12 U.S.C. § 1851) known as the Volcker Rule and various swaps and derivatives regulations, the authority of the Federal Reserve and the Financial Stability Oversight Council, and renewed proposals to separate banks' commercial and investment banking activities.

These new or changed laws, regulations and standards are, or will be, subject to varying interpretations in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. As a result, our efforts to comply with evolving laws, regulations and standards are likely to continue to result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. Members of our board of directors and our principal executive officer and principal financial officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified directors and executive officers, which could harm our business. If the actions we take in our efforts to comply with new or changed laws, regulations and standards differ from the actions intended by regulatory or governing bodies, we could be subject to liability under applicable laws or our reputation may be harmed.

***We have identified material weaknesses in our internal control over financial reporting, and our financial controls and procedures may not in the future be sufficient to ensure timely and reliable reporting of financial information, which could materially harm our stock price and exchange listing, could cause our stock price to decline significantly and could make it more difficult for us to raise capital.***

Sarbanes-Oxley specifically requires, among other things, that we maintain effective internal controls for financial reporting and disclosure of controls and procedures. In particular, we must perform system and process evaluation and testing of our internal controls over financial reporting to allow management to report on the effectiveness of our internal controls over financial reporting, as required by Section 404 of Sarbanes-Oxley. In March 2017, in connection with the preparation of our 2016 financial statements, we identified certain purchase agreements which contained terms for contingent consideration that were not identified timely and accounted for in our historical financial statements on a timely basis. Further, certain other purchase agreements containing terms for contingent consideration were identified timely, but we failed to adjust the liabilities for changes in fair value at each subsequent reporting period. Accordingly, we did not appropriately account for liabilities for contingent consideration payable and the related adjustments to earnings. Based on these findings, our management identified a material weakness in our review controls over unusual or non-recurring and significant transactions. Specifically, our controls were not properly designed to provide reasonable assurance that we (1) timely identify and assess the accounting implications of terms in unusual or non-recurring agreements and (2) reassess the valuation of associated assets or liabilities at the end of each reporting period. The Company concluded that these controls did not operate effectively as of December 31, 2017, which has been identified as a material weakness in our internal control over financial reporting. This material weakness did not result in any material misstatements to the financial statements. Additionally, as a result of the restatement of the condensed consolidated financial statements for the three and nine months ended September 30, 2017 for the impairment discussed in Note 9 to the financial statements to our consolidated financial statements accompanying this Form 10-K, our management identified a material weakness in our review controls with respect to our equity method investments. Specifically, our review controls to assess and monitor the appropriateness of the financial information provided by our equity method investees were not operating effectively beginning in the quarter ended September 30, 2017, to provide reasonable assurance that we timely identify and assess the accounting implications of transactions and events occurring at our equity method investees and properly report such investee financial information in our financial statements.

We have initiated and will continue to implement remediation measures to address the underlying causes of the material weaknesses described above and to improve and strengthen our internal control over financial reporting. We cannot assure you that the measures we have taken to date or any measures we may take in response to the material weaknesses in the future will be sufficient to remediate such material weakness or to avoid potential future material weaknesses. Even if we develop effective controls, these new controls may become inadequate because of changes in conditions or the degree of compliance with these policies or procedures may deteriorate.

Our compliance with Section 404 of Sarbanes-Oxley requires that we incur substantial accounting expense and expend significant management efforts. We currently do not have an internal audit group, and we will need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge. Moreover, if we are not able to comply with the requirements of Section 404 of Sarbanes-Oxley in a timely manner, if we fail to remediate the material weaknesses in internal control over financial reporting or if we or our independent registered public accounting firm identifies additional deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline, and we could be subject to sanctions or investigations by the SEC or other regulatory authorities, which would require additional financial and management resources.

**Item 1B. Unresolved Staff Comments.**

On February 28, 2018, we received a comment letter from the staff of the SEC's Division of Corporation Finance with respect to our Current Report on Form 8-K filed on February 27, 2018, to revise to clarify information regarding the other-than-temporary impairment associated with our equity method investment in Immunotherapy NANTibody, LLC disclosed therein. We filed a response to the SEC's comment letter on March 12, 2018 and we are awaiting the SEC's response to our response letter. Additionally, we have included disclosures in Note 9 to our consolidated financial statements accompanying this Form 10-K that we believe are responsive to the SEC's comment letter.

As of the date of the filing of this Annual Report on Form 10-K, we have not received confirmation from the staff of the Division of Corporation Finance of the SEC that its review process relating to the comment letter had been completed. If we receive additional comments from the staff, we intend to resolve such additional comments promptly.

**Item 2. Properties.**

The Company currently leases in San Diego, California approximately 43,000 square feet of corporate office and laboratory space, approximately 6,350 square feet of laboratory and office space at a second location and approximately 1,405 square feet of office space at a third location. The Company's lease agreements in San Diego, as amended, for its corporate office and laboratory space, its second laboratory and office space and its third office space, expire in December 2026, November 2025 and September 2020, respectively. Additionally, the Company entered into a new lease in San Diego, California for approximately 76,700 square feet of additional corporate office and laboratory space as well as approximately 36,400 square feet for offices, facilities for cGMP fill and finish and storage space. The lease began in February of 2017 and expires in November 2023.

The Company leases an additional 1,405 square feet of office space in California and an additional 2,734 square feet in Pennsylvania. The Company also leases 25,381 square feet of office and laboratory space in Suzhou, China, which lease expires in June 2019. The Company leases 2,312 square feet of office, laboratory, and storage space in Scotland, which lease expires in March 2021.

In July 2017, the Company entered into a new sublease in New York, New York for approximately 4,550 square feet of additional corporate office space. The sublease expires in December 2020.

**Item 3. Legal Proceedings.**

To the best of our knowledge, we are not a party to any legal proceedings that, individually or in the aggregate, are deemed to be material to our financial condition or results of operations.

In the normal course of business, we may be named as a defendant in one or more lawsuits. We are not a party to any outstanding material litigation and management is currently not aware of any legal proceedings that, individually or in the aggregate, are deemed to be material to our financial condition or results of operations.

***Derivative Action Litigation***

On September 8, 2016, Yvonne Williams filed an action both derivatively and on behalf of a purported class of stockholders in the Court of Chancery of the State of Delaware (the "Court") against each of the members of the Henry Ji, William S. Marth, Kim D. Janda, Jaisim Shah, David H. Deming, and Douglas Ebersole (the "Prior Board"); George Ng, the Company's Executive Vice President, Chief Administrative Officer, and Chief Legal Officer; Jeffrey Su, the Company's Executive Vice President & Chief Operating Officer; and the Company as nominal defendant, alleging: (1) breach of fiduciary duty with respect to the formation of, and certain options and warrants issued by, certain of the Company's subsidiaries to Dr. Ji and members of the Prior Board; (2) breach of fiduciary duty with respect to the Company's prior announcement that it had

entered into a voting agreement with Yuhan Corporation in connection with a transaction through which it purchased \$10 million of shares of our common stock and warrants (the "Williams Action"). On November 14, 2016, the Company filed motions to dismiss or in the alternative stay the Williams Action. George Ng and Jeffrey Su were dismissed as defendants by plaintiff during the briefing on the motions. The Court denied the motions on June 28, 2017.

On October 25, 2017, Yvonne Williams filed a Supplemental and Amended Class Action and Derivative Complaint which re-added George Ng as a defendant, added Eragon Ventures, LLC as a defendant, and added certain claims challenging transactions whereby Eragon Ventures, LLC agreed to purchase certain stock in the Company's subsidiary, LA Cell, Inc. Following a mediation held on November 16, 2017, the parties agreed that day to a term sheet reflecting a settlement of the Williams Action, which agreement was memorialized in a Stipulation and Agreement of Settlement executed on December 22, 2017 and filed with the Court. The settlement and plaintiff's counsel's request for an award of attorneys' fees in the amount of \$5 million have been submitted to the Court for approval. The Court has set a hearing on the request for approval of the settlement for April 3, 2018, and the Company has caused notice to be provided concerning the settlement and settlement hearing. Objections to the settlement or the requested award of attorneys' fees were due no later than March 5, 2018. The Company has objected to the amount of fees being requested by plaintiff's counsel and has suggested that a fee award of \$850,000 would be appropriate.

If the Court approves the settlement, this case will be dismissed with prejudice. The settlement consists of non-monetary consideration, such as the cancellation of certain subsidiary shares of stock that were obtained by defendants pursuant to options previously exercised by defendants. Accordingly, the Company does not anticipate any monetary loss with respect to the Williams Action other than for potential payment of the amount of fees and costs that may be awarded to plaintiff's counsel by the Court. With respect to such fees as may be awarded, the Company believes that all such amounts should be covered by the Company's director and officer insurance policies.

### ***Immunomedics Litigation***

On June 26, 2015, Immunomedics, Inc. ("Immunomedics") filed a complaint in the United States District Court for the District of New Jersey (the "Immunomedics Action") against the Board of Directors of Roger Williams Medical Center, Dr. Richard P. Junghans, Dr. Steven C. Katz, the Office of the Board of Advisors of Tufts University School of Medicine, and one or more individuals or entities to be identified later. This complaint (the "Initial Complaint") alleged, among other things: (1) breach of contract; (2) breach of covenant of good faith and fair dealing; (3) tortious interference with prospective economic gain; (4) tortious interference with contracts; (5) misappropriation; (6) conversion; (7) bailment; (8) negligence; (9) vicarious liability; and (10) patent infringement. Overall, the allegations in the Initial Complaint were generally directed to an alleged material transfer agreement dated December 2008 and Immunomedics' alleged request for the return of certain alleged research material, as well as the alleged improper use and conversion of such research materials outside the scope of the material transfer agreement.

On October 22, 2015, Immunomedics filed an amended complaint (the "First Amended Complaint"), which, among other things, no longer named the Board of Directors of Roger Williams Medical Center and The Office of the Board of Advisors of Tufts University School of Medicine as defendants. Roger Williams Medical Center and Tufts Medical Center were added as new defendants. On January 14, 2016, Immunomedics filed a second amended complaint (the "Second Amended Complaint"), which, among other things, no longer named Tufts Medical Center as a defendant. In addition, the Second Amended Complaint contained allegations directed to two additional alleged material transfer agreements dated September 1993 and May 2010, respectively, and also added an allegation of unjust enrichment. The Second Amended Complaint also no longer asserted claims for (1) breach of covenant of good faith and fair dealing; (2) misappropriation; (3) bailment; (4) negligence; and (5) vicarious liability.

On October 12, 2016, Immunomedics filed a third amended complaint (the "Third Amended Complaint"), which added the Company, TNK, BDL and CARgenix as defendants. TNK is a subsidiary of the Company and purchased BDL and CARgenix in August 2015. The Third Amended Complaint includes, among other things, allegations against the Company, TNK, BDL and CARgenix regarding (1) conversion; (2) tortious interference; and (3) unjust enrichment. On December 2, 2016, the Company, TNK, BDL, and CARgenix filed a motion to dismiss Immunomedics's complaint against them for lack of personal jurisdiction. On January 25, 2017, the District of New Jersey granted this motion, and the Company, TNK, BDL and CARgenix were dismissed as defendants from the case. Although dismissed from the case, under various agreements, TNK has certain indemnification obligations to Roger Williams Medical Center, Dr. Richard P. Junghans and Dr. Steven C. Katz that may be implicated by the case. In addition, the possibility exists that Immunomedics could attempt to file suit against the Company and/or TNK in a different jurisdiction. The Immunomedics Action remains pending in the District of New Jersey against defendants Roger Williams Medical Center, Dr. Junghans, and Dr. Katz. A trial date has not yet been set. The Company believes that the Immunomedics Action is without merit, and will vigorously defend itself against this and any further actions. However, should Immunomedics prevail against the Company, Roger Williams Medical Center or other defendants, certain

patent rights optioned, owned and/or licensed by the Company could be at risk of invalidity or enforceability, or the litigation could otherwise adversely impact the Company's ownership or other rights in certain intellectual property. At this point in time, the Company is unable to determine whether any loss will occur with respect to the Immunomedics Action or to estimate the range of such potential loss; therefore, no amount of loss has been accrued by the Company as of the date of filing of this Annual Report on Form 10-K.

<sup>1</sup>Although dismissed from the case, under various agreements, TNK has certain indemnification obligations to Roger Williams Medical Center, Dr. Richard P. Junghans and Dr. Steven C. Katz that may be implicated by the case. In addition, the possibility exists that Immunomedics could attempt to file suit against the Company and/or TNK in a different jurisdiction.

**Item 4. Mine Safety Disclosures.**

None.

**PART II**

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

**Market Information**

Our common stock is listed on the Nasdaq Capital Market under the symbol "SRNE".

The following table sets forth the range of high and low sale prices for our common stock for the periods indicated in 2017 and 2016 as reported by Nasdaq.

|                | 2017    |         | 2016    |         |
|----------------|---------|---------|---------|---------|
|                | High    | Low     | High    | Low     |
| First Quarter  | \$ 6.08 | \$ 3.90 | \$ 8.52 | \$ 4.25 |
| Second Quarter | 3.95    | 1.50    | 7.80    | 5.26    |
| Third Quarter  | 2.15    | 1.50    | 8.00    | 5.55    |
| Fourth Quarter | 4.05    | 1.70    | 8.35    | 4.68    |

**Holders of Record**

As of March 9, 2018, there were 267 holders of record of our common stock.

**Dividend Policy**

We have not declared or paid any cash dividends on our common stock and we do not anticipate paying any dividends or making any other distributions in the foreseeable future. Pursuant to our outstanding convertible notes issued in December 2017, so long as the outstanding principal amount under all such notes is at least \$25,000,000, we are prohibited from paying any dividends without the prior written consent of the holders of such notes. Subject to our obligations under such convertible notes, the payment by us of dividends, if any, in the future, rests within the discretion of our board of directors and will depend, among other things, upon our earnings, capital requirements and financial condition.

**Recent Sales of Unregistered Securities**

On December 11, 2017, we entered into a Securities Purchase Agreement (the "Securities Purchase Agreement" or "Note SPA") with certain accredited investors (collectively, the "Purchasers"). Pursuant to the Securities Purchase Agreement, on December 21, 2017, we issued and sold to the Purchasers, in a private placement transaction (the "Private Placement"), (1) convertible promissory notes in an aggregate principal amount of \$50,000,000 (the "Notes"), which will accrue simple interest at a rate equal to 5.0% per annum and mature upon the earlier to occur of (a) December 21, 2022, and (b) the date of the closing

of a change in control (the “Maturity Date”), and (2) warrants (the “Warrants”) to purchase an aggregate of 12,121,210 shares of our common stock.

At any time and from time to time before the Maturity Date, each Purchaser shall have the option to convert any portion of the outstanding principal amount of such Purchaser’s Note that is equal to or greater than the lesser of: (1) \$4,000,000, and (2) the then-outstanding principal amount of such Purchaser’s Note into shares of our common stock at a price per share of \$2.26875, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions. Accrued but unpaid interest on the Notes shall be paid in cash semi-annually in arrears on or prior to the 30th day of June or 31st day of December of each calendar year commencing with the year ending December 31, 2018. If a Purchaser elects to convert any of the principal amount of their Note, then all accrued but unpaid interest on such portion of the principal amount shall become due and payable in cash. The Notes contain restrictive covenants and event of default provisions that are customary for transactions of this type.

Each Warrant has an exercise price of \$2.61 per share, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions, will become exercisable on June 20, 2018, has a term of five and a half years and is exercisable on a cash basis, unless there is not an effective registration statement covering the resale of the shares issuable upon exercise of the Warrants, in which case the Warrants shall also be exercisable on a cashless exercise basis.

The Notes, the Warrants, the Note Shares and the shares of common stock issuable upon exercise of the Warrants (collectively, the “Securities”) were offered and sold to the Purchasers on December 21, 2017 in a transaction exempt from registration under the Securities Act of 1933, as amended (the “Securities Act”), in reliance on Section 4(a)(2) thereof and Rule 506 of Regulation D thereunder. Each of the Purchasers represented that such Purchaser was an “accredited investor,” as defined in Regulation D, and was acquiring the Securities for investment only and not with a view towards, or for resale in connection with, the public sale or distribution thereof. Accordingly, the Securities have not been registered under the Securities Act and the Securities may not be offered or sold in the United States absent registration or an exemption from registration under the Securities Act and any applicable state securities laws.

### Securities Authorized for Issuance Under Equity Compensation Plans

The following table sets forth additional information with respect to the shares of common stock that may be issued upon the exercise of options and other rights under our existing equity compensation plans and arrangements in effect as of December 31, 2017. The information includes the number of shares covered by, and the weighted average exercise price of, outstanding options and the number of shares remaining available for future grant, excluding the shares to be issued upon exercise of outstanding options.

| Plan Category   | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|---|---|---|---|
|   | (a)   | (b)   | (c)   |
| Equity compensation plans approved by security holders <sup>(1)</sup>     | 6,343,400   | \$ 4.74   | 4,438,696 <sup>(2)</sup>  |
| Equity compensation plans not approved by security holders <sup>(3)</sup> | 3,200   | 1.12  | —   |
| <b>Total</b>  | <b>6,346,600</b>  |   | <b>4,438,696<sup>(2)</sup></b>  |

(1) Comprised of our 2009 Amended and Restated Stock Incentive Plan (the “2009 Plan”).

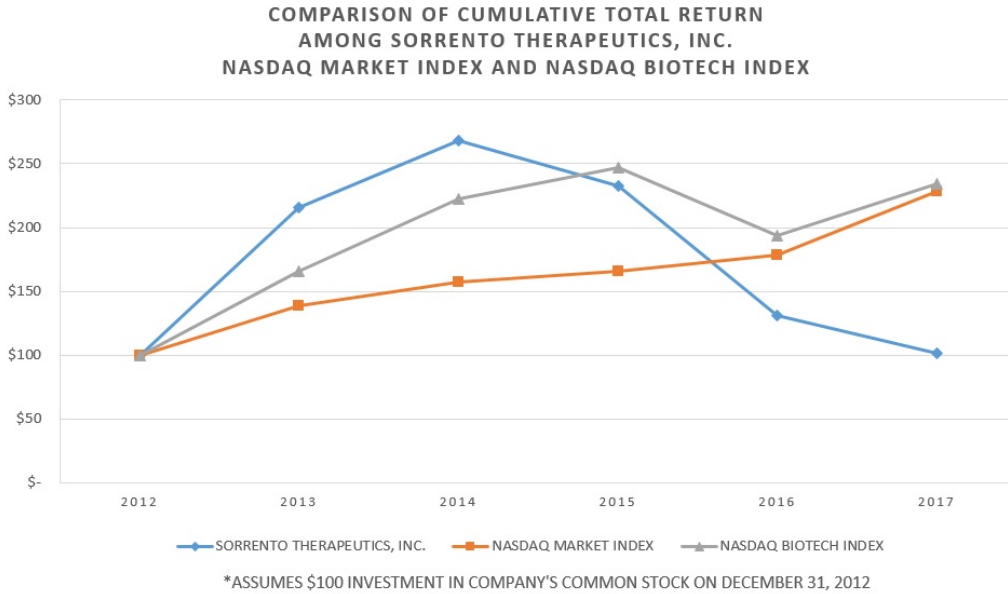
(2) Comprised solely of shares subject to awards available for future issuance under the 2009 Plan. In June 2014, our stockholders approved, among other items, the amendment and restatement of the 2009 Plan to increase the number of shares of common stock authorized to be issued pursuant to the 2009 Plan to 3,760,000. In June 2016, our stockholders approved, among other items, another amendment and restatement of the 2009 Plan to increase the number of shares of common stock authorized to be issued pursuant to the 2009 Plan to 6,260,000. In July 2017, our stockholders approved, among other items, another amendment and restatement of the 2009 Plan to increase the number of shares of common stock authorized to be issued pursuant to the 2009 Plan to 11,260,000. Such shares of common stock are reserved for

issuance to our employees, non-employee directors and consultants. As of December 31, 2017, 11,260,000 shares were authorized under the 2009 Plan, with 4,438,696 shares remaining available for future issuance under the 2009 Plan.

- (3) Comprised solely of shares issued to non-employee directors prior to our adoption of the 2009 Plan.

**Performance Graph**

The following graph compares the cumulative total stockholder return on our common stock from December 31, 2011 to December 31, 2017 with the cumulative total return of (i) the Nasdaq Market Index and (ii) the Nasdaq Biotechnology Index. This graph assumes the investment of \$100.00 after the market closed on December 31, 2011 in our common stock, and in the Nasdaq Market Index and the Nasdaq Biotechnology Index, and it assumes any dividends are reinvested. The stock price performance included in this graph is not necessarily indicative of future stock price performance.



**Item 6. Selected Financial Data.**

You should read the selected consolidated financial data presented below in conjunction with the audited consolidated financial statements appearing elsewhere in this Form 10-K and the notes to those statements and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” The selected consolidated financial data as of December 31, 2017 and 2016, and for each of the years in the three-year period ended December 31, 2017, have been derived from our audited consolidated financial statements which appear elsewhere in this Form 10-K. The selected consolidated financial data as of December 31, 2015, 2014 and 2013 and for the years ended December 31, 2014 and 2013 have been derived from our audited consolidated financial statements which are not included in this Form 10-K. The historical results are not necessarily indicative of the operating results to be expected in the future. All financial information presented has been prepared in United States dollars and in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”).

**Year Ended December 31,**

| (In thousands, except per share data)                         | 2017                   | 2016        | 2015        | 2014        | 2013        |
|---|------------------------|-------------|-------------|-------------|-------------|
| <b>Income Statement Data:</b>                                 |                        |             |             |             |             |
| Revenues:   |                        |             |             |             |             |
| Grant   | \$ 206                 | \$ 1,033    | \$ 1,530    | \$ 488      | \$ 452      |
| Royalties and licenses  | 140,381 <sup>(1)</sup> | 4,017       | 3,010       | 3,337       | 8           |
| Sales and services  | 11,269                 | 3,102       | 50          | —           | —           |
| Total revenues  | 151,856                | 8,152       | 4,590       | 3,825       | 460         |
| Income (Loss) from operations                                 | 25,334                 | (96,777)    | (74,005)    | (34,742)    | (21,668)    |
| Net income (loss)   | \$ 9,132               | \$ (63,937) | \$ (50,074) | \$ (34,657) | \$ (21,911) |
| Net loss per share - basic                                    | \$ 0.13                | \$ (1.21)   | \$ (1.24)   | \$ (1.30)   | \$ (1.46)   |
| Net loss per share - diluted                                  | \$ 0.13                | \$ (1.21)   | \$ (1.24)   | \$ (1.30)   | \$ (1.46)   |
| Weighted average number of shares during the period - basic   | 69,742                 | 50,360      | 36,909      | 26,679      | 15,046      |
| Weighted average number of shares during the period - diluted | 70,357                 | 50,360      | 36,909      | 26,679      | 15,046      |

(1) Year-over-year increase primarily due to revenue recognized from the intangibles transferred to Celularity as a result of closing the Contribution Agreement in 2017.

**As of December 31,**

| (In thousands)             | 2017      | 2016      | 2015      | 2014      | 2013      |
|----------------------------|-----------|-----------|-----------|-----------|-----------|
| <b>Balance Sheet Data:</b> |           |           |           |           |           |
| Cash and cash equivalents  | \$ 20,429 | \$ 82,398 | \$ 39,038 | \$ 71,902 | \$ 31,667 |
| Intangibles, net           | 71,013    | 64,776    | 3,912     | 4,357     | 33,321    |
| Goodwill                   | 38,298    | 41,548    | 20,626    | 24,041    | 24,041    |
| Total assets               | 431,614   | 401,586   | 343,519   | 141,541   | 92,582    |
| Total liabilities          | 225,003   | 315,084   | 202,581   | 32,828    | 25,773    |
| Stockholders' equity       | 206,610   | 86,502    | 140,938   | 108,713   | 66,809    |
| Net Working Capital        | (49,255)  | 13,569    | 110,145   | 64,358    | 27,152    |

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the financial statements and the related notes and other information that are included elsewhere in this Form 10-K. This discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties, such as our plans, objectives, expectations and intentions. Actual results and the timing of events could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth under the cautionary note regarding "Forward-Looking Statements" contained elsewhere in this Form 10-K. Additionally, you should read the "Risk Factors" section of this Form 10-K for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.*

**Overview**

Sorrento Therapeutics, Inc. (Nasdaq: SRNE), together with its subsidiaries (collectively, the "Company", "we", "us" and "our") is a clinical stage biotechnology company focused on delivering clinically meaningful therapies to patients and their families, globally. Our primary focus is to transform cancer into a treatable or chronically manageable disease. We also have programs assessing the use of our technologies and products in auto-immune, inflammatory and neurodegenerative diseases and pain indications with high unmet medical needs.



At our core, we are an antibody-centric company and leverage our proprietary G-MAB™ library and targeted delivery modalities to generate the next generation of cancer therapeutics. Our validated fully human antibodies include PD-1, PD-L1, CD38, CD123, CD47, c-MET, VEGFR2, CCR2, OX40, TIGIT and CD137 among others.

Our vision is to leverage these antibodies in conjunction with proprietary targeted delivery modalities to generate the next generation of cancer therapeutics. These modalities include proprietary antibody drug conjugates (“ADCs”), bispecific approaches, as well as TCR-like antibodies. With LA Cell, Inc. (“LA Cell”), our joint venture with City of Hope, our objective is to become the global leader in the development of antibodies against intracellular targets such as STAT3, mutant KRAS, MYC, p53 and TAU. Additionally, we have acquired and are assessing the regulatory and strategic path forward for our portfolio of late stage biosimilar/biobetter antibodies based on Erbitux®, Remicade®, Xolair®, and Simulect® as these may represent nearer term commercial opportunities.

With each of our programs, we aim to tailor our therapies to treat specific stages in the evolution of cancer, from elimination, to equilibrium and escape. In addition, our objective is to focus on tumors that are resistant to current treatments and where we can design focused trials based on a genetic signature or biomarker to ensure patients have the best chance of a durable and significant response. We have several immuno-oncology programs that are in or near to entering the clinic. These include cellular therapies, an oncolytic virus and a palliative care program targeted to treat intractable cancer pain. Finally, as part of our global aim to provide a wide range of therapeutic products to meet underserved therapeutic markets, we have made investments and developed a separate pain focused franchise which we believe will serve to provide short term upside to our core thesis.

Our cellular therapy programs focus on Chimeric Antigen Receptor-T Cell (“CAR-T”) for adoptive cellular immunotherapy to treat both solid and liquid tumors. We have reported early data from Phase I trials of our carcinoembryonic antigen (“CEA”) and PSMA directed CAR-T programs. Our CD38 CAR-T is being evaluated in the context of highly resistant multiple myeloma (“MM”), amyloidosis and graft-versus-host disease (“GvHD”). We are assessing our CD123 CAR-T in the context of highly resistant acute myeloid leukemia (“AML”). Both of the latter programs have successfully demonstrated strong preclinical anti-tumor activity in animal models. Our plan is to submit Investigational New Drug (“IND”) applications with the U.S. Food and Drug Administration (the “FDA”) for at least one of these CAR-T programs in 2018.

Finally, as part of our global aim to provide a wide range of therapeutic products to meet underserved therapeutic markets, we have made investments and developed a separate pain focused franchise which we believe will serve to provide short term upside to our core thesis. Within this franchise, resiniferatoxin (“RTX”) is a non-opioid-based TRPV1 agonist neurotoxin used as an injectable pain treatment. The compound RTX has been granted orphan drug status for the treatment of intractable pain at end-stage cancer and a Phase I trial with the National Institutes of Health (“NIH”) is concluding. Other applications of RTX are expected to start Phase I trials in 2018. Additionally, we have acquired proprietary technologies to responsibly develop next generation, branded pharmaceutical products to better manage critical conditions and maximize the quality of life of patients and healthcare providers. Scilex’s lead product candidate, ZTlido™ (lidocaine topical system 1.8%), is a next-generation lidocaine delivery system recently approved by the FDA for the treatment of postherpetic neuralgia, a severe neuropathic pain condition. ZTlido™ (lidocaine topical system 1.8%) is manufactured by our collaboration partner in their state of the art manufacturing facility.

## **Significant Developments**

### **Termination of Binding Term Sheet Regarding Acquisition of Semnur Pharmaceuticals, Inc.**

On August 15, 2016, our subsidiary, Scintilla Pharmaceuticals, Inc. (“Scintilla”) and Semnur Pharmaceuticals, Inc. (“Semnur”) entered into a binding term sheet (the “Semnur Binding Term Sheet”) setting forth the terms and conditions by which Scintilla would, through a subsidiary, purchase all of the issued and outstanding equity of Semnur. On October 6, 2017, the Semnur Binding Term Sheet was terminated without additional consideration, effective immediately.

### **Public Offering of Common Stock**

On April 13, 2017, we entered into an underwriting agreement (the “Underwriting Agreement”) with Cantor Fitzgerald & Co., as representative of the several underwriters named therein (the “Underwriters”), relating to an underwritten public offering (the “Offering”) of 23,625,084 shares of our common stock. The public offering price was \$2.00 per share of our common stock and the Underwriters agreed to purchase the shares of our common stock pursuant to the Underwriting Agreement at a price of \$1.8571 per share.

On April 19, 2017, the Offering was completed and resulted in net proceeds of approximately \$43.5 million, after deducting underwriting discounts and commissions and estimated Offering expenses payable by us.

### **Acquisition of Virttu Biologics Limited**

On April 27, 2017, we entered into a Share Purchase Agreement (the “Virttu Purchase Agreement”) with TNK Therapeutics, Inc., our majority-owned subsidiary (“TNK”), Virttu Biologics Limited (“Virttu”), the shareholders of Virttu (the “Virttu Shareholders”) and Dayspring Ventures Limited, as the representative of the Virttu Shareholders, pursuant to which, among other things, TNK acquired from the Virttu Shareholders 100% of the outstanding ordinary shares of Virttu (the “Virttu Acquisition”).

Virttu focuses on the development of oncolytic viruses that infect and selectively multiply in and destroy tumor cells without damaging healthy tissue. Its lead oncolytic virus candidate, Seprehvir, infects and replicates in cancer cells selectively, leaving normal cells unharmed.

Under the Virttu Purchase Agreement, the total amount of the consideration payable to the Virttu Shareholders in the Virttu Acquisition is equal to \$25 million, less Virttu’s net debt (the “Virttu Base Consideration”). An additional \$10 million contingent consideration is payable upon the achievement of certain regulatory milestones (as described below) (the “Regulatory Approval Consideration”).

At the closing of the Virttu Acquisition (the “Closing”) on April 27, 2017, we issued to the Virttu Shareholders consideration valued at approximately \$2.2 million, which consisted primarily of an aggregate of 797,081 shares (the “Virttu Closing Shares”) and approximately \$557,000 in cash (the “Cash Consideration”). The issuance of the Closing Shares and the payment of the Cash Consideration satisfied TNK’s obligation to pay 20% of the Virttu Base Consideration at the Closing. Under the terms of the Virttu Purchase Agreement, we agreed to provide additional consideration to the Virttu Shareholders, as follows:

(1) Upon a financing resulting in gross proceeds (individually or in the aggregate) to TNK of at least \$50.0 million (a “Qualified Financing”), TNK will issue to the Virttu Shareholders an aggregate number of shares of its capital stock (“TNK Capital Stock”) as is equal to the quotient obtained by dividing 80% of the Virttu Base Consideration by the lowest per share price paid by investors in the Qualified Financing (the “TNK Financing Consideration”); provided, however, that 20% of the TNK Financing Consideration shall be held in escrow until April 27, 2018 (the “Financing Due Date”), to be used to, among other things, satisfy the indemnification obligations of the Virttu Shareholders. In the event that a Qualified Financing does not occur, then on the Financing Due Date, we will issue to the Virttu Shareholders an aggregate number of shares of our common stock as is equal to the quotient obtained by dividing 80% of the Virttu Base Consideration, by \$5.55 (as adjusted, as appropriate, to reflect any stock splits or similar events affecting our common stock after the Closing).

(2) Within 45 business days after Virttu becomes aware that certain governmental bodies in the United States, the European Union, the United Kingdom or Japan have approved for commercialization, on or before October 26, 2024, Seprehvir (or any enhancement, combination or derivative thereof) as a monotherapy or in combination with one or more other active components (each of the first two such approvals by a governmental body being a “Regulatory Approval”), TNK shall pay half of the Regulatory Approval Consideration to the Virttu Shareholders, in a combination of (a) up to \$5.0 million in cash (the “Regulatory Approval Cash”) and/or (b) (i) such number of shares of our common stock as is equal to the quotient obtained by dividing \$5.0 million less the Regulatory Approval Cash (the “Regulatory Approval Share Value”) by the 30 Day VWAP (as defined below) of one share of our common stock; (ii) if TNK has completed its first public offering of TNK Capital Stock, the number of shares of TNK Capital Stock as is equal to the quotient obtained by dividing the Regulatory Approval Share Value by the 30 Day VWAP of one share of TNK Capital Stock; or (iii) such number of shares of common stock of a publicly traded company as is equal to the quotient obtained by dividing the Regulatory Approval Share Value by the volume weighted average price of the relevant security, as reported on the Nasdaq Capital Market (or other principal stock exchange or securities market on which the shares are then listed or quoted) for the thirty trading days immediately following the receipt of Regulatory Approval (the “30 Day VWAP”), with the composition of the Regulatory Approval Consideration to be at TNK’s option. In order for a second regulatory approval to qualify as a Regulatory Approval under the Purchase Agreement, the second approval must be granted by a different governmental body in a different jurisdiction than that which granted the first Regulatory Approval.

### **Celularity Transaction**

On November 1, 2016, we loaned \$5.0 million to Celularity, Inc., a research and development company (“Celularity”), pursuant to a promissory note issued by us to Celularity, as amended (as so amended, the “Celularity Note”), in connection with the entry into a nonbinding term sheet by us, TNK and Celularity. Pursuant to the terms of the Celularity Note, the loan was due and payable in full on the earlier of November 1, 2017 and the occurrence of an event of default under the Celularity Note

(the "Maturity Date"). Under the terms of the Celularity Note, in the event that Celularity met certain minimum financing conditions prior to the Maturity Date, all outstanding amounts under the Celularity Note would be forgiven and converted to equity. On May 31, 2017, we loaned an additional \$2.0 million to Celularity pursuant to the terms of the Celularity Note. On June 14, 2017, we loaned an additional \$1.0 million to Celularity. Additionally, on July 7, 2017, we loaned an additional \$2.0 million to Celularity. The loan amounts were forgiven and converted to additional equity investment in Celularity as part of the closing of the Contribution Agreement (as defined below) on June 12, 2017.

On June 12, 2017, we entered into a Contribution Agreement (the "Contribution Agreement") with TNK and Celularity, pursuant to which, among other things, we and TNK agreed to contribute certain intellectual property rights related to our proprietary chimeric antigen receptor ("CAR") constructs and related CARs to Celularity in exchange for shares of Celularity's Series A Preferred Stock equal to 25% of Celularity's outstanding shares of capital stock, calculated on a fully-diluted basis (the "Celularity Shares").

On August 15, 2017, the transactions contemplated by the Contribution Agreement closed, the loan amounts were forgiven, and, on such date, among other things, (a) Celularity issued the Celularity Shares to TNK, and (b) we, TNK and Celularity entered into a License and Transfer Agreement (the "License Agreement"). Pursuant to the License Agreement (i) TNK and we agreed to provide to Celularity (1) our CAR constructs and related CARs for use worldwide in combination with placenta-derived cells and/or cord blood-derived cells for the treatment of any disease or disorder except that anti-CD38 CAR constructs and related CARs may also be used in adult cells for the treatment of multiple myeloma unless TNK exercises its termination rights, and (2) our know-how relating to the foregoing, (ii) TNK and we granted to Celularity a limited, perpetual, transferable and sublicensable license and covenant not to sue with respect to certain of their patents and other intellectual property rights, which license is exclusive for a subset of such patents, and (iii) Celularity agreed to pay to TNK 50% of the first \$200 million and 20% thereafter of any upfront and milestone payments that Celularity receives in connection with any sublicense of a combination of anti-CD38 CAR constructs and either placenta-driven cells and/or cord blood-derived cells or adult cells.

### **Termination of Servier License Agreement**

On July 11, 2016, we announced a license and collaboration agreement with Les Laboratoires Servier, SAS, a corporation incorporated under the laws of France, and Institut de Recherches Internationales Servier, a company duly organized and existing under the laws of France (individually and collectively, "Servier") for the development, manufacture and commercialization of products using our fully human immuno-oncology anti-PD-1mAb STI-A1110 and provided support for Servier's initial development efforts (the "Servier License Agreement").

Effective November 6, 2017, the Servier License Agreement was terminated by mutual agreement pursuant to its terms.

### **New Universal Shelf Registration Statement on Form S-3**

On November 9, 2017, we filed a Universal Shelf Registration Statement on Form S-3 (File No. 33-221443) (the "New Shelf Registration Statement") to replace our existing and expiring Universal Shelf Registration Statement on Form S-3 (File No. 333-199849) (the "Existing Shelf Registration Statement"). The Existing Shelf Registration Statement expired on December 6, 2017, when the New Shelf Registration Statement was declared effective.

### **At Market Issuance Sales Agreement**

On November 9, 2017, we entered into an At Market Issuance Sales Agreement (the "Sales Agreement") with B. Riley FBR, Inc., as sales agent (the "Agent"), pursuant to which we may offer and sell, from time to time, through the Agent (the "Offering") up to \$100,000,000 in shares of our common stock. Any shares of our common stock offered and sold in the Offering will be issued pursuant to the New Shelf Registration Statement and the prospectus relating to the Offering that forms a part of the New Shelf Registration Statement.

### **Private Placement of Convertible Promissory Notes and Warrants**

On December 11, 2017, we entered into a Securities Purchase Agreement (the "Securities Purchase Agreement" or "Note SPA") with certain accredited investors (collectively, the "Purchasers"). Pursuant to the Securities Purchase Agreement, on December 21, 2017, we issued and sold to the Purchasers, in a private placement transaction (the "Private Placement"), (1) convertible promissory notes in an aggregate principal amount of \$50,000,000 (the "Notes"), which will accrue simple interest at a rate equal to 5.0% per annum and mature upon the earlier to occur of (a) December 21, 2022, and (b) the date of the closing

of a change in control (the “Maturity Date”), and (2) warrants (the “Warrants”) to purchase an aggregate of 12,121,210 shares of our common stock.

At any time and from time to time before the Maturity Date, each Purchaser shall have the option to convert any portion of the outstanding principal amount of such Purchaser’s Note that is equal to or greater than the lesser of: (1) \$4,000,000, and (2) the then-outstanding principal amount of such Purchaser’s Note into shares of our common stock at a price per share of \$2.26875, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions. Accrued but unpaid interest on the Notes shall be paid in cash semi-annually in arrears on or prior to the 30th day of June and 31st day of December of each calendar year commencing with the year ending December 31, 2018. If a Purchaser elects to convert any of the principal amount of their Note, then all accrued but unpaid interest on such portion of the principal amount shall become due and payable in cash. The Notes contain restrictive covenants and event of default provisions that are customary for transactions of this type.

Each Warrant has an exercise price of \$2.61 per share, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions, will become exercisable on June 20, 2018, has a term of five and a half years and is exercisable on a cash basis, unless there is not an effective registration statement covering the resale of the shares issuable upon exercise of the Warrants, in which case the Warrants shall also be exercisable on a cashless exercise basis.

### **Termination of Hercules Loan and Security Agreement**

On December 21, 2017, we paid off all obligations owing under, and terminated, the Loan and Security Agreement dated November 23, 2016, as amended, among us, certain of our domestic subsidiaries and Hercules Capital, Inc., as a lender and agent for the several banks and other financial institutions or entities from time to time party to the agreement (the “Terminated Loan Agreement”). The Terminated Loan Agreement permitted us to borrow up to an aggregate principal amount of \$75.0 million, subject to funding in multiple tranches. The Terminated Loan Agreement was secured by substantially all of our assets, excluding intellectual property. The secured interests under the Terminated Loan Agreement were terminated in connection with our discharge of indebtedness thereunder.

### **Results of Operations**

The following discussion of our operating results explains material changes in our results of operations for the years ended December 31, 2017, 2016 and 2015. The discussion should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this Form 10-K.

#### ***Comparison of the Years Ended December 31, 2017 and 2016***

**Revenues.** Revenues were \$151.9 million for the year ended December 31, 2017, as compared to \$8.2 million for the year ended December 31, 2016. The net increase of \$143.7 million is primarily due to an increase in royalty and licensing activities for the year ended December 31, 2017 compared to the corresponding period of 2016. Royalties and license revenues increased \$136.4 million for the year ended December 2017 as compared to the same period of 2016 primarily due to revenue recognized from the intangibles transferred to Celularity of approximately \$116.2 million as a result of closing the Contribution Agreement in 2017 as well as the cancellation of the Servier agreement which resulted in revenue of approximately \$16 million. Sales and service revenues generated from the sale of customized reagents and providing contract development services increased \$8.2 million for the year ended December 2017 as compared to the same period of 2016.

We expect that any revenue we generate will fluctuate from year to year as a result of the unpredictability of the demand for products and services offered as well as the timing and amount of grant awards, research and development reimbursements and other payments received under any strategic collaborations.

**Cost of revenues.** Cost of revenues for the years ended December 31, 2017 and 2016 were \$3.9 million and \$0.8 million, respectively. The increase is due primarily to increased contract manufacturing activities and higher direct materials and overhead costs for the year ended December 31, 2017 compared to the prior year period. The costs generally include employee salaries and benefits, direct materials and overhead costs including rent, depreciation, utilities, facility maintenance and insurance. We expect cost of revenues to fluctuate with related sales and service revenues.

**Research and Development Expenses.** Research and development expenses for the years ended December 31, 2017 and 2016 were \$55.5 million and \$42.2 million, respectively. Research and development expenses include expenses associated with the ramp up of ZTlido<sup>TM</sup> (lidocaine topical system 1.8%) as well as the costs related to our RTX program activities towards

entering into future clinical trials, costs to identify, isolate and advance human antibody drug candidates derived from our libraries as well as advancing our ADC preclinical drug candidates, preclinical testing expenses and the expenses associated with fulfilling our development obligations related to the NIH grant awards (collectively the “NIH Grants”). Such expenses consist primarily of salaries and personnel related expenses, stock-based compensation expense, clinical development expenses, preclinical testing, lab supplies, consulting costs, depreciation and other expenses. The increase of \$13.4 million is attributable to increased clinical activities related to consulting and lab supply costs incurred in connection with our expanded research and development activities and activities to advance RTX into clinical trials and potentially pursue other development activities and regulatory related activities associated with ZTlido™ (lidocaine topical system 1.8%). We expect research and development expenses to increase in absolute dollars as we: (i) advance RTX and our other product candidates into clinical trials and pursue other development, acquire, develop and manufacture clinical trial materials and increase other regulatory operating activities, (ii) incur incremental expenses associated with our efforts to further advance a number of potential product candidates into preclinical development activities, (iii) continue to identify and advance a number of fully human therapeutic antibody and ADC preclinical product candidates, (iv) incur higher salary, lab supply and infrastructure costs incurred in connection with supporting all of our programs, (v) invest in our joint ventures, collaborations or other third party agreements, and (vi) expand our corporate infrastructure.

*Acquired In-process Research and Development Expenses.* Acquired in-process research and development expenses for the years ended December 31, 2017 and 2016 were \$26.1 million and \$45.0 million, respectively, with the decrease due to higher levels of acquisition related activities in the prior year. Acquired in-process research and development expenses for the year ended December 31, 2017 include costs associated with the acquisition of acquired in-process research and development from Mabtech. Acquired in-process research and development expenses for the year ended December 31, 2016 include costs associated with the acquisition of acquired in-process research and development from Mabtech Limited and LA Cell.

*General and Administrative Expenses.* General and administrative expenses for the years ended December 31, 2017 and 2016 were \$38.3 million and \$24.2 million, respectively. General and administrative expenses consist primarily of salaries and personnel related expenses for executive, finance and administrative personnel, stock-based compensation expense, professional fees, infrastructure expenses, legal and accounting expenses and other general corporate expenses. The increase of \$14.1 million is primarily attributable to higher salaries and related compensation expenses, stock-based compensation, legal costs related to acquisitions, general corporate and intellectual property matters, consulting and business development expenses and higher compliance costs associated with our public reporting obligations. We expect general and administrative expenses to increase in absolute dollars as we: (i) incur incremental expenses associated with expanded operations and development efforts, (ii) expand our efforts to ensure continued compliance with our public reporting obligations, (iii) build our infrastructure, and (iv) invest in our joint ventures, collaborations or other third party agreements.

*Intangible Amortization.* Intangible amortization for the years ended December 31, 2017 and 2016 was \$2.6 million and \$0.8 million, respectively. The increase in the year ended December 31, 2017 as compared to the same period in 2016 is due to the impact of the acquisition of Scilex and the start of patent right amortization in 2017.

*Gain or Loss on derivative liability.* Gain on derivative liability for the year ended December 31, 2017 was \$0 compared to a gain on derivative liability of \$5,520 thousand for the year ended December 31, 2016. The decrease in the year ended December 31, 2017 as compared to the same period in 2016 is due to the expiration of the unexercised derivative liability on March 31, 2016 associated with the cancelled call option on shares of NantKwest, Inc. stock.

*Interest Expense.* Interest expense for the years ended December 31, 2017 and 2016 was \$5.0 million and \$1.6 million, respectively.

*Interest Income.* Interest income for the years ended December 31, 2017 and 2016 was \$0.2 million and \$0.3 million, respectively.

*Income tax expense (benefit).* Income tax benefit for the year ended December 31, 2017 was \$36.0 million. Income tax benefit for the year ended December 31, 2016 was \$0.9 million. The increase in the year ended December 31, 2017 as compared to the same period in 2016 is primarily due to re-measurement adjustments related to the impact of U.S. tax reform under the Tax Cut and Jobs Act which was enacted on December 22, 2017.

*Income (loss) on equity method investments.* Loss on equity investments for the year ended December 31, 2017 was \$40.2 million compared to a gain on equity investments of \$0.4 million for the year ended December 31, 2016. The decrease was primarily due to the recognition of other-than-temporary impairment associated with our equity method investment in NANTibody for the year ended December 31, 2017. (See Note 9 to the notes to our consolidated financial statements accompanying this Form 10-K).

*Net Income (Loss).* Net income (loss) for the years ended December 31, 2017 and 2016 was \$11.1 million and \$(63.9) million, respectively. The increase in net income is mainly attributable to revenue recognized from the intangibles transferred to Celularity as a result of closing the Contribution Agreement in 2017.

#### **Comparison of the Years Ended December 31, 2016 and 2015**

*Revenues.* Revenues were \$8,152 thousand for the year ended December 31, 2016, as compared to \$4,590 thousand for the year ended December 31, 2015. The net increase of \$3,562 thousand is primarily due to an increase in royalty and licensing activities for the year ended December 31, 2016 compared to the corresponding period of 2015. Royalties and license revenues increased \$3,052 thousand for the year ended December 2016 as compared to the same period of 2015. Sales and service revenues generated from the sale of customized reagents and providing contract development services increased \$1,007 thousand for the year ended December 2016 as compared to the same period of 2015.

In June 2014, the NIAID, a division of the NIH, awarded us the Staph Grant III Award to support the advanced preclinical development of human bispecific antibody therapeutics to prevent and treat Staph infections, including MRSA. The project period for the Staph Grant III Award covered a two-year period which commenced in June 2014, with total funds available of approximately \$1 million per year for up to 2 years. During the years ended December 31, 2016 and 2015, we recorded \$699 thousand and \$884 thousand of revenue, respectively, associated with the Staph Grant III Award.

In June 2014, we were awarded the Phase I STTR Grant Award. The Phase I STTR Grant Award was to support the preclinical development of novel anti-*Pseudomonas aeruginosa* mAb immunotherapy or an antibody-mediated targeted antibiotic delivery vehicle. Each modality may be an effective and safe stand-alone therapy and/or a component of a “cocktail” therapeutic option for prevention and treatment of *P. aeruginosa* infections. The project period for the Phase I STTR Grant Award covered a two-year period which commenced in July 2014, with total funds available of approximately \$300 thousand per year for up to 2 years. During the years ended December 31, 2016 and 2015, we recorded \$256 thousand and \$302 thousand of revenue, respectively, associated with the Phase I STTR Grant Award.

In July 2014, we were awarded a Phase I STTR grant from the National Cancer Institute (“NCI”), a division of the NIH, entitled “Targeting of Myc-Max Dimerization for the Treatment of Cancer” (the “Phase I Myc Grant Award”). The Phase I Myc Grant Award was to support the preclinical development of the Myc inhibitor, which interferes with the protein-protein interaction (“PPI”) between Myc and its obligatory dimerization partner, Max, preventing sequence-specific binding to DNA and subsequent initiation of oncogenic transformation. The project period for the Phase I Myc Grant Award covered a one-year period which commenced in August 2014, with total funds available of approximately \$225 thousand. During the years ended December 31, 2016 and 2015, we recorded \$0 and \$139 thousand of revenue, respectively associated with the Phase I Myc Grant Award.

In August 2014, we were awarded a Phase I Small Business Innovation Research (“SBIR”) grant from the National Heart, Lung, and Blood Institute (“NHBLI”), a division of the NIH, entitled “Human Anti-WISP-1 Antibodies for Treatment of Idiopathic Pulmonary Fibrosis” (the “Phase I WISP1 Grant Award”). The Phase I WISP1 Grant Award was to advance our immunotherapy targeting WNT-1 Inducible Signaling Protein-1 (“WISP1”) for the treatment of Idiopathic Pulmonary Fibrosis (“IPF”). WISP1 is a protein that has been shown to be upregulated in IPF, linked to key growth factors, cellular proliferation, hyperplasia and is correlated with late stage cancers. IPF is a fatal disease, which results in progressive loss of lung function due to fibrosis of the lungs. The project period for the Phase I WISP1 Grant Award covered a one-year period which commenced in August 2014, with total funds available of approximately \$225 thousand. During the years ended December 31, 2016 and 2015, we recorded \$51 thousand and \$156 thousand of revenue, respectively, associated with the Phase I WISP1 Grant Award.

Revenues from a human immuno-oncology anti PD-L1 license agreement for each of the years ended December 31, 2016 and 2015, were \$50 thousand. We had no other revenue during the years ended December 31, 2016 and 2015 as we have not yet developed any product candidates for commercialization or earned any licensing or royalty payments.

We expect that any revenue we generate will fluctuate from year to year as a result of the unpredictability of the demand for products and services offered as well as the timing and amount of grant awards, research and development reimbursements and other payments received under any strategic collaborations.

*Cost of revenues.* Cost of revenues for the years ended December 31, 2016 and 2015 were \$811 thousand and \$1,950 thousand, respectively. The decrease is due primarily to lower direct materials and overhead costs for the year ended December 31, 2016 compared to the prior year period. The costs generally include employee salaries and benefits, direct materials and

overhead costs including rent, depreciation, utilities, facility maintenance and insurance. We expect cost of revenues to fluctuate with related revenues.

*Research and Development Expenses.* Research and development expenses for the years ended December 31, 2016 and 2015 were \$42,175 thousand and \$31,343 thousand, respectively. Research and development expenses include the costs related to our RTX program activities towards entering into future clinical trials, costs to identify, isolate and advance human antibody drug candidates derived from our libraries as well as advancing our ADC preclinical drug candidates, preclinical testing expenses and the expenses associated with fulfilling our development obligations related to the NIH Grants. Such expenses consist primarily of salaries and personnel related expenses, stock-based compensation expense, clinical development expenses, preclinical testing, lab supplies, consulting costs, depreciation and other expenses. The increase of \$10,832 thousand is primarily attributable to preclinical testing and completion of our BE registration trial prior to its sale in July 2015, salaries and compensation related expense, consulting and lab supply costs incurred in connection with our expanded research and development activities and activities to advance RTX into clinical trials and potentially pursue other development activities. We expect research and development expenses to increase in absolute dollars as we: (i) advance RTX and our other product candidates into clinical trials and pursue other development, acquire, develop and manufacture clinical trial materials and increase other regulatory operating activities, (ii) incur incremental expenses associated with our efforts to further advance a number of potential product candidates into preclinical development activities, (iii) continue to identify and advance a number of fully human therapeutic antibody and ADC preclinical product candidates, (iv) incur higher salary, lab supply and infrastructure costs incurred in connection with supporting all of our programs, (v) invest in our joint ventures, collaborations or other third party agreements, and (vi) expand our corporate infrastructure.

*Acquired In-process Research and Development Expenses.* Acquired in-process research and development expenses for the years ended December 31, 2016 and 2015 were \$45,000 thousand and \$24,013 thousand, respectively. Acquired in-process research and development expenses for the year ended December 31, 2016 include costs associated with the acquisition of acquired in-process research and development from Mabtech Limited and LA Cell. Acquired in-process research and development expenses for the year ended December 31, 2015 include costs associated with the purchase price of the license rights from Mabtech Limited, the purchase price of the license rights from the City of Hope and the purchase price of CARgenix Holdings LLC and BDL Products, Inc.

*General and Administrative Expenses.* General and administrative expenses for the years ended December 31, 2016 and 2015 were \$24,219 thousand and \$20,132 thousand, respectively. General and administrative expenses consist primarily of salaries and personnel related expenses for executive, finance and administrative personnel, stock-based compensation expense, professional fees, infrastructure expenses, legal and accounting expenses and other general corporate expenses. The increase of \$4,087 thousand is primarily attributable to higher salaries and related compensation expenses, stock-based compensation, legal costs related to acquisitions, general corporate and intellectual property matters, consulting and business development expenses and higher compliance costs associated with our public reporting obligations. We expect general and administrative expenses to increase in absolute dollars as we: (i) incur incremental expenses associated with expanded operations and development efforts, (ii) expand our efforts to ensure continued compliance with our public reporting obligations, (iii) build our infrastructure, and (iv) invest in our joint ventures, collaborations or other third party agreements.

*Intangible Amortization.* Intangible amortization for the years ended December 31, 2016 and 2015 was \$845 thousand and \$1,157 thousand, respectively. The decrease in the year ended December 31, 2016 as compared to the same period in 2015 is due to license rights being amortized on a straight line basis through the date those assets were held for sale.

*Gain or Loss on derivative liability.* Gain on derivative liability for the year ended December 31, 2016 was \$5,520 thousand compared to a loss on derivative liability of \$3,360 thousand for the year ended December 31, 2015. The increase in the year ended December 31, 2016 as compared to the same period in 2015 is due to the expiration of the unexercised derivative liability on March 31, 2016 associated with the cancelled call option on shares of NantKwest, Inc. stock.

*Interest Expense.* Interest expense for the years ended December 31, 2016 and 2015 was \$1,610 thousand and \$1,652 thousand, respectively.

*Interest Income.* Interest income for the years ended December 31, 2016 and 2015 was \$272 thousand and \$24 thousand, respectively. The increase in interest income resulted in an increase in notes receivables in the current year compared to prior period. We expect that continued low interest rates will significantly limit our interest income in the near term.

*Income tax expense (benefit).* Income tax benefit for the year ended December 31, 2016 was \$896 thousand. Income tax expense for the year ended December 31, 2015 was \$36,314 thousand.

*Income (loss) on equity method investments.* Gain on equity method investments for the year ended December 31, 2016 was \$435 thousand compared to a loss on equity investments of \$4,041 thousand for the year ended December 31, 2015. The increase was primarily due to the recognition of our portion of the loss from operations from our joint venture entities which did not exist during the same period in 2015.

*Net Loss.* Net loss for the years ended December 31, 2016 and 2015 was \$63,937 thousand and \$50,074 thousand, respectively. The increase in net loss is mainly attributable to the expanded research and development activities, and an increase in acquired in-process research and development and general and administrative activities.

## **Liquidity and Capital Resources**

As of December 31, 2017, we had \$20.4 million in cash and cash equivalents attributable in part to the net proceeds received in connection with the Private Placement. Pursuant to the Securities Purchase Agreement, on December 21, 2017, we issued and sold the Notes and the Warrants to the Purchasers in a private placement transaction.

At any time and from time to time before the Maturity Date, each Purchaser shall have the option to convert any portion of the outstanding principal amount of such Purchaser's Note that is equal to or greater than the lesser of: (1) \$4,000,000, and (2) the then-outstanding principal amount of such Purchaser's Note into shares of our common stock at a price per share of \$2.26875, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions. Accrued but unpaid interest on the Notes shall be paid in cash semi-annually in arrears on or prior to the 30th day of June or 31st day of December of each calendar year commencing with the year ending December 31, 2018. If a Purchaser elects to convert any of the principal amount of their Note, then all accrued but unpaid interest on such portion of the principal amount shall become due and payable in cash. The Notes contain restrictive covenants and event of default provisions that are customary for transactions of this type.

Each Warrant has an exercise price of \$2.61 per share, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions, will become exercisable on June 20, 2018, has a term of five and a half years and is exercisable on a cash basis, unless there is not an effective registration statement covering the resale of the shares issuable upon exercise of the Warrants, in which case the Warrants shall also be exercisable on a cashless exercise basis.

If we issue additional equity securities to raise funds, the ownership percentage of existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of common stock. If we are unable to raise additional capital in sufficient amounts or on terms acceptable to us we may have to significantly delay, scale back or discontinue the development or commercialization of one or more of our product candidates. We may also seek collaborators for one or more of our current or future product candidates at an earlier stage than otherwise would be desirable or on terms that are less favorable than might otherwise be available. These factors raise substantial doubt about our ability to continue as a going concern. Our financial statements and related notes thereto included elsewhere in this Annual Report on Form 10-K do not include any adjustments that might result from the outcome of this uncertainty.

*Cash Flows from Operating Activities.* Net cash used for operating activities was \$99.2 million for 2017 and is primarily due to an increase in cash flow associated with accrued payroll, deferred rent, accrued expenses and other operating activities.

We expect to continue to incur substantial and increasing losses and negative net cash flows from operating activities as we seek to expand and support our clinical and preclinical development and research activities and fund our joint ventures, collaborations and other third party agreements.

*Cash Flows from Investing Activities.* Net cash used for investing activities was \$16.5 million for 2017 as compared to net cash used for investing activities of \$17.5 million for 2016.

We expect to increase our investment in equipment as we seek to expand and progress our research and development capabilities.

*Cash Flows from Financing Activities.* Net cash provided by financing activities was \$53.7 million for 2017, which was primarily from the net proceeds from the issuance of common stock and the issuance of the Notes in the Private Placement partially offset by the repayment of the Hercules loan.

*Future Liquidity Needs.* We have principally financed our operations through underwritten public offerings and private equity financings with aggregate net proceeds of \$211.3 million since inception, as we have not generated any product related revenue from our principal operations to date, and do not expect to generate significant revenue for several years, if ever. We



will need to raise additional capital before we exhaust our current cash resources in order to continue to fund our research and development, including our plans for clinical and preclinical trials and new product development, as well as to fund operations generally. As and if necessary, we will seek to raise additional funds through various potential sources, such as equity and debt financings, or through corporate collaboration and license agreements. We can give no assurances that we will be able to secure such additional sources of funds to support our operations, or, if such funds are available to us, that such additional financing will be sufficient to meet our needs. These conditions, among others, raise substantial doubt about the Company's ability to continue as a going concern.

We anticipate that we will continue to incur net losses into the foreseeable future as we: (i) advance RTX and other product candidates into clinical trials and potentially pursue other development, (ii) continue to identify and advance a number of potential mAb and ADC product candidates into preclinical development activities, (iii) continue our development of, and seek regulatory approvals for, our product candidates, (iv) expand our corporate infrastructure, including the costs associated with being a Nasdaq listed public company, and (v) incur our share of joint venture and collaboration costs for our products and technologies.

We plan to continue to fund our operating losses and capital funding needs through public or private equity or debt financings, strategic collaborations, licensing arrangements, asset sales, government grants or other arrangements.

In November 2014, we filed a universal shelf registration statement on Form S-3 with the U.S. Securities and Exchange Commission (the "SEC"), which was declared effective by the SEC in December 2014 (the "2014 Shelf Registration Statement"). The 2014 Shelf Registration Statement provided us with the ability to offer up to \$250 million of securities, including equity and other securities as described in the registration statement. Included in the November 2014 shelf registration was a sales agreement prospectus covering the offering, issuance and sale by us of up to a maximum aggregate offering price of \$50.0 million of our common stock that could have been issued and sold under a sales agreement with MLV & Co. LLC (the "2014 ATM Facility"). During the twelve months ended December 31, 2017, we sold approximately \$3.6 million in shares of common stock under the 2014 ATM Facility. On November 9, 2017, we filed a universal shelf registration statement on Form S-3 with the SEC (the "2017 Shelf Registration Statement") to replace the 2014 Shelf Registration Statement. The 2014 Shelf Registration Statement expired on December 6, 2017, when the New Shelf Registration Statement was declared effective by the SEC. Included in the 2017 Shelf Registration Statement is a sales agreement prospectus covering the offering, issuance and sale by us of up to a maximum aggregate offering price of \$100.0 million of our common stock that may be issued and sold under a sales agreement with B. Riley FBR, Inc. (the "ATM Facility"). During the twelve months ended December 31, 2017, we sold approximately \$0.9 million in shares of common stock under the ATM Facility. We have the ability to offer up to \$99.1 million of additional shares of common stock under the ATM Facility, subject to certain limitations.

Pursuant to this Shelf Registration Statement, we may offer such securities from time to time and through one or more methods of distribution, subject to market conditions and our capital needs. Specific terms and prices will be determined at the time of each offering under a separate prospectus supplement, which will be filed with the SEC at the time of any offering.

On April 13, 2017, we entered into the Underwriting Agreement with the Underwriters, relating to the Offering of 23,625,084 shares of our common stock. The public offering price was \$2.00 per share of our common stock and the Underwriters agreed to purchase the shares of common stock pursuant to the Underwriting Agreement at a price of \$1.8571 per share.

On April 19, 2017, the Offering was completed and resulted in net proceeds of approximately \$43.5 million, after deducting underwriting discounts and commissions and estimated Offering expenses payable by us.

On December 11, 2017, we entered into a Securities Purchase Agreement (the "Securities Purchase Agreement" or "Note SPA") with certain accredited investors (collectively, the "Purchasers"). Pursuant to the Securities Purchase Agreement, on December 21, 2017, we issued and sold to the Purchasers, in a private placement transaction (the "Private Placement"), (1) convertible promissory notes in an aggregate principal amount of \$50,000,000 (the "Notes"), which will accrue simple interest at a rate equal to 5.0% per annum and mature upon the earlier to occur of (a) December 21, 2022, and (b) the date of the closing of a change in control (the "Maturity Date"), and (2) warrants (the "Warrants") to purchase an aggregate of 12,121,210 shares of our common stock.

At any time and from time to time before the Maturity Date, each Purchaser shall have the option to convert any portion of the outstanding principal amount of such Purchaser's Note that is equal to or greater than the lesser of: (1) \$4,000,000, and (2) the then-outstanding principal amount of such Purchaser's Note into shares of our common stock at a price per share of \$2.26875, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions. Accrued but unpaid interest on the Notes shall be paid in cash semi-annually in arrears on or prior to the 30th day of June and 31st day of December of each calendar year commencing with the year ending December 31, 2018. If a Purchaser elects to convert any of

the principal amount of their Note, then all accrued but unpaid interest on such portion of the principal amount shall become due and payable in cash. The Notes contain restrictive covenants and event of default provisions that are customary for transactions of this type. If the Notes are converted, substantial dilution to existing stockholders would result.

Each Warrant has an exercise price of \$2.61 per share, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions, will become exercisable on June 20, 2018, has a term of five and a half years and is exercisable on a cash basis, unless there is not an effective registration statement covering the resale of the shares issuable upon exercise of the Warrants, in which case the Warrants shall also be exercisable on a cashless exercise basis.

If we raise additional funds by issuing equity securities, substantial dilution to existing stockholders would result. If we raise additional funds by incurring debt financing, the terms of the debt may involve significant cash payment obligations as well as covenants and specific financial ratios that may restrict our ability to operate our business.

### **Critical Accounting Policies**

Our consolidated financial statements are prepared in accordance with U.S. GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We evaluate our estimates and assumptions on an ongoing basis. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Our actual results could differ from these estimates.

We believe the following accounting policies and estimates are most critical to aid in understanding and evaluating our reported financial results.

*Stock-Based Compensation.* We account for stock-based compensation in accordance with authoritative guidance for stock-based compensation, which requires us to measure the cost of employee services received in exchange for equity incentive awards, including stock options, based on the grant date fair value of the award. The fair value is estimated using the Black-Scholes option pricing model. The resulting cost is recognized over the period during which the employee is required to provide services in exchange for the award, which is usually the vesting period. We recognize compensation expense over the vesting period using the straight-line method and classify these amounts in the consolidated statements of operations based on the department to which the related employee reports. To the extent that we issue future stock incentive awards to employees, our stock-based compensation expense will be increased by the additional unearned compensation resulting from such additional issuances.

We account for equity instruments, including restricted stock or stock options, issued to non-employees in accordance with authoritative guidance for equity based payments to non-employees. Stock options issued to non-employees are accounted for at their estimated fair value determined using the Black-Scholes option-pricing model. The fair value of options granted to non-employees is re-measured as they vest, and the resulting increase in value, if any, is recognized as expense during the period the related services are rendered. Restricted stock issued to non-employees is accounted for at its estimated fair value upon vesting. We evaluate the assumptions used to value stock awards to non-employees on a periodic basis. If factors change and we employ different assumptions, including any significant change in the estimated fair value of common stock, stock-based compensation expense may differ significantly from what we have recorded historically. In addition, to the extent that we issue future stock incentive awards to non-employees, our stock-based compensation expense will be increased by the additional unearned compensation resulting from such additional issuances.

*Revenue Recognition.* The revenue from grant awards is based upon subcontractor costs and internal costs incurred that are specifically covered by each grant, and where applicable, plus a facilities and administrative rate that provides funding for overhead expenses. These revenues are recognized when expenses have been incurred by subcontractors or when we incur internal expenses that are related to the grant. Any amounts received prior to satisfying our revenue recognition criteria are recorded as deferred revenue. (See Note 3 to the notes to our consolidated financial statements accompanying this Form 10-K).

License fees for the licensing of product rights are recorded as deferred revenue upon receipt of cash and recognized as revenue on a straight-line basis over the license period, with the exception of license agreements with no remaining performance obligations or undelivered obligations.

Revenues from sales and services are generated from the sale of customized reagents and providing contract development services. Reagents are used for preparing ADCs, these reagents include industrial standard cytotoxins, linkers, and linker-toxins. The contract development services include providing synthetic expertise to customer's synthesis by delivering them proprietary cytotoxins, linkers and linker-toxins and ADC service using industry standard toxin and antibodies provided

by customers. Revenue is recognized when (i) persuasive evidence of an arrangement exists, (ii) the product has been shipped or the services have been rendered, (iii) the price is fixed or determinable, and (iv) collectability is reasonably assured.

*Investments in Other Entities.* We hold a portfolio of investments in equity securities that are accounted for under either the equity method or cost method. Investments in entities over which we have significant influence but not a controlling interest are accounted for using the equity method, with our share of earnings or losses reported in loss on equity investments.

Our cost method investments are included in cost method investments on the consolidated balance sheets. Our equity method investments are included in equity method investments on the consolidated balance sheets.

All investments are reviewed on a regular basis for possible impairment. If an investment's fair value is determined to be less than its net carrying value and the decline is determined to be other-than-temporary, the investment is written down to its fair value. Such an evaluation is judgmental and dependent on specific facts and circumstances. Factors considered in determining whether an other-than-temporary decline in value has occurred include: the magnitude of the impairment and length of time that the market value was below the cost basis; financial condition and business prospects of the investee; our intent and ability to retain the investment for a sufficient period of time to allow for recovery in market value of the investment; issues that raise concerns about the investee's ability to continue as a going concern; any other information that we may be aware of related to the investment. We do not report the fair value of our equity investments in non-publicly traded companies because it is not practical to do so. (See Note 9 to the notes to our consolidated financial statements accompanying this Form 10-K).

*Debt With Detachable Warrants.* Debt with detachable warrants are evaluated for the classification of warrants as either equity instruments, derivative liabilities, or liabilities depending on the specific terms of the warrant agreement. In circumstances in which debt is issued with equity-classified warrants, the proceeds from the issuance of convertible debt are first allocated to the debt and the warrants at their relative estimated fair values. The portion of the proceeds so allocated to the warrants are accounted for as paid-in capital and a debt discount. The remaining proceeds, as further reduced by discounts created by the bifurcation of embedded derivatives and beneficial conversion features, are allocated to the debt. We account for debt as liabilities measured at amortized cost and amortizes the resulting debt discount from the allocation of proceeds, to interest expense using the effective interest method over the expected term of the debt instrument. We consider whether there are any embedded features in debt instruments that require bifurcation and separate accounting as derivative financial instruments pursuant to ASC 815.

If the amount allocated to the convertible debt results in an effective per share conversion price less than the fair value of our common stock on the commitment date, the intrinsic value of this beneficial conversion feature is recorded as a discount to the convertible debt with a corresponding increase to additional paid in capital. The beneficial conversion feature discount is equal to the difference between the effective conversion price and the fair value of our common stock at the commitment date, unless limited by the remaining proceeds allocated to the debt.

*Income Taxes.* The provisions of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 740-10, *Uncertainty in Income Taxes*, address the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under ASC Topic 740-10, we may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. We have determined that we have uncertain tax positions.

We account for income taxes using the asset and liability method to compute the differences between the tax basis of assets and liabilities and the related financial amounts, using currently enacted tax rates.

We have deferred tax assets, which are subject to periodic recoverability assessments. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that more likely than not will be realized. As of December 31, 2016, we maintained a full valuation allowance against our deferred tax assets, with the exception of an amount equal to our deferred tax liabilities, which can be expected to reverse over a definite life.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation referred to as the Tax Cuts and Jobs Act (the "Tax Act"), which significantly revises the Internal Revenue Code of 1986, as amended. The Tax Act contains, among other things, significant changes to corporate taxation, including reduction of the corporate tax rate from a top marginal rate of 35% to a flat rate of 21% for tax years beginning after December 31, 2017, limitations of the deduction for net operating losses to 80% of current year taxable income, and elimination of net operating loss carrybacks.

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 (“SAB 118”), which allows us to record provisional amounts during a measurement period not to extend beyond one year of the enactment date. We are currently analyzing the impact of the various provisions of the Tax Act. The ultimate impact may differ from the provisional amounts recorded. We expect to complete our analysis within the measurement period in accordance with SAB 118.

*Acquisitions and Intangibles.* We have engaged in business combination activity. The accounting for business combinations requires management to make judgments and estimates of the fair value of assets acquired, including the identification and valuation of intangible assets, as well as liabilities assumed. Such judgments and estimates directly impact the amount of goodwill recognized in connection with each acquisition, as goodwill presents the excess of the purchase price of an acquired business over the fair value of its net tangible and identifiable intangible assets.

*Acquired In-Process Research and Development Expense.* We have acquired and may continue to acquire the rights to develop and commercialize new drug candidates. The up-front payments to acquire a new drug compound, as well as future milestone payments, may be immediately expensed as acquired in-process research and development (“IPR&D”) provided that the drug has not achieved regulatory approval for marketing and, absent obtaining such approval, have no alternative future use. Prior to November 8, 2016, all acquired IPR&D was expensed immediately. The acquired in-process research and development related to the business combination of Scilex Pharmaceuticals Inc. (“Scilex”) for which certain products are under development and expected to be commercialized in the near future was capitalized and recorded within “Intangibles, net” on the accompanying consolidated balance sheet. Capitalized IPR&D will be reviewed annually for impairment or more frequently as changes in circumstance or the occurrence of events suggest that the remaining value may not be recoverable.

*Acquisition Consideration Payable - Gain on Contingent Liabilities.* Acquisition consideration payable relates to our acquisition of businesses and various other assets and is recorded on our consolidated balance sheets at fair value and is re-measured at each balance sheet date until such contingent liabilities have been settled, with changes in fair value recorded as gain on contingent liabilities. We estimate the fair value of contingent consideration based on level 3 inputs primarily driven by the probability of achieving certain financing or operating related milestones.

### Contractual Obligations

As of December 31, 2017, our contractual obligations are as follows (in thousands):

|                                | Payments Due by Fiscal Year |          |          |          |            |        | Total      |
|--------------------------------|-----------------------------|----------|----------|----------|------------|--------|------------|
|                                | 2018                        | 2019     | 2020     | 2021     | Thereafter |        |            |
| Convertible debt (See Note 12) | \$ 2,500                    | \$ 2,500 | \$ 2,500 | \$ 2,500 | \$ 52,500  | \$     | \$ 62,500  |
| Operating leases               | 5,304                       | 5,287    | 5,315    | 4,949    | 5,003      | 20,403 | 46,261     |
| Total financial obligations    | \$ 7,804                    | \$ 7,787 | \$ 7,815 | \$ 7,449 | \$ 72,903  | \$     | \$ 108,761 |

### Off-Balance Sheet Arrangements

From our inception through December 31, 2017, we did not engage in any off-balance sheet arrangements, as defined in Item 303(a)(4) of Regulation S-K.

### Recent Accounting Pronouncements

Refer to Note 3, “Nature of Operations and Summary of Significant Accounting Policies,” in the accompanying notes to the consolidated financial statements for a discussion of recent accounting pronouncements.

### Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

*Interest Rate Risk.* Our exposure to market risk is confined to our cash and cash equivalents. We have cash and cash equivalents and invest primarily in high-quality money market funds, which we believe are subject to limited credit risk. Due to the low risk profile of our investments, an immediate 10% change in interest rates would not have a material effect on the fair market value of our portfolio. We do not believe that we have any material exposure to interest rate risk arising from our investments.

*Capital Market Risk.* We currently do not have significant revenues from grants or sales and services and we have no product revenues from our planned principal operations and therefore depend on funds raised through other sources. One source of funding is through future debt or equity offerings. Our ability to raise funds in this manner depends upon, among other things, capital market forces affecting our stock price.

**Item 8. Financial Statements and Supplementary Data.**

Our consolidated financial statements and supplementary data required by this item are set forth at the pages indicated in Item 15(a)(1) and (a)(2), respectively, of this Form 10-K.

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.**

**Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's regulations, rules and forms and that such information is accumulated and communicated to our management, including our chief executive officer and principal financial and accounting officer, as appropriate, to allow for timely decisions regarding required disclosure.

In designing and evaluating the Company's disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. As required by Rule 13a-15(b) promulgated by the SEC under the Exchange Act, we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and principal financial and accounting officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Form 10-K. Based on the foregoing, our chief executive officer and principal financial and accounting officer concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this Form 10-K as a result of the material weaknesses described below.

**Management's Annual Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for our company. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f) promulgated under the Exchange Act, as a process designed by, or under the supervision of, a company's principal executive officer and principal financial and accounting officer and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP and includes those policies and procedures that:

- (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;
- (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that receipts and expenditures of the company are being made in accordance with authorizations of management and directors of the company; and
- (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate

because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible enhancements to controls and procedures.

We conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In March 2017, in connection with the preparation of our 2016 financial statements, we identified certain purchase agreements which contained terms for contingent consideration that were not identified timely and accounted for in our historical financial statements on a timely basis. Further, certain other purchase agreements containing terms for contingent consideration were identified timely, but we failed to adjust the liabilities for changes in fair value at each subsequent reporting period. Accordingly, we did not appropriately account for liabilities for contingent consideration payable and the related adjustments to earnings.

Based on these findings and the criteria discussed above, our management identified a material weakness in its review controls over unusual or non-recurring and significant transactions: specifically, our controls were not properly designed to provide reasonable assurance that we (1) timely identify and assess the accounting implications of terms in unusual or non-recurring agreements and (2) reassess the valuation of associated assets or liabilities at the end of each reporting period. The material weakness did not result in a restatement of previously issued annual consolidated financial statements, but it did result in an immaterial restatement of our 2016 quarterly financial information included in Note 19 of the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2016.

During 2017, the Company undertook remediation measures, including designing new internal controls which, if effectively implemented, would provide reasonable assurance that we (1) timely identify and assess the accounting implications of terms in unusual or non-recurring agreements and (2) reassess the valuation of associated assets or liabilities at the end of each reporting period. These included measures designed to improve centralized documentation control, improve the internal communication procedures between senior executive management, accounting personnel, and related business owners, leverage external accounting experts as appropriate to perform the necessary reviews, and strengthen policies and procedures related to the transferring of responsibilities and the handoff of personnel duties. However, the Company concluded that these controls did not operate effectively as of December 31, 2017, which has been identified as a material weakness in our internal control over financial reporting. This material weakness did not result in any material misstatements to the financial statements.

Additionally, in connection with the restatement of the Company's interim condensed consolidated financial statements for the three and nine months ended September 30, 2017 to correct a material error in our equity method investments, our management identified a material weakness in our review controls with respect to our equity method investments. Specifically, our review controls to assess and monitor the appropriateness of the financial information provided by our equity method investees were not operating effectively beginning in the quarter ended September 30, 2017, to provide reasonable assurance that we timely identify and assess the accounting implications of transactions and events occurring at our equity method investees and properly report such investee financial information in our financial statements.

These material weaknesses are principally the result of insufficient accounting resources, including a Chief Financial Officer, to appropriately perform, and to monitor the performance of, control activities. Such material weaknesses could result in material misstatements of the aforementioned account balances or disclosures in the annual or interim consolidated financial statements that would not be prevented or detected.

Accordingly, our chief executive officer and principal financial and accounting officer concluded that, at December 31, 2017, our internal control over financial reporting was not effective. Notwithstanding the material weaknesses in our internal control over financial reporting, based on the additional analyses and procedures performed, we believe the consolidated financial statements included in our Annual Report on Form 10-K, are fairly presented in all material respects, in conformity with accounting principles generally accepted in the United States of America.

The effectiveness of our internal control over financial reporting at December 31, 2017 has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report which appears herein.

### **Remediation Efforts to Address Material Weaknesses**

As a result of the material weaknesses, we are in the process of implementing remediation measures including, but not limited to, hiring a Chief Financial Officer and other personnel with sufficient accounting expertise to improve the operating effectiveness of the Company's review controls and monitoring activities and utilizing external accounting experts as appropriate. We believe that our remediation measures, if effectively implemented, will provide reasonable assurance that we timely identify terms in agreements that could have material accounting implications, assess the accounting and disclosure implications of the terms, and account for such items in the financial statements appropriately. Further, we will implement remediation measures including, but not limited to, establishing monitoring procedures to ensure that our existing controls to assess and evaluate the appropriateness of the financial information provided by our equity method investees operate as designed. We believe that our remediation measures, when implemented, will provide reasonable assurance that we timely identify transactions and events occurring at our equity method investees that could have material accounting implications, assess the accounting and disclosure implications of the transactions and events, and account for such items in the financial statements appropriately in the time period in which such transactions and events occur. Any failure to implement these improvements to our internal control over financial reporting would result in continued material weaknesses in our internal control and could impact our ability to produce reliable financial reports, effectively manage the company or prevent fraud, and could potentially harm our business and our performance.

### **Changes in Internal Control Over Financial Reporting**

There has been no change in our internal control over financial reporting during the quarter ended December 31, 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. As identified above under "Management's Annual Report on Internal Control Over Financial Reporting," two material weaknesses were identified in our internal control over financial reporting as of December 31, 2017. Our plans for remediating such material weaknesses, which would constitute changes in our internal control over financial reporting prospectively, when such controls are effectively implemented, are also enumerated above.

#### **Item 9B. Other Information.**

On March 16, 2018, Dean Ferrigno, our Vice President of Finance and Chief Accounting Officer, notified us that he will be resigning from his roles with the Company, effective March 23, 2018 in order to pursue other opportunities.

### **PART III**

Certain information required by Part III is omitted from this Annual Report on Form 10-K since we intend to file our definitive Proxy Statement for our next Annual Meeting of Stockholders, pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended (the "2018 Proxy Statement"), no later than April 30, 2018, and certain information to be included in the 2018 Proxy Statement is incorporated herein by reference. To the extent that we do not file the 2018 Proxy Statement by April 30, 2018, we will file an amendment to this Annual Report on Form 10-K that includes the information required by Part III.

#### **Item 10. Directors, Executive Officers and Corporate Governance.**

The information required by this item regarding our directors, executive officers and corporate governance will be included in our 2018 Proxy Statement and is incorporated herein by reference.

#### **Item 11. Executive Compensation.**

The information required by this item regarding executive compensation will be included in our 2018 Proxy Statement and is incorporated herein by reference.

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information required by this item regarding security ownership of certain beneficial owners and management will be included in our 2018 Proxy Statement and is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information required by this item regarding certain relationships and related transactions and director independence will be included in our 2018 Proxy Statement and is incorporated herein by reference.

**Item 14. Principal Accounting Fees and Services.**

The information required by this item regarding principal accounting fees and services will be included in our 2018 Proxy Statement and is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules.**

(a)(1) Financial Statements

Reference is made to the Index to Consolidated Financial Statements of Sorrento Therapeutics, Inc. appearing on page F-1 of this Form 10-K.

(a)(2) Financial Statement Schedules

Schedule II – Valuation of Qualifying Accounts

All other schedules not listed above have been omitted because of the absence of conditions under which they are required, or because the required information is included in the consolidated financial statements or the notes thereto.

(a)(3) Exhibits



| Exhibit No. | Description  |
|-------------|--|
| 2.1*        | <a href="#"><u>Agreement and Plan of Merger between Sorrento Therapeutics, Inc. and IgDraSol, Inc. dated September 9, 2013 (incorporated by reference to Exhibit 2.1 to the Registrant’s Current Report on Form 8-K filed with the SEC on September 11, 2013).</u></a>   |
| 2.2*        | <a href="#"><u>Stock Purchase Agreement, dated November 8, 2016, by and among Sorrento Therapeutics, Inc., Scilex Pharmaceuticals Inc., the stockholders of Scilex Pharmaceuticals Inc. party thereto and SPI Shareholders Representative, LLC, as representative of the stockholders of Scilex Pharmaceuticals Inc. party thereto (incorporated by reference to Exhibit 2.1 to the Registrant’s Current Report on Form 8-K filed with the SEC on November 8, 2016).</u></a> |
| 2.3*        | <a href="#"><u>Share Purchase Agreement, dated April 27, 2017, by and among Sorrento Therapeutics, Inc., TNK Therapeutics, Inc., Virttu Biologics, Limited, the shareholders of Virttu Biologics Limited and Dayspring Ventures Limited as representative of the shareholders of Virttu Biologics Limited (incorporated by reference to Exhibit 2.1 to the Registrant’s Current Report on Form 8-K filed with the SEC on April 28, 2017).</u></a>                            |
| 3.1         | <a href="#"><u>Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Registrant’s Quarterly Report on Form 10-Q filed with the SEC on May 15, 2013).</u></a>  |
| 3.2         | <a href="#"><u>Certificate of Amendment of the Restated Certificate of Incorporation of Sorrento Therapeutics, Inc. (incorporated by reference to Exhibit 3.1 to the Registrant’s Current Report on Form 8-K filed with the SEC on August 1, 2013).</u></a>  |
| 3.3         | <a href="#"><u>Bylaws (incorporated by reference to Exhibit 3.2 to the Registrant’s Current Report on Form 8-K filed with the SEC on October 23, 2009).</u></a>  |
| 3.4         | <a href="#"><u>Certificate of Designation of Rights, Preferences and Privileges of Series A Junior Participating Preferred Stock of Sorrento Therapeutics, Inc. (incorporated by reference to Exhibit 3.1 to the Registrant’s Current Report on Form 8-K filed with the SEC on November 12, 2013).</u></a>   |
| 4.1         | <a href="#"><u>Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant’s Current Report on Form 8-K filed with the SEC on October 23, 2009).</u></a>   |
| 4.2         | <a href="#"><u>Amended and Restated Rights Agreement, dated as of December 21, 2015 by and between Sorrento Therapeutics, Inc. and Philadelphia Stock Transfer, Inc., as rights agent (incorporated by reference to Exhibit 4.1 to the Registrant’s Current Report on Form 8-K filed with the SEC on December 21, 2015).</u></a>   |
| 4.3         | <a href="#"><u>Common Stock Purchase Warrant issued to Cambridge Equities, LP. (incorporated by reference to Exhibit 4.4 to the Registrant’s Annual Report on Form 10-K filed with the SEC on March 16, 2015).</u></a>   |
| 4.4         | <a href="#"><u>Securities Purchase Agreement, dated as of April 3, 2016, by and among Sorrento Therapeutics, Inc., ABG SRNE Limited and Ally Bridge LB Healthcare Master Fund Limited (incorporated by reference to Exhibit 4.5 to the Registrant’s Registration Statement on Form S-3 filed with the SEC on June 29, 2016).</u></a>   |
| 4.5         | <a href="#"><u>Securities Purchase Agreement, dated as of April 3, 2016, by and between Sorrento Therapeutics, Inc. and FREJOY Investment Management Co., Ltd. (incorporated by reference to Exhibit 4.6 to the Registrant’s Registration Statement on Form S-3 filed with the SEC on June 29, 2016).</u></a>  |
| 4.6         | <a href="#"><u>Securities Purchase Agreement, dated as of April 3, 2016, by and between Sorrento Therapeutics, Inc. and Beijing Shijilongxin Investment Co., Ltd. (incorporated by reference to Exhibit 4.7 to the Registrant’s Registration Statement on Form S-3 filed with the SEC on June 29, 2016).</u></a>   |
| 4.7         | <a href="#"><u>Securities Purchase Agreement, dated as of April 3, 2016, by and between Sorrento Therapeutics, Inc. and Yuhan Corporation (incorporated by reference to Exhibit 4.8 to the Registrant’s Registration Statement on Form S-3 filed with the SEC on June 29, 2016).</u></a>   |
| 4.8         | <a href="#"><u>Form of Common Stock Purchase Warrant issued to investors pursuant to the Securities Purchase Agreement, dated as of April 3, 2016, by and among Sorrento Therapeutics, Inc., ABG SRNE Limited and Ally Bridge LB Healthcare Master Fund Limited (incorporated by reference to Exhibit 4.9 to the Registrant’s Registration Statement on Form S-3 filed with the SEC on June 29, 2016).</u></a>   |

| Exhibit No. | Description  |
|-------------|--|
| 4.9         | <a href="#">Form of Common Stock Purchase Warrant issued to investors pursuant to the Securities Purchase Agreement, dated as of April 3, 2016, by and between Sorrento Therapeutics, Inc. and FREJOY Investment Management Co., Ltd. and Securities Purchase Agreement, dated as of April 3, 2016, by and between Sorrento Therapeutics, Inc. and Beijing Shijilongxin Investment Co., Ltd. (incorporated by reference to Exhibit 4.10 to the Registrant's Registration Statement on Form S-3 filed with the SEC on June 29, 2016).</a> |
| 4.10        | <a href="#">Common Stock Purchase Warrant issued to Yuhan Corporation on April 29, 2016 (incorporated by reference to Exhibit 4.11 to the Registrant's Registration Statement on Form S-3 filed with the SEC on June 29, 2016).</a>  |
| 4.11        | <a href="#">Voting Agreement, dated as of April 29, 2016, by and between Sorrento Therapeutics, Inc. and Yuhan Corporation (incorporated by reference to Exhibit 4.12 to the Registrant's Registration Statement on Form S-3 filed with the SEC on June 29, 2016).</a>   |
| 4.12        | <a href="#">Registration Rights Agreement, dated November 8, 2016, by and among Sorrento Therapeutics, Inc. and the persons party thereto (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the SEC on November 8, 2016).</a>  |
| 4.13        | <a href="#">Warrant Agreement, dated November 23, 2016, issued to Hercules Capital, Inc. (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the SEC on November 29, 2016).</a>  |
| 4.14        | <a href="#">Registration Rights Agreement, dated April 27, 2017, by and among Sorrento Therapeutics, Inc. and the persons party thereto (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the SEC on April 28, 2017).</a>  |
| 4.15        | <a href="#">Securities Purchase Agreement, dated as of December 11, 2017, by and among Sorrento Therapeutics, Inc. and the purchasers identified on Schedule A thereto (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on December 11, 2017).</a>   |
| 4.16        | <a href="#">Form of Convertible Promissory Note issued to investors pursuant to the Securities Purchase Agreement, dated as of December 11, 2017, by and among Sorrento Therapeutics, Inc. and the purchasers identified on Schedule A thereto (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the SEC on December 21, 2017).</a>  |
| 4.17        | <a href="#">Form of Common Stock Purchase Warrant issued to investors pursuant to the Securities Purchase Agreement, dated as of December 11, 2017, by and among Sorrento Therapeutics, Inc. and the purchasers identified on Schedule A thereto (incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed with the SEC on December 21, 2017).</a>  |
| 4.18        | <a href="#">Registration Rights Agreement, dated December 21, 2017, by and among Sorrento Therapeutics, Inc. and the purchasers identified on Schedule A thereto (incorporated by reference to Exhibit 4.3 to the Registrant's Current Report on Form 8-K filed with the SEC on December 21, 2017).</a>  |
| 10.1+       | <a href="#">Exclusive License and Development Agreement between Sorrento Therapeutics, Inc. and China Oncology Focus Limited dated October 3, 2014 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q/A filed with the SEC on November 25, 2014).</a>  |
| 10.2+       | <a href="#">License Agreement, dated January 8, 2010, by and between The Scripps Research Institute and Sorrento Therapeutics, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on May 14, 2010).</a>  |
| 10.3±       | <a href="#">Form of Stock Option Agreement (incorporated by reference to Exhibit 10.11 to the Registrant's Current Report on Form 8-K/A filed with the SEC on September 22, 2009).</a>   |
| 10.4±       | <a href="#">Form of Indemnification Agreement (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on September 7, 2012).</a>  |
| 10.5±       | <a href="#">2009 Amended and Restated Stock Incentive Plan, and forms of agreements related thereto (incorporated by reference to Appendix A to the definitive proxy statement filed by Sorrento Therapeutics, Inc. with the Securities and Exchange Commission on May 13, 2016).</a>  |
| 10.6±       | <a href="#">2009 Equity Incentive Plan, and forms of agreement related thereto (incorporated by reference to Exhibit 10.17 to the Registrant's Annual Report on Form 10-K filed with the SEC on March 25, 2010).</a>   |
| 10.7        | <a href="#">Option Agreement between Sorrento Therapeutics, Inc. and B.G. Negev Technologies and Applications Ltd. (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on August 13, 2013).</a>  |

| Exhibit<br>No. | Description   |
|----------------|---|
| 10.8+          | <a href="#">Exclusive License Agreement dated as of April 21, 2015 by and between NantCell, Inc. and Sorrento Therapeutics, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on August 7, 2015).</a>  |
| 10.9*          | <a href="#">Stock Sale and Purchase Agreement dated as of May 14, 2015 by and between NantPharma, LLC and Sorrento Therapeutics, Inc. (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on August 7, 2015).</a>   |
| 10.10*         | <a href="#">Stock Purchase Agreement by and among TNK Therapeutics, Inc., BDL Products, Inc., the Stockholders of BDL Products, Inc., Richard Junghans, M.D., Ph.D. as the Stockholders' Representative and Sorrento Therapeutics, Inc. dated as of August 7, 2015 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on November 16, 2015).</a> |
| 10.11          | <a href="#">Amendment No. 1 to Stock Purchase Agreement, dated as of March 7, 2016, by and between TNK Therapeutics, Inc. and Richard P. Junghans, M.D., Ph.D., as the Stockholders' Representative (incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on November 9, 2016).</a>   |
| 10.12          | <a href="#">Amendment No. 2 to Stock Purchase Agreement, dated as of September 14, 2016, by and between TNK Therapeutics, Inc. and Richard P. Junghans, M.D., Ph.D., as the Stockholders' Representative. (incorporated by reference to Exhibit 10.33 to the Registrant's Annual Report on Form 10-K filed with the SEC on March 22, 2017).</a>   |
| 10.13          | <a href="#">Amendment No. 3 to Stock Purchase Agreement, dated as of March 14, 2017, by and between TNK Therapeutics, Inc. and Richard P. Junghans, M.D., Ph.D., as the Stockholders' Representative (incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on May 15, 2017).</a>  |
| 10.14          | <a href="#">Binding Term Sheet for License Between Cytolumina/Fetolumina and TNK Therapeutics, Inc. (incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on November 16, 2015).</a>  |
| 10.15+         | <a href="#">Exclusive License Agreement dated September 25, 2015 by and between LA Cell, Inc. and City of Hope (incorporated by reference to Exhibit 10.26 to the Registrant's Annual Report on Form 10-K filed with the SEC on March 15, 2016).</a>  |
| 10.16±         | <a href="#">Employment Agreement, dated December 8, 2014, by and between Sorrento Therapeutics, Inc. and George Ng (incorporated by reference to Exhibit 10.28 to the Registrant's Annual Report on Form 10-K/A filed with the SEC on April 29, 2016).</a>  |
| 10.17±         | <a href="#">Employment Agreement between Sorrento Therapeutics, Inc. and Kevin M. Herde dated as of April 5, 2016 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on May 10, 2016).</a>   |
| 10.18          | <a href="#">Letter Agreement, dated June 30, 2016, among Chan Soon-Shiong Family Foundation, Cambridge Equities, L.P. and Sorrento Therapeutics, Inc. (incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on August 8, 2016).</a>   |
| 10.19          | <a href="#">Lease Agreement, dated September 12, 2016, between Sorrento Therapeutics, Inc. and HCP Life Science REIT, Inc. (incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on November 9, 2016).</a>  |
| 10.20          | <a href="#">Unit Purchase Agreement dated August 5, 2016, by and among MedoveX Corporation and the purchasers party thereto (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed by MedoveX Corporation (File No. 001-36763) with the SEC on August 8, 2016).</a>   |

| Exhibit<br>No. | Description   |
|----------------|---|
| 10.21          | <a href="#">Registration Rights Agreement, dated August 5, 2016, by and among MedoveX Corporation and the investors party thereto (incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K filed by MedoveX Corporation (File No. 001-36763) with the SEC on August 8, 2016).</a> |
| 10.22±         | <a href="#">Amended and Restated Employment Agreement between Sorrento Therapeutics, Inc. and Henry Ji, Ph.D. dated May 9, 2017 (incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on May 15, 2017).</a>                                 |

|         |  |
|---------|--|
| 10.23+  | <a href="#"><u>Contribution Agreement, dated as of June 12, 2017, by and among Sorrento Therapeutics, Inc., TNK Therapeutics, Inc. and Celularity, Inc. (incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2017).</u></a>                        |
| 10.24+  | <a href="#"><u>Amendment No. 1 to Contribution Agreement, dated as of June 30, 2017, by and among Sorrento Therapeutics, Inc., TNK Therapeutics, Inc. and Celularity, Inc. (incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2017).</u></a>     |
| 10.25   | <a href="#"><u>Amendment No. 2 to Contribution Agreement, dated as of August 10, 2017, by and among Sorrento Therapeutics, Inc., TNK Therapeutics, Inc. and Celularity, Inc. (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on November 9, 2017).</u></a> |
| 10.26+  | <a href="#"><u>License and Transfer Agreement dated August 15, 2017 by and among Sorrento Therapeutics, Inc., TNK Therapeutics, Inc. and Celularity, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on November 9, 2017).</u></a>                    |
| 10.27   | <a href="#"><u>At Market Issuance Sales Agreement, dated as of November 9, 2017, by and between Sorrento Therapeutics, Inc. and B. Riley FBR, Inc. (incorporated by reference to Exhibit 1.2 to the Registrant's Registration Statement on Form S-3 filed with the SEC on November 9, 2017).</u></a>                       |
| 12.1    | <a href="#"><u>Ratio of Earnings to Fixed Charges</u></a>  |
| 21.1    | <a href="#"><u>List of Subsidiaries</u></a>  |
| 23.1    | <a href="#"><u>Consent of Deloitte &amp; Touche LLP</u></a>  |
| 23.2    | <a href="#"><u>Consent of Mayer Hoffman McCann P.C.</u></a>  |
| 24      | Power of Attorney (included on signature page hereto)  |
| 31.1    | <a href="#"><u>Certification of Henry Ji, Ph.D., Principal Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended.</u></a>   |
| 31.2    | <a href="#"><u>Certification of Dean Ferrigno, Principal Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended.</u></a>   |
| 32.1    | <a href="#"><u>Certification of Henry Ji, Ph.D., Principal Executive Officer and Dean Ferrigno, Principal Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended.</u></a>  |
| 101.INS | XBRL Instance Document   |
| 101.SCH | XBRL Taxonomy Extension Schema Document  |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document   |

\* Non-material schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Registrant hereby undertakes to furnish supplementally copies of any of the omitted schedules and exhibits upon request by the SEC.

+ The SEC has granted confidential treatment with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.

± Management contract or compensatory plan.

The following financial statement schedule is filed as part of this Annual Report on Form 10-K:

| Schedule Number | Description                       |
|-----------------|-----------------------------------|
| II              | Valuation and Qualifying Accounts |

**SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS**

| (in thousands)                 | Balance at Beginning of Period | Reserves Acquired | Additions | Deductions  | Balance at End of Period |
|--------------------------------|--------------------------------|-------------------|-----------|-------------|--------------------------|
| Fiscal Year 2017:              |                                |                   |           |             |                          |
| Income tax valuation allowance | 81,039                         | 797               | —         | (38,431)    | 43,405                   |
|                                | \$ 81,039                      | \$ 797            | \$ —      | \$ (38,431) | \$ 43,405                |
| Fiscal Year 2016:              |                                |                   |           |             |                          |
| Income tax valuation allowance | 39,605                         | —                 | 41,434    | —           | 81,039                   |
|                                | \$ 39,605                      | \$ —              | \$ 41,434 | \$ —        | \$ 81,039                |
| Fiscal Year 2015:              |                                |                   |           |             |                          |
| Income tax valuation allowance | 25,350                         | —                 | 14,255    | —           | 39,605                   |
|                                | \$ 25,350                      | \$ —              | \$ 14,255 | \$ —        | \$ 39,605                |

**Item 16. Form 10-K Summary.**

None.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 16, 2018

SORRENTO THERAPEUTICS, INC.

By:   /s/ Henry Ji  
**Henry Ji, Ph.D.**  
**Chairman of the Board of Directors, Chief Executive Officer**  
**& President**

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints, jointly and severally, Henry Ji, Ph.D., and George Ng, and each of them acting individually, as his attorney-in-fact, each with full power of substitution and resubstitution, for him in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature   | Title(s)   | Date           |
|---|--|----------------|
| <u>  /s/ Henry Ji, Ph.D.</u><br><b>Henry Ji, Ph.D.</b>          | Chairman of the Board of<br>Directors, Chief Executive Officer<br>& President<br>(Principal Executive Officer) | March 16, 2018 |
| <u>  /s/ Dean Ferrigno</u><br><b>Dean Ferrigno</b>              | Chief Accounting Officer<br>(Principal Financial and Accounting Officer)                                       | March 16, 2018 |
| <u>  /s/ Dorman Followwill</u><br><b>Dorman Followwill</b>      | Director   | March 16, 2018 |
| <u>  /s/ Yue Alexander Wu</u><br><b>Yue Alexander Wu, Ph.D.</b> | Director   | March 16, 2018 |
| <u>  /s/ Kim D. Janda, Ph.D.</u><br><b>Kim D. Janda, Ph.D.</b>  | Director   | March 16, 2018 |
| <u>  /s/ David Deming</u><br><b>David Deming</b>                | Director   | March 16, 2018 |
| <u>  /s/ Jaisim Shah</u><br><b>Jaisim Shah</b>                  | Director   | March 16, 2018 |
| <u>  /s/ David Lemus</u><br><b>David Lemus</b>                  | Director   | March 16, 2018 |



**Sorrento Therapeutics, Inc.**  
**Index to Consolidated Financial Statements**

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## Reports of Independent Registered Public Accounting Firms

To the Board of Directors and Stockholders of  
Sorrento Therapeutics, Inc. and Subsidiaries  
San Diego, California

We have audited the accompanying consolidated statements of operations, comprehensive loss, stockholders' equity (deficit) and cash flows of **Sorrento Therapeutics, Inc. and Subsidiaries** for the year ended December 31, 2015. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of their operations and their cash flows of Sorrento Therapeutics, Inc. and Subsidiaries for the year ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

/s/ Mayer Hoffman McCann P.C.

San Diego, CA  
March 14, 2016

To the stockholders and Board of Directors of Sorrento Therapeutics, Inc.

### **Opinion on Internal Control over Financial Reporting**

We have audited the internal control over financial reporting of Sorrento Therapeutics, Inc. and subsidiaries (the “Company”) as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, because of the effect of the material weaknesses identified below on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2017, of the Company and our report dated March 16, 2018, expressed an unqualified opinion on those consolidated financial statements and financial statement schedule and included an explanatory paragraph regarding substantial doubt about the Company’s ability to continue as a going concern.

### **Basis for Opinion**

The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### **Definition and Limitations of Internal Control over Financial Reporting**

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### **Material Weaknesses**

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company’s annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management’s assessment: 1) The Company’s review controls over unusual or non-recurring and significant transactions were not operating effectively to provide reasonable assurance that it (a) timely identifies and assesses the accounting implications of terms in unusual or non-recurring agreements, and (b) reassesses the valuation of associated assets or liabilities at the end of each reporting period; and 2) the Company’s review controls to assess and monitor the appropriateness of the financial information provided by its equity method investees were not operating effectively to timely identify and assess the accounting implications of transactions and events occurring at its equity method investees and properly report such investee financial

information. Such material weaknesses are principally the result of insufficient accounting resources, including a Chief Financial Officer, to appropriately perform, and to monitor the performance of, the control activities.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2017, of the Company, and this report does not affect our report on such consolidated financial statements and financial statement schedule.

*/s/ DELOITTE & TOUCHE LLP*

San Diego, California

March 16, 2018

To the stockholders and the Board of Directors of Sorrento Therapeutics, Inc.

### **Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheets of Sorrento Therapeutics, Inc. and subsidiaries (the "Company") as of December 31, 2017 and 2016, the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2017, and the related notes and the schedule listed in the Index at Item 15 (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2018, expressed an adverse opinion on the Company's internal control over financial reporting because of material weaknesses.

### **Going Concern**

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company's recurring losses from operations and working capital deficiencies raise substantial doubt about its ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

### **Basis for Opinion**

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ DELOITTE & TOUCHE LLP

San Diego, California  
March 16, 2018

We have served as the Company's auditor since 2016.



**CONSOLIDATED BALANCE SHEETS**

(In thousands, except for share amounts)

|   | December 31,      |                   |
|---|-------------------|-------------------|
|   | 2017              | 2016              |
| <b>ASSETS</b>   |                   |                   |
| <b>Current assets:</b>  |                   |                   |
| Cash and cash equivalents   | \$ 20,429         | \$ 82,398         |
| Marketable securities   | 441               | 1,106             |
| Grants and accounts receivables, net  | 2,211             | 1,696             |
| Income tax receivable   | 1,715             | 1,289             |
| Prepaid expenses and other, net   | 4,904             | 3,165             |
| <b>Total current assets</b>   | <b>29,700</b>     | <b>89,654</b>     |
| Property and equipment, net   | 19,345            | 12,707            |
| Intangibles, net  | 71,013            | 64,766            |
| Goodwill  | 38,298            | 41,548            |
| Cost method investments   | 237,008           | 112,008           |
| Equity method investments   | 32,999            | 76,994            |
| Other, net  | 3,250             | 3,909             |
| <b>Total assets</b>   | <b>\$ 431,613</b> | <b>\$ 401,586</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                   |                   |
| <b>Current liabilities:</b>   |                   |                   |
| Accounts payable  | \$ 9,911          | \$ 8,282          |
| Accrued payroll and related   | 4,485             | 3,565             |
| Current portion of deferred compensation  | —                 | 1,012             |
| Accrued expenses  | 7,274             | 4,741             |
| Current portion of deferred revenue   | 3,864             | 9,666             |
| Current portion of deferred rent  | 212               | 248               |
| Acquisition consideration payable   | 53,209            | 48,362            |
| Current portion of debt   | —                 | 209               |
| <b>Total current liabilities</b>  | <b>78,955</b>     | <b>76,085</b>     |
| Long-term debt, net of discount   | 5,211             | 47,107            |
| Deferred tax liabilities, net   | 15,535            | 53,238            |
| Deferred revenue  | 119,287           | 134,376           |
| Deferred rent and other   | 6,015             | 4,278             |
| <b>Total liabilities</b>  | <b>225,003</b>    | <b>315,084</b>    |
| <b>Commitments and contingencies</b>  |                   |                   |
| <b>Equity:</b>  |                   |                   |
| <b>Sorrento Therapeutics, Inc. equity</b>   |                   |                   |
| Preferred stock, \$0.0001 par value; 100,000,000 shares authorized and no shares issued or outstanding  | —                 | —                 |
| Common stock, \$0.0001 par value; 750,000,000 shares authorized and 82,903,567 and 50,882,856 shares issued and outstanding at December 31, 2017 and 2016, respectively | 9                 | 6                 |
| Additional paid-in capital  | 413,901           | 303,865           |
| Accumulated other comprehensive income (loss)   | 242               | (118)             |
| Accumulated deficit   | (165,120)         | (174,252)         |
| Treasury stock, 7,568,182 shares and 7,568,182 shares at cost at December 31, 2017 and 2016, respectively   | (49,464)          | (49,464)          |
| <b>Total Sorrento Therapeutics, Inc. stockholders' equity</b>   | <b>199,568</b>    | <b>80,037</b>     |

|                                     |                   |                   |
|-------------------------------------|-------------------|-------------------|
| <b>Noncontrolling interests</b>     | 7,042             | 6,465             |
| <b>Total equity</b>                 | <u>206,610</u>    | <u>86,502</u>     |
| <b>Total liabilities and equity</b> | <u>\$ 431,613</u> | <u>\$ 401,586</u> |

See accompanying notes

**SORRENTO THERAPEUTICS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Years Ended December 31, 2017, 2016 and 2015**

(In thousands, except for per share amounts)

|   | 2017            | 2016               | 2015               |
|---|-----------------|--------------------|--------------------|
| <b>Revenues:</b>  |                 |                    |                    |
| Grant   | \$ 206          | \$ 1,033           | \$ 1,530           |
| Royalties and licenses  | 140,381         | 4,017              | —                  |
| Sales and services  | 11,269          | 3,102              | 3,060              |
| <b>Total revenues</b>   | <b>151,856</b>  | <b>8,152</b>       | <b>4,590</b>       |
| <b>Operating costs and expenses:</b>  |                 |                    |                    |
| Costs of revenues   | 3,945           | 811                | 1,950              |
| Research and development  | 55,532          | 42,175             | 31,343             |
| Acquired in-process research and development  | 26,102          | 45,000             | 24,013             |
| General and administrative  | 38,332          | 24,219             | 20,132             |
| Intangible amortization   | 2,610           | 845                | 1,157              |
| (Gain) on contingent liabilities  | —               | (8,121)            | —                  |
| <b>Total costs and operating expenses</b>   | <b>126,521</b>  | <b>104,929</b>     | <b>78,595</b>      |
| Income (loss) from operations   | 25,335          | (96,777)           | (74,005)           |
| Gain on sale of IgDraSol, net   | —               | —                  | 69,274             |
| Gain (loss) on derivative liabilities   | —               | 5,520              | (3,360)            |
| Gain on marketable securities   | —               | 27,193             | —                  |
| Loss on foreign currency exchange   | (178)           | —                  | —                  |
| (Loss) gain on trading securities   | (665)           | 356                | —                  |
| Interest expense  | (4,980)         | (1,610)            | (1,652)            |
| Interest income   | 241             | 272                | 24                 |
| Loss on debt extinguishment   | (4,275)         | (222)              | —                  |
| Loss on receivable  | (163)           | —                  | —                  |
| Income (loss) before income tax expense <sup>(1)</sup>                                  | 15,315          | (65,268)           | (9,719)            |
| Income tax (benefit) expense  | (36,038)        | (896)              | 36,314             |
| (Loss) income on equity method investments  | (40,244)        | 435                | (4,041)            |
| <b>Net income (loss)</b>  | <b>11,109</b>   | <b>(63,937)</b>    | <b>(50,074)</b>    |
| Net income (loss) attributable to noncontrolling interests                              | 1,977           | (3,014)            | (4,263)            |
| <b>Net income (loss) attributable to Sorrento</b>                                       | <b>\$ 9,132</b> | <b>\$ (60,923)</b> | <b>\$ (45,811)</b> |
| Net income (loss) per share - basic per share attributable to Sorrento                  | \$ 0.13         | \$ (1.21)          | \$ (1.24)          |
| Net income (loss) per share - diluted per share attributable to Sorrento                | \$ 0.13         | \$ (1.21)          | \$ (1.24)          |
| Weighted-average shares used during period - basic per share attributable to Sorrento   | 69,742          | 50,360             | 36,909             |
| Weighted-average shares used during period - diluted per share attributable to Sorrento | 70,381          | 50,360             | 36,909             |

<sup>(1)</sup> Activity for the years ended December 31, 2016 and December 31, 2015 have been recast to present (loss) income on equity method investments below income (loss) before income tax expense.

See accompanying notes



**SORRENTO THERAPEUTICS, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**For the Years Ended December 31, 2017, 2016 and 2015**

(In thousands, except for share amounts)

|  | <u>2017</u>     | <u>2016</u>         | <u>2015</u>      |
|--|-----------------|---------------------|------------------|
| Net income (loss)  | 11,109          | (63,937)            | (50,074)         |
| Other comprehensive income:  |                 |                     |                  |
| Unrealized (loss) gain on marketable securities, net of tax of \$0, \$(14,294), and \$14,294 | —               | (73,579)            | 73,579           |
| Foreign currency translations adjustments and other  | 360             | (118)               | —                |
| Total other comprehensive income (loss)  | <u>360</u>      | <u>(73,697)</u>     | <u>73,579</u>    |
| Comprehensive income (loss)  | 11,469          | (137,634)           | 23,505           |
| Comprehensive income (loss) attributable to noncontrolling interests                         | <u>1,977</u>    | <u>(3,014)</u>      | <u>(4,263)</u>   |
| Comprehensive income (loss) attributable to Sorrento   | <u>\$ 9,492</u> | <u>\$ (134,620)</u> | <u>\$ 27,768</u> |

See accompanying notes

**SORRENTO THERAPEUTICS, INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**For the Years Ended December 31, 2017, 2016 and 2015**

(In thousands, except for share amounts)

|   | Common Stock      |             | Treasury Stock   |                 | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss) | Accumulated Deficit | Noncontrolling Interest | Total             |
|---|-------------------|-------------|------------------|-----------------|----------------------------|---|---------------------|-------------------------|-------------------|
|   | Shares            | Amount      | Shares           | Amount          |                            |   |                     |                         |                   |
| <b>Balance, December 31, 2014</b>                                   | 36,184,912        | 4           | —                | —               | 176,227                    | —   | (67,518)            | —                       | 108,713           |
| Issuance of common stock with exercise of warrants                  | 3,563             | —           | —                | —               | —                          | —   | —                   | —                       | —                 |
| Issuance of common stock with exercise of options                   | 276,712           | —           | —                | —               | 1,699                      | —   | —                   | —                       | 1,699             |
| Issuance of common stock upon achievement of milestone              | 1,306,272         | —           | —                | —               | —                          | —   | —                   | —                       | —                 |
| Stock-based compensation  | —                 | —           | —                | —               | 6,972                      | —   | —                   | —                       | 6,972             |
| Change in unrealized gain on marketable securities                  | —                 | —           | —                | —               | —                          | 73,579  | —                   | —                       | 73,579            |
| Sale of noncontrolling interest                                     | —                 | —           | —                | —               | —                          | —   | —                   | 49                      | 49                |
| Net loss  | —                 | —           | —                | —               | —                          | —   | (45,811)            | (4,263)                 | (50,074)          |
| <b>Balance, December 31, 2015</b>                                   | 37,771,459        | 4           | —                | —               | 184,898                    | 73,579  | (113,329)           | (4,214)                 | 140,938           |
| Issuance of common stock with exercise of options                   | 204,668           | —           | —                | —               | 524                        | —   | —                   | —                       | 527               |
| Issuance of common stock for private placement and investments, net | 27,598,235        | 3           | —                | —               | 108,298                    | —   | —                   | —                       | 108,301           |
| Issuance of common stock upon acquisition of Scilex                 | 754,911           | 1           | —                | —               | 5,368                      | —   | —                   | 13,693                  | 19,061            |
| Cancellation of stock issuance                                      | (15,446,417)      | (2)         | 7,568,182        | (49,464)        | (1,341)                    | —   | —                   | —                       | (50,807)          |
| Stock-based compensation  | —                 | —           | —                | —               | 4,741                      | —   | —                   | —                       | 4,741             |
| Change in unrealized gain on marketable securities                  | —                 | —           | —                | —               | —                          | (73,579)                                      | —                   | —                       | (73,579)          |
| Foreign currency translation adjustment                             | —                 | —           | —                | —               | —                          | (118)   | —                   | —                       | (118)             |
| Hercules warrant  | —                 | —           | —                | —               | 1,377                      | —   | —                   | —                       | 1,377             |
| Net loss  | —                 | —           | —                | —               | —                          | —   | (60,923)            | (3,014)                 | (63,937)          |
| <b>Balance, December 31, 2016</b>                                   | 50,882,856        | 6           | 7,568,182        | (49,464)        | 303,865                    | (118)   | (174,252)           | 6,465                   | 86,502            |
| Scilex acquisition adjustments                                      | —                 | —           | —                | —               | (627)                      | —   | —                   | (1,400)                 | (2,027)           |
| Issuance of common stock for placements and investments, net        | 30,468,700        | 3           | —                | —               | 57,925                     | —   | —                   | —                       | 57,928            |
| Beneficial conversion feature recorded on convertible notes         | —                 | —           | —                | —               | 32,062                     | —   | —                   | —                       | 32,062            |
| Warrants issued in connection with convertible notes                | —                 | —           | —                | —               | 12,669                     | —   | —                   | —                       | 12,669            |
| Issuance of common stock for business combinations                  | 1,552,011         | —           | —                | —               | 3,055                      | —   | —                   | —                       | 3,055             |
| Stock-based compensation  | —                 | —           | —                | —               | 4,952                      | —   | —                   | —                       | 4,952             |
| Foreign currency translation adjustment                             | —                 | —           | —                | —               | —                          | 360   | —                   | —                       | 360               |
| Net income  | —                 | —           | —                | —               | —                          | —   | 9,132               | 1,977                   | 11,109            |
| <b>Balance, December 31, 2017</b>                                   | <u>82,903,567</u> | <u>\$ 9</u> | <u>7,568,182</u> | <u>(49,464)</u> | <u>\$ 413,901</u>          | <u>\$ 242</u>                                 | <u>\$ (165,120)</u> | <u>\$ 7,042</u>         | <u>\$ 206,610</u> |

See accompanying notes

**SORRENTO THERAPEUTICS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Years Ended December 31, 2017, 2016 and 2015**  
(In thousands, except for share amounts)

|   | 2017            | 2016            | 2015            |
|---|-----------------|-----------------|-----------------|
| <b>Operating activities</b>   |                 |                 |                 |
| Net income (loss)   | 11,109          | (63,937)        | (50,074)        |
| Adjustments to reconcile net loss to net cash provided by and (used in) operating activities: |                 |                 |                 |
| Depreciation and amortization   | 7,079           | 2,885           | 2,370           |
| Non-cash interest expense   | 1,326           | 164             | 392             |
| Gain on sale of IgDraSol  | —               | —               | (69,274)        |
| Amortization of debt issuance costs and debt discount   | 477             | —               | —               |
| (Gain) loss on sale of marketable securities  | —               | (27,193)        | —               |
| Loss on trading securities  | 665             | —               | —               |
| Stock-based compensation  | 4,952           | 4,741           | 6,972           |
| Acquired in-process research and development  | —               | —               | 12,000          |
| Provision for doubtful accounts   | —               | —               | 5               |
| Loss on disposal for property and equipment   | 59              | —               | —               |
| Loss on receivable  | 163             | —               | —               |
| Loss on debt extinguishment   | 4,275           | —               | —               |
| (Gain) or loss on derivative liability  | —               | (5,520)         | 3,360           |
| Loss (income) on equity method investments  | 40,244          | (435)           | 4,041           |
| Non-cash income on cost method investments  | (116,249)       | —               | —               |
| (Gain) on contingent liabilities  | —               | (8,121)         | —               |
| Deferred tax provision  | (35,679)        | 982             | 33,337          |
| Changes in operating assets and liabilities; net of dispositions:                             |                 |                 |                 |
| Grants and other receivables  | (515)           | (472)           | (176)           |
| Accrued payroll   | 920             | —               | —               |
| Prepaid expenses and other  | (1,902)         | 40              | (1,052)         |
| Deposits and other assets   | 233             | (448)           | (1,715)         |
| Accounts payable  | 1,592           | 3,714           | (2,713)         |
| Deferred revenue  | (20,891)        | 23,534          | 9,876           |
| Deferred rent and other   | 639             | (2,535)         | —               |
| Accrued expenses and other liabilities  | 2,323           | 1,673           | 10,582          |
| <b>Net cash used for operating activities</b>   | <b>(99,180)</b> | <b>(70,928)</b> | <b>(42,069)</b> |
| <b>Investing activities</b>   |                 |                 |                 |
| Purchases of property and equipment   | (10,972)        | (6,860)         | (3,707)         |
| Proceeds from sale of IgDraSol  | —               | —               | 27,759          |
| Investment in SiniWest  | —               | (1,000)         | —               |
| Investment in Celularity  | (5,000)         | (5,000)         | —               |
| Purchase of business, net of cash acquired  | (557)           | (3,842)         | —               |
| Purchase of MedoveX Investment  | —               | (750)           | —               |
| Cost method investments   | —               | —               | (11,500)        |
| <b>Net cash (used in) provided by investing activities</b>                                    | <b>(16,529)</b> | <b>(17,452)</b> | <b>12,552</b>   |
| <b>Financing activities</b>   |                 |                 |                 |
| Proceeds from issuance of convertible note, net of fees                                       | 49,916          | —               | —               |
| Proceeds from issuance of common stock, net   | 57,928          | 107,986         | —               |
| Cash payments for treasury shares   | —               | (15,639)        | —               |
| Proceeds from loan and security agreement, net of fees  | —               | 48,320          | (3,095)         |

|   |                 |                |                 |
|---|-----------------|----------------|-----------------|
| Payments of debt on retired note  | (53,157)        | (9,451)        | —               |
| Net payments of deferred compensation   | (1,012)         | —              | (2,000)         |
| Sale of a noncontrolling interest   | —               | —              | 49              |
| Proceeds from exercise of stock options   | —               | 524            | 1,699           |
| <b>Net cash provided by (used in) financing activities</b>                      | <b>53,675</b>   | <b>131,740</b> | <b>(3,347)</b>  |
| <b>Net change in cash and cash equivalents</b>                                  | <b>(62,034)</b> | <b>43,360</b>  | <b>(32,864)</b> |
| <b>Net effect of exchange rate changes on cash</b>                              | <b>65</b>       | <b>—</b>       | <b>—</b>        |
| <b>Cash and cash equivalents at beginning of period</b>                         | <b>82,398</b>   | <b>39,038</b>  | <b>71,902</b>   |
| <b>Cash and cash equivalents at end of period</b>                               | <b>20,429</b>   | <b>82,398</b>  | <b>39,038</b>   |
| <b>Supplemental disclosures:</b>  |                 |                |                 |
| Cash paid during the period for:  |                 |                |                 |
| Income taxes  | 34              | 2              | 3,001           |
| Interest  | 3,499           | 1,342          | 1,574           |
| <b>Supplemental disclosures of non-cash investing and financing activities:</b> |                 |                |                 |
| Virttu acquisition non-cash consideration                                       | 15,465          | —              | —               |
| Scilex acquisition non-cash consideration                                       | —               | (45,368)       | —               |
| Scilex non-cash consideration for regulatory milestone                          | 1,380           | —              | —               |
| SiniWest non-cash consideration   | —               | (2,832)        | —               |
| Roger Williams Medical Center non-cash consideration                            | —               | (3,398)        | —               |
| Investment in ImmuneOncia   | —               | (9,608)        | —               |
| Common stock received in exchange for license                                   | —               | —              | (100,000)       |
| Contributions to equity method investments made on Company's behalf             | —               | —              | (60,000)        |
| Property and equipment costs incurred but not paid                              | 37              | —              | 2,396           |

**SORRENTO THERAPEUTICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Nature of Operations and Business Activities**

***Nature of Operations and Basis of Presentation***

Sorrento Therapeutics, Inc. (Nasdaq: SRNE), together with its subsidiaries (collectively, the “Company”) is a clinical stage biotechnology company focused on delivering clinically meaningful therapies to patients and their families, globally. The Company’s primary focus is to transform cancer into a treatable or chronically manageable disease. The Company also has programs assessing the use of its technologies and products in auto-immune, inflammatory, neurodegenerative, infectious diseases and pain indications with high unmet medical needs.

At its core, the Company is an antibody-centric company and leverages its proprietary G-MAB™ library to identify, screen and validate fully human antibodies against high impact oncogenic targets and mutations, immune modulators and intracellular targets. To date, the Company has screened over 100 validated targets and generated a number of fully human antibodies against these targets which are at various stages of preclinical development. These include PD-1, PD-L1, CD38, CD123, CD47, c-MET, VEGFR2, CCR2, OX40, TIGIT and CD137 among others.

The Company’s vision is to leverage these antibodies in conjunction with proprietary targeted delivery modalities to generate the next generation of cancer therapeutics. These modalities include proprietary antibody drug conjugates (“ADCs”), bispecific approaches, as well as T-Cell Receptor (“TCR”)-like antibodies. With LA Cell, Inc. (“LA Cell”), the Company’s joint venture with City of Hope, the Company’s objective is to become the global leader in the development of antibodies against intracellular targets such as STAT3, mutant KRAS, MYC, p53 and TAU. Additionally, the Company has acquired and is assessing the regulatory and strategic path forward for its portfolio of late stage biosimilar/biobetter antibodies based on Erbitux®, Remicade®, Xolair®, and Simulect® as these may represent nearer term commercial opportunities.

With each of its programs, the Company aims to tailor its therapies to treat specific stages in the evolution of cancer, from elimination, to equilibrium and escape. In addition, the Company’s objective is to focus on tumors that are resistant to current treatments and where the Company can design focused trials based on a genetic signature or biomarker to ensure patients have the best chance of a durable and significant response. The Company has several immuno-oncology programs that are in or near to entering the clinic. These include cellular therapies, an oncolytic virus and a palliative care program targeted to treat intractable cancer pain. Finally, as part of its global aim to provide a wide range of therapeutic products to meet underserved therapeutic markets, the Company has made investments and developed a separate pain focused franchise which the Company believes will serve to provide short term upside to its core thesis.

Through December 31, 2017, the Company had devoted substantially all of its efforts to product development, raising capital and building infrastructure, and had not realized revenues from its planned principal operations.

The accompanying consolidated financial statements include the accounts of the Company’s subsidiaries. For consolidated entities where the Company owns or is exposed to less than 100% of the economics, the Company records net income (loss) attributable to noncontrolling interests in its consolidated statements of operations equal to the percentage of the economic or ownership interest retained in such entities by the respective noncontrolling parties. All intercompany balances and transactions have been eliminated in consolidation.

**2. Liquidity and Going Concern**

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company has working capital deficiencies as of December 31, 2017 and has incurred substantial net losses for the years ended December 31, 2017, 2016, and 2015 and anticipates that it will continue to do so for the foreseeable future as it continues to identify and invest in advancing product candidates, as well as expanding corporate infrastructure. These conditions, among others, raise substantial doubt about the Company’s ability to continue as a going concern.

As of December 31, 2017, the Company had \$50 million of long term debt associated with the Securities Purchase Agreement, dated December 21, 2017, among the Company and certain accredited investors in a private placement (the “Securities Purchase Agreement” or “Note SPA”). Pursuant to the Securities Purchase Agreement, the Company issued and sold to the Purchasers, in a private placement transaction (the “Private Placement”), (1) convertible promissory notes in an aggregate principal amount of \$50,000,000 (the “Notes”), which will accrue simple interest at a rate equal to 5.0% per annum

and mature upon the earlier to occur of (a) December 21, 2022, and (b) the date of the closing of a change in control of the Company (the “Maturity Date”), and (2) warrants (the “Warrants”) to purchase an aggregate of 12,121,210 shares of the common stock of the Company, par value \$0.0001 per share (“Common Stock”).

The Company has plans in place to obtain sufficient additional fundraising to fulfill its operating and capital requirements for the next 12 months. The Company’s plans include continuing to fund its operating losses and capital funding needs through public or private equity or debt financings, strategic collaborations, licensing arrangements, asset sales, government grants or other arrangements. Although management believes such plans, if executed as planned, should provide the Company sufficient financing to meet its needs, successful completion of such plans is dependent on factors outside of the Company’s control. As such, management cannot conclude that such plans will be effectively implemented within one year after the date that the financial statements are issued.

Each of the Notes provide that, upon the occurrence of an event of default, the Purchasers thereof may, by written notice to the Company, declare all of the outstanding principal and interest under such Note immediately due and payable. For purposes of the Notes, an event of default includes, among other things, one or more events that have, or could reasonably be expected to have, a material adverse effect on (i) the Company’s ability to comply with its obligations under the Securities Purchase Agreement, the Notes or the Warrants or the registration rights agreement entered into with the Purchasers in connection with the Private Placement, or (ii) the rights of the Purchasers under the Notes. The Company believes that it is not probable that the material adverse event clause under the Notes will be exercised.

If the Company is unable to raise additional capital in sufficient amounts or on terms acceptable, the Company may have to significantly delay, scale back or discontinue the development or commercialization of one or more of its product candidates. The Company may also seek collaborators for one or more of its current or future product candidates at an earlier stage than otherwise would be desirable or on terms that are less favorable than might otherwise be available.

The consolidated financial statements do not reflect any adjustments that might be necessary if the Company is unable to continue as a going concern.

### ***Universal Shelf Registration***

In November 2014, the Company filed a universal shelf registration statement on Form S-3 (the “2014 Shelf Registration Statement”) with the SEC, which was declared effective by the SEC in December 2014. This 2014 Shelf Registration Statement provided the Company with the ability to offer up to \$250 million of securities, including equity and other securities as described in the registration statement. Included in the 2014 shelf registration is a sales agreement prospectus covering the offering, issuance and sale by the Company of up to a maximum aggregate offering price of \$50.0 million of the Company’s common stock that may be issued and sold under a sales agreement with MLV & Co. LLC (the “2014 ATM Facility”). During the twelve months ended December 31, 2017 and 2016, the Company sold approximately \$13.9 million and \$3.6 million in shares of common stock under the 2014 ATM Facility, respectively.

In April 2017, the Company completed a public offering of \$47.5 million of shares of common stock pursuant to the 2014 Shelf Registration Statement for net proceeds of approximately \$43.1 million.

In November 2017, the Company filed a universal shelf registration statement on Form S-3 (the “2017 Shelf Registration Statement”) with the SEC, which was declared effective by the SEC in December 2017. The 2014 Shelf Registration Statement expired on December 6, 2017 when the 2017 Shelf Registration was declared effective. This 2017 Shelf Registration Statement provides the Company with the ability to offer up to \$350 million of securities, including equity and other securities as described in the registration statement. Included in the 2017 Shelf Registration Statement is a sales agreement prospectus covering the offering, issuance and sale by the Company of up to a maximum aggregate offering price of \$100.0 million of the Company’s common stock that may be issued and sold under a sales agreement with B. Riley FBR, Inc. (the “ATM Facility”). During the twelve months ended December 31, 2017, the Company sold approximately \$0.9 million in shares of common stock under the ATM Facility. The Company can offer up to \$99.1 million of additional shares of common stock under the ATM Facility, subject to certain limitations.

Pursuant to the 2017 Shelf Registration Statement, the Company may offer such securities from time to time and through one or more methods of distribution, subject to market conditions and the Company’s capital needs. Specific terms and prices will be determined at the time of each offering under a separate prospectus supplement, which will be filed with the SEC at the time of any offering. However, the Company cannot be sure that such additional funds will be available on reasonable terms, or at all.

### ***2016 Private Investment in Public Entity Financing***

On April 3, 2016, the Company entered into a Securities Purchase Agreement (the “ABG Purchase Agreement”) with ABG SRNE Limited and Ally Bridge LB Healthcare Master Fund Limited (collectively, “Ally Bridge”), pursuant to which, among other things, the Company agreed to issue and sell to Ally Bridge and other purchasers that may be designated by Ally Bridge (collectively, the “ABG Purchasers”), in a private placement transaction (the “ABG Private Placement”), up to \$50.0 million in shares of the Common Stock and warrants to purchase shares of Common Stock. Upon the closing of the ABG Private Placement, the Company issued to the ABG Purchasers (1) an aggregate of 9,009,005 shares (the “ABG Shares”) of Common Stock, and (2) warrants to purchase an aggregate of 2,702,700 shares of Common Stock (each, an “ABG Warrant”). Each ABG Warrant had an exercise price of \$8.50 per share, was immediately exercisable upon issuance, had a term of three years and was exercisable on a cash or cashless exercise basis.

Under the terms of the ABG Purchase Agreement, the Company was obligated to prepare and file with the SEC, within 30 days of the closing date of the ABG Private Placement, a registration statement to register for resale the ABG Shares and the shares of Common Stock issuable upon exercise of each ABG Warrant (the “ABG Warrant Shares”), and may be required to effect certain registrations to register for resale the ABG Shares and the ABG Warrant Shares in connection with certain “piggy-back” registration rights granted to the ABG Purchasers.

On April 3, 2016, the Company also entered into a Securities Purchase Agreement (collectively, the “Additional Purchase Agreements”) with each of Beijing Shijilongxin Investment Co., Ltd. (“Beijing Shijilongxin”), FREJOY Investment Management Co., Ltd. (“Frejoy”) and Yuhan Corporation (“Yuhan”), pursuant to which, among other things, the Company agreed to issue and sell, in separate private placement transactions: (1) to Beijing Shijilongxin, 8,108,108 shares of Common Stock, and a warrant to purchase 1,176,471 shares of Common Stock, for an aggregate purchase price of \$45.0 million; (2) to Frejoy, 8,108,108 shares of Common Stock, and a warrant to purchase 1,176,471 shares of Common Stock, for an aggregate purchase price of \$45.0 million; and (3) to Yuhan, 1,801,802 shares of Common Stock, and a warrant to purchase 235,294 shares of Common Stock, for an aggregate purchase price of \$10.0 million. The warrants to be issued pursuant to each of the Additional Purchase Agreements (collectively, the “Additional Warrants” and, together with each ABG Warrant, the “Warrants”) had an exercise price of \$8.50 per share, were immediately exercisable upon issuance, had a term of three years and were exercisable on a cash or cashless exercise basis.

Under the terms of the Additional Purchase Agreements, each of Beijing Shijilongxin, Frejoy and Yuhan had the right to demand, at any time beginning six months after the closing of the transactions contemplated by the applicable Additional Purchase Agreement, that the Company prepare and file with the SEC a registration statement to register for resale such investor’s shares of Common Stock purchased pursuant to the applicable Additional Purchase Agreement and the shares of Common Stock issuable upon exercise of such investor’s Additional Warrant. In addition, the Company may be required to effect certain registrations to register for resale such shares in connection with certain “piggy-back” registration rights granted to Beijing Shijilongxin, Frejoy and Yuhan.

On May 2, 2016, the Company closed its private placement of common stock and warrants with Yuhan for gross proceeds of \$10.0 million. Yuhan purchased 1,801,802 shares of common stock at \$5.55 per share and a warrant to purchase 235,294 shares of common stock. The warrant was exercisable for three years at an exercise price of \$8.50 per share.

Between May 31, 2016 and June 7, 2016, the Company closed on the remainder of the \$150.0 million financing with the ABG Purchasers, Beijing Shijilongxin, and Frejoy. The ABG Purchasers led the financing and, together with Beijing Shijilongxin and Frejoy, collectively purchased 25,225,221 shares of common stock at \$5.55 per share, and warrants to purchase 5,055,642 shares of common stock for total cash consideration of \$86.5 million and secured promissory notes (the “Notes”) in an aggregate principal amount of \$53.5 million.

On December 31, 2016, the Company entered into Warrant and Note Cancellation and Share Forfeiture Agreements (the “Cancellation and Forfeiture Agreements”) with certain investors (the “Investors”) that held an aggregate of 7,838,259 shares of Common Stock and certain of the Warrants granting the right to purchase an aggregate of 1,137,316 shares of Common Stock. Pursuant to the Cancellation and Forfeiture Agreements, effective December 31, 2016, the Warrants held by the Investors and the Notes, of which \$43.5 million was then outstanding, were cancelled and the shares of Common Stock held by the Investors were forfeited and returned to the Company.

### ***2017 Private Investment in Public Entity Financing***

On December 11, 2017, the Company entered into a Securities Purchase Agreement (the “Securities Purchase Agreement” or “Note SPA”) with certain accredited investors (collectively, the “Purchasers”). Pursuant to the Securities Purchase Agreement, on December 21, 2017, the Company issued and sold to the Purchasers, in a private placement transaction (the “Private Placement”), (1) convertible promissory notes in an aggregate principal amount of \$50,000,000 (the “Notes”),

which will accrue simple interest at a rate equal to 5.0% per annum and mature upon the earlier to occur of (a) December 21, 2022, and (b) the date of the closing of a change in control (the “Maturity Date”), and (2) warrants (the “Warrants”) to purchase an aggregate of 12,121,210 shares of our common stock.

At any time and from time to time before the Maturity Date, each Purchaser shall have the option to convert any portion of the outstanding principal amount of such Purchaser’s Note that is equal to or greater than the lesser of: (1) \$4,000,000, and (2) the then-outstanding principal amount of such Purchaser’s Note into shares of Common Stock at a price per share of \$2.26875, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions. Accrued but unpaid interest on the Notes shall be paid in cash semi-annually in arrears on or prior to the 30th day of June and 31st day of December of each calendar year commencing with the year ending December 31, 2018. If a Purchaser elects to convert any of the principal amount of their Note, then all accrued but unpaid interest on such portion of the principal amount shall become due and payable in cash. The Notes contain restrictive covenants and event of default provisions that are customary for transactions of this type.

Each Warrant has an exercise price of \$2.61 per share, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions, will become exercisable on June 20, 2018, has a term of five and a half years and is exercisable on a cash basis, unless there is not an effective registration statement covering the resale of the shares issuable upon exercise of the Warrants, in which case the Warrants shall also be exercisable on a cashless exercise basis.

If the Company raises additional funds by issuing equity securities, substantial dilution to existing stockholders would result. If the Company raises additional funds by incurring debt financing, the terms of the debt may involve significant cash payment obligations as well as covenants and specific financial ratios that may restrict the Company’s ability to operate its business.

### **3. Significant Accounting Policies**

#### **Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Management believes that these estimates are reasonable; however, actual results may differ from these estimates.

#### **Cash and Cash Equivalents**

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. The Company minimizes its credit risk associated with cash and cash equivalents by periodically evaluating the credit quality of its primary financial institution. The balance at times may exceed federally insured limits. The Company has not experienced any losses on such accounts.

#### **Fair Value of Financial Instruments**

The Company follows accounting guidance on fair value measurements for financial instruments measured on a recurring basis, as well as for certain assets and liabilities that are initially recorded at their estimated fair values. Fair value is defined as the exit price, or the amount that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company uses the following three-level hierarchy that maximizes the use of observable inputs and minimizes the use of unobservable inputs to value its financial instruments:

- Level 1: Observable inputs such as unadjusted quoted prices in active markets for identical instruments.
- Level 2: Quoted prices for similar instruments that are directly or indirectly observable in the marketplace.
- Level 3: Significant unobservable inputs which are supported by little or no market activity and that are financial instruments whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant judgment or estimation.

Financial instruments measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company’s assessment of the significance of a particular input to the fair value measurement in its entirety requires it to make judgments and consider factors specific to the asset or liability. The use of different assumptions and/or estimation methodologies may have a material effect on estimated fair values. Accordingly, the



fair value estimates disclosed or initial amounts recorded may not be indicative of the amount that the Company or holders of the instruments could realize in a current market exchange.

The carrying amounts of cash equivalents and marketable securities approximate their fair value based upon quoted market prices. Certain of the Company's financial instruments are not measured at fair value on a recurring basis, but are recorded at amounts that approximate their fair value due to their liquid or short-term nature, such as cash, accounts receivable and payable, and other financial instruments in current assets or current liabilities.

### **Marketable Securities**

Marketable securities are designated either as trading or available-for-sale securities and are accounted for at fair value. Marketable securities are classified as short-term or long-term based on the nature of the securities and their availability to meet current operating requirements. Marketable securities that are readily available for use in current operations and are classified as short-term available-for-sale securities are reported as a component of current assets in the accompanying consolidated balance sheets. Marketable securities that are not trading securities and are not considered available for use in current operations are classified as long-term available-for-sale securities and are reported as a component of long-term assets in the accompanying consolidated balance sheets.

Securities that are classified as trading are carried at fair value, with changes to fair value reported as a component of income. Securities that are classified as available-for-sale are carried at fair value, with temporary unrealized gains and losses reported as a component of stockholders' equity until their disposition. The cost of securities sold is based on the specific identification method.

All of the Company's marketable securities are subject to a periodic impairment review. The Company recognizes an impairment charge when a decline in the fair value of its investments below the cost basis is judged to be other-than-temporary. For the year ended December 31, 2017, no other-than-temporary impairment charges were recorded for marketable securities.

### **Grants and Accounts Receivable**

Grants receivable at December 31, 2017 and 2016 represent amounts due under several federal contracts with the National Institute of Allergy and Infectious Diseases ("NIAID"), a division of the National Institutes of Health ("NIH") (collectively, the "NIH Grants"). The Company considers the grants receivable to be fully collectible; accordingly, no allowance for doubtful amounts has been established. If amounts become uncollectible, they are charged to operations.

Accounts receivable at December 31, 2017 and 2016 consists of trade receivables from sales and services provided to certain customers, which are generally unsecured and due within 30 days. Estimated credit losses related to trade accounts receivable are recorded as general and administrative expenses and as an allowance for doubtful accounts within grants and accounts receivable, net. The Company reviews reserves and makes adjustments based on historical experience and known collectability issues and disputes. When internal collection efforts on accounts have been exhausted, the accounts are written off by reducing the allowance for doubtful accounts. As of December 31, 2017 and 2016, the allowance for doubtful accounts was \$20 thousand and \$26 thousand, respectively.

### **Property and Equipment**

Property and equipment are carried at cost less accumulated depreciation. Depreciation of property and equipment is computed using the straight-line method over the estimated useful lives of the assets, which are generally three to five years. Leasehold improvements are amortized over the lesser of the life of the lease or the life of the asset. Repairs and maintenance are charged to expense as incurred.

### **Acquisitions and Intangibles**

The Company has engaged in business combination activity. The accounting for business combinations requires management to make judgments and estimates of the fair value of assets acquired, including the identification and valuation of intangible assets, as well as liabilities assumed. Such judgments and estimates directly impact the amount of goodwill recognized in connection with each acquisition, as goodwill presents the excess of the purchase price of an acquired business over the fair value of its net tangible and identifiable intangible assets.

## **Goodwill and Other Long-Lived Assets**

Goodwill, which has an indefinite useful life, represents the excess of cost over fair value of net assets acquired. Goodwill is reviewed for impairment at least annually during the fourth quarter, or more frequently if events occur indicating the potential for impairment. During its goodwill impairment review, the Company may assess qualitative factors to determine whether it is more likely than not that the fair value of its reporting unit is less than its carrying amount, including goodwill. The qualitative factors include, but are not limited to, macroeconomic conditions, industry and market considerations, and the overall financial performance of the Company. If, after assessing the totality of these qualitative factors, the Company determines that it is not more likely than not that the fair value of its reporting unit is less than its carrying amount, then no additional assessment is deemed necessary. Otherwise, the Company proceeds to perform the two-step test for goodwill impairment. The first step involves comparing the estimated fair value of the reporting unit with its carrying value, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the Company performs the second step of the goodwill impairment test to determine the amount of loss, which involves comparing the implied fair value of the goodwill to the carrying value of the goodwill. The Company may also elect to bypass the qualitative assessment in a period and elect to proceed to perform the first step of the goodwill impairment test. The Company performed its annual assessment for goodwill impairment in the fourth quarter of 2017, noting no impairment.

The Company evaluates its long-lived and intangible assets with definite lives, such as property and equipment, acquired technology, customer relationships, patent and license rights, for impairment by considering competition by products prescribed for the same indication, the likelihood and estimated future entry of non-generic and generic competition with the same or similar indication and other related factors. The factors that drive the estimate of useful life are often uncertain and are reviewed on a periodic basis or when events occur that warrant review. Recoverability is measured by comparison of the assets' book value to future net undiscounted cash flows that the assets are expected to generate. There have not been any impairment losses of long-lived assets through December 31, 2017.

## **Acquisition Consideration Payable - Gain on Contingent Liabilities**

Acquisition consideration payable relates to the Company's acquisition of businesses and various other assets and is recorded on the Company's consolidated balance sheets at fair value and is re-measured at each balance sheet date until such contingent liabilities have been settled, with changes in fair value recorded as gain on contingent liabilities. The Company estimates the fair value of contingent consideration based on level 3 inputs primarily driven by the probability of achieving certain financing or operating related milestones.

During the first quarter of 2017, the Company identified an error in the valuation of acquisition consideration associated with the Scilex Pharmaceuticals Inc. ("Scilex") Acquisition, primarily related to the acquisition consideration payable, resulting in an overstatement of acquisition consideration payable of \$6.5 million, and a corresponding overstatement of intangible assets of \$6.7 million, goodwill of \$4.6 million, deferred income tax liability of \$2.8 million, additional paid-in capital of \$0.6 million, and noncontrolling interest of \$1.4 million as of December 31, 2016. The Company evaluated the materiality of this misstatement from quantitative and qualitative perspectives, and concluded that it was immaterial to the prior periods. Consequently, the Company corrected this error by recording the adjustment in the Company's condensed consolidated balance sheet in the quarter ended March 31, 2017.

## **Debt With Detachable Warrants**

Debt with detachable warrants are evaluated for the classification of warrants as either equity instruments, derivative liabilities, or liabilities depending on the specific terms of the warrant agreement. In circumstances in which debt is issued with equity-classified warrants, the proceeds from the issuance of convertible debt are first allocated to the debt and the warrants at their relative estimated fair values. The portion of the proceeds so allocated to the warrants are accounted for as paid-in capital and a debt discount. The remaining proceeds, as further reduced by discounts created by the bifurcation of embedded derivatives and beneficial conversion features, are allocated to the debt. The Company accounts for debt as liabilities measured at amortized cost and amortizes the resulting debt discount from the allocation of proceeds, to interest expense using the effective interest method over the expected term of the debt instrument. The Company considers whether there are any embedded features in debt instruments that require bifurcation and separate accounting as derivative financial instruments pursuant to ASC 815.

If the amount allocated to the convertible debt results in an effective per share conversion price less than the fair value of the Company's common stock on the commitment date, the intrinsic value of this beneficial conversion feature is recorded as a discount to the convertible debt with a corresponding increase to additional paid in capital. The beneficial conversion feature discount is equal to the difference between the effective conversion price and the fair value of the Company's common stock at the commitment date, unless limited by the remaining proceeds allocated to the debt.

## **Derivative Liability**

Derivative liabilities are recorded on the Company's consolidated balance sheets at their fair value on the date of issuance and are revalued on each balance sheet date until such instruments are exercised or expire, with changes in the fair value between reporting periods recorded as other income or expense. The Company estimates the fair value of derivative liabilities using the Black-Scholes option pricing model.

## **Investments in Other Entities**

The Company holds a portfolio of investments in equity securities that are accounted for under either the equity method or cost method. Investments in entities over which the Company has significant influence but not a controlling interest are accounted for using the equity method, with the Company's share of earnings or losses reported in loss on equity method investments.

The Company's cost method investments are included in cost method investments on the consolidated balance sheets. The Company's equity method investments are included in equity method investments on the consolidated balance sheets.

All investments are reviewed on a regular basis for possible impairment. If an investment's fair value is determined to be less than its net carrying value and the decline is determined to be other-than-temporary, the investment is written down to its fair value. Such an evaluation is judgmental and dependent on specific facts and circumstances. Factors considered in determining whether an other-than-temporary decline in value has occurred include: the magnitude of the impairment and length of time that the market value was below the cost basis; financial condition and business prospects of the investee; the Company's intent and ability to retain the investment for a sufficient period of time to allow for recovery in market value of the investment; issues that raise concerns about the investee's ability to continue as a going concern; any other information that the Company may be aware of related to the investment.

In the fourth quarter for 2017, the Company determined it had an other-than-temporary decline in the value of NANTibody equity method investment and recognized a loss of \$36.0 million in loss on equity investments on its condensed consolidated statement of operations for the quarter ended September 30, 2017. (See Note 9).

## **Research and Development Costs and Collaborations**

All research and development costs are charged to expense as incurred. Such costs primarily consist of lab supplies, contract services, stock-based compensation expense, salaries and related benefits.

## **Acquired In-Process Research and Development Expense**

The Company has acquired and may continue to acquire the rights to develop and commercialize new drug candidates. The up-front payments to acquire a new drug compound, as well as future milestone payments, may be immediately expensed as acquired in-process research and development provided that the drug has not achieved regulatory approval for marketing and, absent obtaining such approval, have no alternative future use. Prior to November 8, 2016, all acquired IPR&D was expensed immediately. The acquired in-process research and development related to the business combination of Scilex for which certain products are under development and expected to be commercialized in the near future was capitalized and recorded within "Intangibles, net" on the accompanying consolidated balance sheet. Capitalized IPR&D will be reviewed annually for impairment or more frequently as changes in circumstance or the occurrence of events suggest that the remaining value may not be recoverable.

## **Income Taxes**

The provisions of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 740 "Income Taxes," addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under ASC Topic 740-10, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The Company has determined that it has uncertain tax positions.

The Company accounts for income taxes using the asset and liability method to compute the differences between the tax basis of assets and liabilities and the related financial amounts, using currently enacted tax rates.

The Company has deferred tax assets, which are subject to periodic recoverability assessments. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that more likely than not will be realized. As of December 31, 2017, the Company maintained a full valuation allowance against its deferred tax assets, with the exception of an amount equal to its deferred tax liabilities, which can be expected to reverse over a definite life.

### **Revenue Recognition**

The Company's revenues are generated primarily from royalties and license fees, various NIH grant awards, and from the sale of customized reagents and the provision of contract development services. The revenue from the NIH grant awards is based upon subcontractor and internal costs incurred that are specifically covered by the grant, and where applicable, a facilities and administrative rate that provides funding for overhead expenses. These revenues are recognized when expenses have been incurred by subcontractors or when the Company incurs internal expenses that are related to the grant.

License fees for the licensing of product rights are recorded as deferred revenue upon receipt of cash and recognized as revenue on a straight-line basis over the license period, with the exception of license agreements with no remaining performance obligations or undelivered obligations.

Revenues from sales are generated from the sale of customized reagents which include industrial standard cytotoxins, linkers, and linker-toxins used for preparing ADCs. Contract development services include providing synthetic expertise to customers' synthesis by delivering proprietary cytotoxins, linkers and linker-toxins and ADC service using industry standard toxin and antibodies provided by customers. Revenue is recognized when, (i) persuasive evidence of an arrangement exists, (ii) the product has been shipped or the services have been rendered, (iii) the price is fixed or determinable, and (iv) collectability is reasonably assured.

The Company is obligated to accept from customers the return of products sold that are damaged or do not meet certain specifications. The Company may authorize the return of products sold in accordance with the terms of its sales contracts, and estimates allowances for such amounts at the time of sale. The Company has not experienced any sales returns.

### **Stock-Based Compensation**

The Company accounts for stock-based compensation in accordance with FASB ASC Topic 718 "*Compensation – Stock Compensation*," which establishes accounting for equity instruments exchanged for employee services. Under such provisions, stock-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense, under the straight-line method, over the employee's requisite service period (generally the vesting period of the equity grant).

The Company accounts for equity instruments, including restricted stock or stock options, issued to non-employees in accordance with authoritative guidance for equity based payments to non-employees. Stock options issued to non-employees are accounted for at their estimated fair value determined using the Black-Scholes option-pricing model. The fair value of options and restricted stock granted to non-employees is re-measured over the vesting period, and the resulting changes in fair value are recognized as expense in the period of the change in proportion to the services rendered to date.

### **Comprehensive (Loss) Income**

Comprehensive (loss) income is primarily comprised of net income (loss) and adjustments for the change in unrealized gains and losses on the Company's investments in available-for-sale marketable securities, net of taxes. The Company displays comprehensive (loss) income and its components in its consolidated statements of comprehensive (loss) income.

### **Net Income (Loss) per Share**

Basic net income (loss) per share is computed by dividing net loss for the period by the weighted average number of common shares outstanding during the period. Diluted net loss per share reflects the additional dilution from potential issuances of common stock, such as stock issuable pursuant to the exercise of stock options or the exercise of outstanding warrants. The treasury stock method and if-converted method are used to calculate the potential dilutive effect of these common stock equivalents. Potentially dilutive shares are excluded from the computation of diluted net loss per share when their effect is anti-dilutive. In periods where a net loss is presented, all potentially dilutive securities are anti-dilutive and are excluded from the computation of diluted net loss per share.

During 2017, 2016 and 2015, the Company had securities outstanding which could potentially dilute basic earnings per share in the future, but were excluded from the computation of diluted net loss per share, as their effect would have been anti-dilutive.

These outstanding securities consist of the following:

|                      | Years Ended December 31, |           |           |
|----------------------|--------------------------|-----------|-----------|
|                      | 2017                     | 2016      | 2015      |
| Outstanding options  | 6,321,400                | 4,332,876 | 2,960,816 |
| Outstanding warrants | 4,708,860                | 7,740,340 | 1,972,630 |

### Segment Information

The Company is engaged primarily in the discovery and development of innovative therapies focused on oncology and the treatment of chronic cancer pain as well as immunology and infectious diseases based on its platform technologies. Accordingly, the Company has determined that it operates in one operating segment. During the year ended December 31, 2016, the Company acquired a majority stake in Scilex a developer of specialty pharmaceutical products for the treatment of chronic pain. The operating activities of Scilex are considered to be qualitatively and economically similar to the operating activities of the Company.

### Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which supersedes all existing revenue recognition requirements, including most industry-specific guidance. The new standard requires a company to recognize revenue when it transfers goods or services to customers in an amount that reflects the consideration that the company expects to receive for those goods or services. ASU No. 2014-09 was originally effective for annual reporting periods beginning after December 15, 2016, and interim periods thereafter. In August 2015, the FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which delayed the effective date of the new standard for annual reporting periods beginning after December 15, 2017, and interim periods thereafter. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. The standard allows for either a full retrospective or modified retrospective method of adoption. The Company has performed a review of the new standards as compared to our current accounting policies for our customer contracts and licensing arrangements. The Company adopted this standard on its effective date, January 1, 2018 under the modified retrospective method of adoption. The Company has assessed the impact of the adoption of this standard and concluded it will not have a material impact on the Company’s consolidated financial position, results of operations or cash flows. The Company has not experienced significant issues in its implementation process and it does not anticipate significant changes to its accounting policies.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU amends the guidance in U.S. GAAP on the classification and measurement of financial instruments. Changes to the current guidance primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. ASU No. 2016-01 is effective for fiscal years and interim periods beginning after December 15, 2017, and upon adoption, an entity should apply the amendments by means of a cumulative-effect adjustment to the balance sheet at the beginning of the first reporting period in which the guidance is effective. Early adoption is not permitted except for the provision to record fair value changes for financial liabilities under the fair value option resulting from instrument-specific credit risk in other comprehensive income. The Company has assessed the impact of the adoption of this standard which is not expected to have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. ASU No. 2016-02 is aimed at making leasing activities more transparent and comparable, and requires substantially all leases be recognized by lessees on their balance sheet as a right-of-use asset and corresponding lease liability, including leases currently accounted for as operating leases. ASU No. 2016-2 is effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact that the adoption of ASU No. 2016-2 will have on its consolidated financial position, results of operations and cash flows.

In March 2016, the FASB issued ASU No. 2016-06, *Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments*, which clarifies the steps required when assessing whether the economic characteristics and risks

of call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts based on a four-step decision process. ASU No. 2016-06 is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. The adoption of this standard did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In March 2016, the FASB issued ASU No. 2016-07, *Investments – Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting*, requires that an entity that has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for the equity method and eliminates the requirement for retroactive adjustment of the investment as a result of an increase in the level of ownership interest or degree of influence. ASU No. 2016-07 is effective for financial statements issued for fiscal years and interim periods within those fiscal years beginning after December 15, 2016. The adoption of this standard did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The ASU includes various provisions to simplify the accounting for share-based payments with the goal of reducing the cost and complexity of accounting for share-based payments. The amendments may significantly impact net income, earnings per share and the statement of cash flows as well as present implementation and administration challenges for companies with significant share-based payment activities. ASU No. 2016-09 is effective for public companies for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The adoption of this standard did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. The ASU also requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early application will be permitted for all organizations for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact that the adoption of ASU No. 2016-13 will have on its consolidated financial position, results of operations and cash flows.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, to improve financial reporting in regards to how certain transactions are classified in the statement of cash flows. The ASU requires that (1) debt extinguishment costs be classified as cash outflows for financing activities and provides additional classification guidance for the statement of cash flows, (2) the classification of cash receipts and payments that have aspects of more than one class of cash flows to be determined by applying specific guidance under generally accepted accounting principles, and (3) each separately identifiable source or use within the cash receipts and payments be classified on the basis of their nature in financing, investing or operating activities. The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company has assessed the adoption of ASU No. 2016-15 and is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*, to clarify the definition of a business to add guidance for evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. Specifically, this ASU provides a screen to assist entities in determining when a set should not be considered a business, which screen provides that if substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or group of similar assets, the set is not a business. The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company has assessed the adoption of ASU No. 2017-01 and does not believe that the adoption will have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In January 2017, the FASB issued ASU No. 2017-04, *Simplifying the Test for Goodwill Impairment (Topic 350)*. This standard eliminates Step 2 from the goodwill impairment test, instead requiring an entity to recognize a goodwill impairment charge for the amount by which the goodwill carrying amount exceeds the reporting unit's fair value. This guidance is effective for interim and annual goodwill impairment tests in fiscal years beginning after December 15, 2019 with early adoption

permitted. This guidance must be applied on a prospective basis. The Company is currently evaluating the impact that the adoption of ASU No. 2017-04 will have on the Company's consolidated financial position, results of operations or cash flows.

In May 2017, the FASB issued ASU No. 2017-09, Compensation - *Stock Compensation (Topic 718): Scope of Modification Accounting*, to provide clarity and reduce both the diversity in practice and cost of complexity when applying the guidance. Specifically, the ASU provides additional modification conditions in determining whether or not modification accounting should be applied. The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company has assessed the adoption of ASU No. 2017-09 and does not believe that the adoption will have a material impact on the Company's consolidated financial position, results of operations or cash flows.

#### **4. Acquisitions**

##### ***Acquisition of Virtu Biologics Limited***

On April 27, 2017, the Company entered into a Share Purchase Agreement (the "Virtu Purchase Agreement") with TNK Therapeutics, Inc., a majority-owned subsidiary of the Company ("TNK"), Virtu Biologics Limited ("Virtu"), the shareholders of Virtu (the "Virtu Shareholders") and Dayspring Ventures Limited, as the representative of the Virtu Shareholders, pursuant to which, among other things, TNK acquired from the Virtu Shareholders 100% of the outstanding ordinary shares of Virtu (the "Virtu Acquisition").

Virtu focuses on the development of oncolytic viruses that infect and selectively multiply in and destroy tumor cells without damaging healthy tissue. Its lead oncolytic virus candidate, Seprehvir, infects and replicates in cancer cells selectively, leaving normal cells unharmed.

Under the Virtu Purchase Agreement, the total amount of the consideration payable to the Virtu Shareholders in the Virtu Acquisition is equal to \$25 million, less Virtu's net debt (the "Virtu Base Consideration"). An additional \$10 million contingent consideration is payable upon the achievement of certain regulatory milestones (as described below) (the "Regulatory Approval Consideration").

At the closing of the Virtu Acquisition (the "Closing"), the Company issued to the Virtu Shareholders consideration valued at approximately \$2.2 million, which consisted primarily of an aggregate of 797,081 shares (the "Virtu Closing Shares") and approximately \$557,000 in cash (the "Cash Consideration"). The issuance of the Virtu Closing Shares and the payment of the Cash Consideration satisfied TNK's obligation to pay 20% of the Virtu Base Consideration at the Closing. Under the terms of the Virtu Purchase Agreement, the Company agreed to provide additional consideration to the Virtu Shareholders, as follows:

(1) Upon a financing resulting in gross proceeds (individually or in the aggregate) to TNK of at least \$50.0 million (a "Qualified Financing"), TNK will issue to the Virtu Shareholders an aggregate number of shares of its capital stock ("TNK Capital Stock") as is equal to the quotient obtained by dividing 80% of the Virtu Base Consideration by the lowest per share price paid by investors in the Qualified Financing (the "TNK Financing Consideration"); provided, however, that 20% of the TNK Financing Consideration shall be held in escrow until April 27, 2018 (the "Financing Due Date"), to be used to, among other things, satisfy the indemnification obligations of the Virtu Shareholders. In the event that a Qualified Financing does not occur, then on the Financing Due Date, the Company will issue to the Virtu Shareholders an aggregate number of shares of the Company's common stock as is equal to the quotient obtained by dividing 80% of the Virtu Base Consideration, by \$5.55 (as adjusted, as appropriate, to reflect any stock splits or similar events affecting the Company's common stock after the Closing).

(2) Within 45 business days after Virtu becomes aware that certain governmental bodies in the United States, the European Union, the United Kingdom or Japan have approved for commercialization, on or before October 26, 2024, Seprehvir (or any enhancement, combination or derivative thereof) as a monotherapy or in combination with one or more other active components (each of the first two such approvals by a governmental body being a "Regulatory Approval"), TNK shall pay half of the Regulatory Approval Consideration to the Virtu Shareholders, in a combination of (a) up to \$5.0 million in cash (the "Regulatory Approval Cash") and/or (b) (i) such number of shares of the Company's common stock as is equal to the quotient obtained by dividing \$5.0 million less the Regulatory Approval Cash (the "Regulatory Approval Share Value") by the 30 Day VWAP (as defined below) of one share of the Company's common stock; (ii) if TNK has completed its first public offering of TNK Capital Stock, the number of shares of TNK Capital Stock as is equal to the quotient obtained by dividing the Regulatory Approval Share Value by the 30 Day VWAP of one share of TNK Capital Stock; or (iii) such number of shares of common stock of a publicly traded company as is equal to the quotient obtained by dividing the Regulatory Approval Share Value by the volume weighted average price of the relevant security, as reported on the Nasdaq Capital Market (or other principal stock exchange or securities market on which the shares are then listed or quoted) for the thirty trading days immediately following the receipt of Regulatory Approval (the "30 Day VWAP"), with the composition of the Regulatory Approval Consideration to be at TNK's option. In order for a second regulatory approval to qualify as a Regulatory Approval under the Purchase

Agreement, the second approval must be granted by a different governmental body in a different jurisdiction than that which granted the first Regulatory Approval.

At April 27, 2017, the 80% of the Virttu Base Consideration was valued at \$12.8 million. The fair value of the 80% of the Virttu Base Consideration is recorded as a current liability and will be adjusted quarterly for changes in fair value or as events and circumstances arise. At April 27, 2017, the contingent Regulatory Approval Consideration was valued at \$1.0 million. The fair value of the contingent Regulatory Approval Consideration is recorded as a non-current liability within "Deferred rent and other" on the accompanying condensed consolidated balance sheet and will be adjusted quarterly for changes in fair value or as events and circumstances arise.

The consolidated financial statements include the results of operations from this transaction, which have been accounted for as a business combination, and require, among other things, that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. The valuation of the acquired assets and liabilities resulted in the recognition of identifiable assets of approximately \$16.0 million comprised mainly of in-process research and development of approximately \$15.4 million, deferred tax liabilities of \$0.8 million and goodwill of approximately \$1.4 million subject to final adjustments including tax related items. Various factors contributed to the establishment of goodwill, including an assembled workforce.

In connection with the Virttu transaction, we recorded acquisition costs of approximately \$0.9 million in general and administrative expenses for the twelve months ended December 31, 2017, for legal and related costs. Acquisition costs are expensed as incurred.

The acquisition of Virttu was not significant to the Company's consolidated financial statements.

#### **Acquisition of Scilex Pharmaceuticals Inc.**

On November 8, 2016, the Company entered into a Stock Purchase Agreement (the "Scilex Purchase Agreement") with Scilex and a majority of the stockholders of Scilex (the "Scilex Stockholders") pursuant to which, on November 8, 2016, the Company acquired from the Scilex Stockholders, and the Scilex Stockholders sold to the Company, approximately 72% of the outstanding capital stock of Scilex (the "Scilex Acquisition"), which remains a stand-alone company. The remainder of the outstanding capital stock of Scilex represents a noncontrolling interest of which approximately 23% continues to be held by ITOCHU CHEMICAL FRONTIER CORPORATION following the Scilex Acquisition.

Scilex focuses on the development and commercialization of specialty pharmaceutical products for the treatment of pain; its lead product, ZTlido™ (lidocaine topical system 1.8%), is a branded lidocaine topical system formulation being developed for the treatment of chronic pain. ZTlido™ (lidocaine topical system 1.8%) will be manufactured by a contract manufacturer.

At the closing of the Scilex Acquisition, the Company issued to the Scilex Stockholders that were accredited investors (the "Accredited Scilex Stockholders") consideration valued at \$4.8 million which consisted primarily of an aggregate of 754,911 shares of the Company's common stock (the "Common Stock"). Under the terms of the Scilex Purchase Agreement, the Company agreed to provide additional consideration to the Accredited Scilex Stockholders upon the achievement of certain milestones, as follows:

(1) Upon receipt of notice from the U.S. Food and Drug Administration (the "FDA") that the FDA has accepted Scilex's resubmitted new drug application for ZTlido™ (lidocaine topical system 1.8%) for the treatment of postherpetic neuralgia (the "NDA"), the Company will deliver to the Accredited Scilex Stockholders a number of shares of Common Stock equal to the quotient obtained by dividing 10% of the total undiscounted purchase consideration of approximately \$47.8 million (the "Adjusted Base Consideration") by a price (the "FDA Acceptance Price") equal to the closing market price of one share of Common Stock, as reported by The Nasdaq Stock Market LLC ("Nasdaq") on the date of Scilex's receipt of the FDA notice or, if no closing price is reported for such date, the closing price on the last preceding date for which such quotation exists; provided, however, that in no event shall the FDA Acceptance Price be greater than \$25.32 or less than \$6.33 (in each case as adjusted, as appropriate, to reflect any stock splits or similar events affecting the Common Stock).

On September 11, 2017, the Company received notice from the FDA that the FDA had accepted the NDA and the Company issued to the Accredited Scilex Stockholders consideration valued at \$1.4 million, which consisted primarily of an aggregate of 754,930 shares of Common Stock.

(2) Upon receipt of notice from the FDA that the FDA has approved the NDA for commercialization, the Company will deliver to the Accredited Scilex Stockholders cash and shares of Common Stock in such proportion to be determined in the Company's sole discretion, with a total value equal to 80% of the Adjusted Base Consideration (the "FDA Approval Consideration"). To the extent that the Company elects to pay any portion of the FDA Approval Consideration in shares of Common Stock, the number of shares shall be equal to the quotient obtained by dividing (a) the portion of the FDA Approval



Consideration to be paid in shares of Common Stock by (b) a price (the “FDA Approval Price”) equal to the closing market price of one share of Common Stock, as reported by Nasdaq on the date of the Scilex’s receipt of the FDA notice or, if no closing price is reported for such date, the closing price on the last preceding date for which such quotation exists; provided, however, that in no event shall the FDA Approval Price be greater than \$25.32 or less than \$6.33 (in each case as adjusted, as appropriate, to reflect any stock splits or similar events affecting the Common Stock). However, in no event may the Company make an election with respect to the FDA Approval Consideration so as to cause the total number of shares of Common Stock issued in connection with the Scilex Acquisition to exceed 4.99% of the total number of shares of Common Stock of the Company outstanding as of immediately prior to the Closing (as adjusted, as appropriate, to reflect any stock splits or similar events affecting the Common Stock), unless the Company has obtained stockholder approval to issue a greater number of shares.

On February 28, 2018, the Company received notice that the FDA had approved the NDA and the Company will issue the Accredited Scilex Stockholders consideration valued at \$38.2 million, which included an aggregate of 1,381,346 shares of Common Stock.

During the first quarter of 2017, the Company identified an error in the valuation of acquisition consideration associated with the Scilex Acquisition, primarily related to the acquisition consideration payable, resulting in an overstatement of acquisition consideration payable of \$6.5 million, and a corresponding overstatement of intangible assets of \$6.7 million, goodwill of \$4.6 million, deferred income tax liability of \$2.8 million, additional paid-in capital of \$0.6 million, and noncontrolling interest of \$1.4 million as of December 31, 2016. The Company evaluated the materiality of this misstatement from quantitative and qualitative perspectives, and concluded that it was immaterial to the prior periods. Consequently, the Company corrected this error by recording the adjustment in the Company’s condensed consolidated balance sheet in the quarter ended March 31, 2017.

At November 8, 2016, the contingent consideration was valued at \$33.5 million, resulting in a total purchase consideration of approximately \$38.2 million. The fair value of the contingent consideration is recorded as a current liability and will be periodically adjusted for changes in fair value or as events and circumstances arise. The remainder of the outstanding capital stock of Scilex represents a noncontrolling interest which was valued at \$12.3 million at November 8, 2016.

The consolidated financial statements include the results of operations from this transaction, which have been accounted for as a business combination, and require, among other things, that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. The valuation of the acquired assets resulted in the recognition of identifiable assets of approximately \$54.9 million comprised mainly of in-process research and development of \$21.9 million and patents of \$32.6 million. The valuation of the acquired liabilities resulted in the recognition of liabilities of approximately \$17.9 million comprised mainly deferred tax liabilities of \$13.9 million. The Company recorded goodwill of \$13.5 million associated with the acquisition. The amounts in this footnote reflect the adjustment described above. Various factors contributed to the establishment of goodwill, including an assembled workforce.

#### ***Acquired In-process Research and Development of BDL***

In August 2015, the Company and TNK entered into a Stock Purchase Agreement (the “Stock Purchase Agreement”) with BDL Products, Inc. (“BDL”) and the stockholders of BDL (“Stockholders”) pursuant to which the Stockholders sold all of their shares of capital stock in BDL to TNK for: (1) a cash payment of \$100.00, and (2) \$6.0 million in shares of TNK Class A Stock, subject to adjustment in certain circumstances, to be issued to the Stockholders upon a financing resulting in gross proceeds (individually or in the aggregate) to TNK of at least \$50.0 million (a “Qualified Financing”). In accordance with subsequent amendments to the Stock Purchase Agreement, in the event a Qualified Financing does not occur by October 15, 2017 (which is subject to further extension as implied and based on previously amended dates) or TNK does not complete an initial public offering of shares of its capital stock by September 15, 2017, in lieu of receiving shares of TNK pursuant to the acquisition, the Stockholders shall receive an aggregate of 309,917 shares of the Company’s common stock, subject to adjustment in certain circumstances.

Although a Qualified Financing did not occur by October 15, 2017 and TNK did not complete an initial public offering by September 15, 2017, as of the date of the filing of this Annual Report on Form 10-K, the Company has not issued shares to the Stockholders pursuant to the Stock Purchase Agreement as it is currently negotiating the terms of the Stock Purchase Agreement with the Stockholders. (See Note 5).

#### ***Acquired In-process Research and Development of Cargenix***

In August 2015, the Company and TNK Therapeutics, Inc., its subsidiary (“TNK”) entered into a Membership Interest Purchase Agreement (the “Membership Interest Purchase Agreement”) with CARgenix Holdings LLC (“CARgenix”) and the members of CARgenix (the “Members”) pursuant to which the Members sold all of their membership interests in CARgenix to

TNK for: (1) a cash payment of \$100.00, and (2) \$6.0 million in shares of TNK Class A common stock (“TNK Class A Stock”), subject to adjustment in certain circumstances, to be issued to the Members upon a financing resulting in gross proceeds (individually or in the aggregate) to TNK of at least \$50.0 million (a “Qualified Financing”). In accordance with an amendment to the Membership Interest Purchase Agreement entered into in March 2016, in the event a Qualified Financing did not occur by September 15, 2016 or TNK did not complete an initial public offering of shares of its capital stock by October 15, 2016, in lieu of receiving shares of TNK pursuant to the acquisition, the Members would receive an aggregate of 309,917 shares of the Company’s common stock, subject to adjustment in certain circumstances. TNK did not complete a Qualified Financing by the amended financing deadline and the Company issued 309,917 shares of its common stock to the Members on October 7, 2016.

## 5. Fair Value Measurements

Fair value measurement is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy is established, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs, other than quoted prices in active markets, that are observable either directly or indirectly.

Level 3—Unobservable inputs based on the Company’s own assumptions.

The following table presents the Company’s financial assets and liabilities that are measured at fair value on a recurring basis. (in thousands):

|                                   | Fair Value Measurements at December 31, 2017 |   |   |   |
|-----------------------------------|--|---|---|---|
|                                   | Balance                                      | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <i>Assets:</i>                    |  |   |   |   |
| Cash and Cash Equivalents         | \$ 20,429                                    | \$ 20,429                                 | \$ —  | \$ —                                      |
| Marketable securities             | \$ 441                                       | \$ 356                                    | \$ —  | \$ 85                                     |
| Total assets                      | \$ 20,870                                    | \$ 20,785                                 | \$ —  | \$ 85                                     |
| <i>Liabilities:</i>               |  |   |   |   |
| Acquisition consideration payable | \$ 54,272                                    | \$ —                                      | \$ —  | \$ 54,272                                 |
| Total liabilities                 | \$ 54,272                                    | \$ —                                      | \$ —  | \$ 54,272                                 |
|                                   | Fair Value Measurements at December 31, 2016 |   |   |   |
|                                   | Balance                                      | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <i>Assets:</i>                    |  |   |   |   |
| Cash and Cash Equivalents         | \$ 82,398                                    | \$ 82,398                                 | \$ —  | \$ —                                      |
| Marketable securities             | \$ 1,106                                     | \$ 831                                    | \$ —  | \$ 275                                    |
| Total assets                      | \$ 83,504                                    | \$ 83,229                                 | \$ —  | \$ 275                                    |
| <i>Liabilities:</i>               |  |   |   |   |
| Derivative liability              | \$ 48,362                                    | \$ —                                      | \$ —  | \$ 48,362                                 |
| Total liabilities                 | \$ 48,362                                    | \$ —                                      | \$ —  | \$ 48,362                                 |

The Company's financial assets and liabilities carried at fair value are comprised of cash and cash equivalents, marketable securities, acquisition consideration payable and derivative instruments. Cash and cash equivalents consist of money market accounts and bank deposits which are highly liquid and readily tradable. These investments are valued using inputs observable in active markets for identical securities. Marketable securities are valued using inputs observable in active markets for identical securities. The Company recorded contingent consideration as part of its acquisitions of Shanghai Three Alliance Biotech Co. LTD ("Shanghai Three"), Roger Williams Medical Center ("RWMC"), Concertis, Inc., ("Concertis"), BDL, CARgenix, Scilex, and Virttu. The fair value of the contingent consideration measured at fair value on a recurring basis using significant unobservable inputs (Level 3). Contingent consideration is measured using the income approach and discounting to present value the contingent payments expected to be made based on assessment of the probability that the company would be required to make such future payment.

The following is a summary of the contingent consideration liabilities associated with acquisitions entered into during the year ended December 31, 2016. The contingent consideration was measured at fair value using significant unobservable inputs (Level 3) as of December 31, 2016. Contingent consideration associated with acquisitions increased by \$46.8 million during the year ended December 31, 2016. During the ended December 31, 2016, the fair value remeasurement adjustments related to the Company's acquisitions resulted in a decrease to the contingent consideration liabilities by \$1.8 million, and there were no payments of contingent consideration related to such liabilities. The ending balance at December 31, 2016 for the Company's acquisitions during the year ended December 31, 2016, was \$45.0 million.

The following table includes a summary of the changes to contingent consideration liabilities during the year ended December 31, 2017. The contingent consideration is measured at fair value using significant unobservable inputs (Level 3) during the twelve months ended December 31, 2017:

| (in thousands)  | 2017             |
|---|------------------|
| Beginning Balance at December 31, 2016  | 48,362           |
| Scilex acquisition adjustment (See Note 4)                                      | (6,500)          |
| Acquisition consideration payable - current year acquisitions (See Note 4)      | 12,807           |
| Contingent consideration (Non-current) - current year acquisitions (See Note 4) | 983              |
| Re-measurement of Fair Value  | —                |
| Payment of shares for current year contingent consideration                     | (1,380)          |
| Ending Balance at December 31, 2017   | <u>\$ 54,272</u> |

The following table includes a summary of the derivative liabilities measured at fair value using significant unobservable inputs (Level 3) during the twelve months ended December 31, 2016.

| (in thousands)                     | 2016        |
|------------------------------------|-------------|
| Fair Value at Beginning of Year    | \$ 5,520    |
| Additions                          | —           |
| Expiration of derivative liability | (5,520)     |
| Payments                           | —           |
| Balance at End of Year             | <u>\$ —</u> |

The following table includes a summary of the Company's contingent and financing liabilities, related inputs used to determine fair value, and the valuation methodologies used for the fair value measurements using significant unobservable inputs (Level 3) at December 31, 2017:

| (in thousands)                                | Fair Value Measurements at December 31, 2017 | Valuation Methodology                 | Significant Unobservable Input                                | Weighted Average (range, if applicable) |
|---|--|---------------------------------------|---|---|
| BDL Contingent Consideration                  | \$ 1,643                                     | Multiple outcome discounted cash flow | Discount Rate<br>Percent probabilities assigned to scenarios  | 4.41%<br>10% and 90%                    |
| Virttu Contingent Consideration (Non-Current) | \$ 1,063                                     | Multiple outcome discounted cash flow | Discount Rate<br>Probability of Regulatory Milestone          | 12.21%<br>16%                           |
| Virttu Contingent Consideration               | \$ 14,884                                    | Multiple outcome discounted cash flow | Discount Rate<br>Percent probabilities assigned to scenarios  | 1.47%<br>20% and 80%                    |
| Scilex Contingent Consideration               | \$ 32,200                                    | Monte Carlo simulation method         | Discount Rate<br>Probability of Regulatory Milestone          | 10.54%<br>95%                           |
| Concertis Contingent Consideration            | \$ 511                                       | Multiple outcome discounted cash flow | Discount Rate<br>Percent probabilities assigned to scenarios  | 19.20%<br>20%                           |
| Shanghai Three Contingent Consideration       | \$ 1,588                                     | Multiple outcome discounted cash flow | Discount Rate<br>Percent probabilities assigned to scenarios  | 12.21%<br>50%                           |
| RWMC Contingent Consideration                 | \$ 2,383                                     | Multiple outcome discounted cash flow | Discount Rate,<br>Percent probabilities assigned to scenarios | 12.21%<br>50%                           |

The principal significant unobservable inputs used in the valuations of the contingent considerations are the discount rates, and probabilities assigned to scenario outcomes. An increase in the discount rate or regulatory milestone will cause a decrease in the fair value of the contingent consideration. Conversely, a decrease in the discount rate will cause an increase in the fair value of the contingent consideration. An increase in the probabilities assigned to certain scenarios will cause the fair value of contingent consideration to increase. Conversely, a decrease in the probabilities assigned to certain scenarios will cause the fair value of contingent considerations to decrease.

## 6. Marketable Securities

Marketable securities consisted of the following as of December 31, 2017 (in thousands):

|                                    | December 31, 2017 |                               |            |
|------------------------------------|-------------------|-------------------------------|------------|
|                                    | Cost              | Gross Realized Gains (Losses) | Fair Value |
| Trading securities:                |                   |                               |            |
| MedoveX common shares and warrants | \$ 750            | \$ (309)                      | \$ 441     |

|                                    | December 31, 2016 |                               |            |
|------------------------------------|-------------------|-------------------------------|------------|
|                                    | Cost              | Gross Realized Gains (Losses) | Fair Value |
| Trading securities:                |                   |                               |            |
| MedoveX common shares and warrants | \$ 750            | \$ 356                        | \$ 1,106   |

### Trading Securities

On August 5, 2016, the Company entered into a Unit Purchase Agreement (the "Unit Purchase Agreement") with MedoveX Corporation ("MedoveX"). Pursuant to the terms of the Unit Purchase Agreement, the Company purchased three Units for \$750 thousand. Each Unit had a purchase price of \$250 thousand and consisted of (i) 208,333 shares of MedoveX common stock (the "MedoveX Common Stock"), and (ii) a warrant to purchase 104,167 shares of MedoveX Common Stock (the "MedoveX Warrant"). The MedoveX Warrant has an initial exercise price of \$1.52 per share, subject to adjustment, and is initially exercisable six months following the date of issuance for a period of five years from the date of issuance. In addition, the Company entered into a Registration Rights Agreement with MedoveX pursuant to which MedoveX was required

to file a registration statement registering for resale all shares of MedoveX Common Stock and shares of MedoveX Common Stock issuable pursuant to the MedoveX Warrant issued as part of the Units.

For the twelve months ended December 31, 2017 and 2016, the Company recorded a loss of \$0.7 million and a gain of \$0.4 million on trading securities. The Company's investment in MedoveX will be revalued on each balance sheet date. The fair value of the Company's holding in MedoveX Common Stock at December 31, 2017 is a Level 1 measurement. The fair value of the Company's holdings in the MedoveX Warrant was estimated using the Black-Scholes option-pricing method. The risk-free rate was derived from the U.S. Treasury yield curve, matching the MedoveX Warrant's term, in effect at the measurement date. The volatility factor was determined based on MedoveX's historical stock prices. The warrant valuation is a Level 3 measurement.

The following table includes a summary of the warrant measured at fair value using significant unobservable inputs (Level 3) during the twelve months ended December 31, 2017 (in thousands):

|  | Total        |
|--|--------------|
| Beginning balance at December 31, 2016 | \$ 275       |
| Addition of warrant                    | —            |
| Change in fair value of warrant        | (191)        |
| Ending balance at December 31, 2017    | <u>\$ 84</u> |

#### **Available-for-sale Securities**

On July 27, 2015, NantKwest, Inc. ("NantKwest") completed its initial public offering ("IPO"). Prior to the IPO the Company's investment in NantKwest was accounted for using the cost method and the total investment of \$10.0 million was classified as part of cost method investments on the Company's consolidated balance sheets. The common shares were subject to restrictions in a lock-up agreement through December 27, 2015 as well as limitations under Rule 144 of the Securities Act of 1933, as amended. As these were short term restrictions, the Company did not apply a marketability discount. At December 31, 2015, the Company recorded an unrealized gain of \$73.6 million, representing the difference between the \$10.0 million cost basis and the estimated fair value net of tax, as accumulated other comprehensive income in the stockholder's equity section of the Company's consolidated balance sheet and as a change in unrealized gains and losses on marketable securities in the Company's consolidated statements of comprehensive income (loss). The Company's investment in NantKwest was revalued on each balance sheet date.

In July 2016, the Company completed the transactions contemplated by a letter agreement (the "Letter Agreement") with the Chan Soon-Shiong Family Foundation ("Foundation") and Cambridge Equities, LP ("Cambridge"). Pursuant to the terms of the Letter Agreement, among other things, (i) the Company agreed to sell to Foundation, and Foundation agreed to purchase from the Company, an aggregate of 5,618,326 shares of common stock of NantKwest held by the Company (representing all shares of NantKwest held by the Company), (ii) Foundation agreed to sell to the Company, and the Company agreed to purchase all reported shares held by Foundation and Cambridge, constituting an aggregate of 7,878,098 shares of Common Stock, (iii) Cambridge agreed to forfeit its right to purchase 500,000 shares of Common Stock issuable pursuant to a warrant to purchase 1,724,138 shares of Common Stock issued by the Company, and (iv) the Company agreed to pay to Foundation an aggregate of approximately \$15.6 million. Effective upon closing, the Company repurchased the 7,878,098 shares of Common Stock. The Company recognized a gain of \$27.2 million on the sale of the NantKwest stock in its consolidated statement of operations for the twelve months ended December 31, 2016 as a result of the transaction.

#### **7. Property and Equipment**

Property and equipment consisted of the following as of December 31, 2017 and 2016 (in thousands):

|                               | December 31,     |                  |
|-------------------------------|------------------|------------------|
|                               | 2017             | 2016             |
| Furniture and fixtures        | \$ 1,035         | \$ 458           |
| Office equipment              | 493              | 326              |
| Machinery and lab equipment   | 19,868           | 13,220           |
| Leasehold improvements        | 7,327            | 3,625            |
|                               | <u>\$ 28,723</u> | <u>\$ 17,630</u> |
| Less accumulated depreciation | (9,378)          | (4,922)          |
|                               | <u>\$ 19,345</u> | <u>\$ 12,707</u> |

Depreciation expense for the years ended December 31, 2017, 2016 and 2015 was \$4,470 thousand, \$1,951 thousand and \$1,134 thousand, respectively.

## 8. Cost Method Investments

As of December 31, 2017, the aggregate carrying amount of the Company's cost-method investments in non-publicly traded companies was \$237.0 million and included an ownership interest in NantCell, Inc. ("NantCell"), NantBioScience, Inc. ("NantBioScience"), Globavir Biosciences, Inc., Brink Biologics, Inc., Coneksis, Inc., and Celularity Inc. (See Note 9).

As of December 31, 2016, the aggregate carrying amount of the Company's cost-method investments in non-publicly traded companies was \$112.0 million and included an ownership interest in NantCell, NantBioScience, Globavir Biosciences, Inc., Brink Biologics, Inc., and Coneksis, Inc.

The Company's cost-method investments are assessed for impairment quarterly. The Company has determined that it is not practicable to estimate the fair value of its cost-method investments on a regular basis and does not reassess the fair value of cost-method investments if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investments. No impairment losses were recorded during the years ended December 31, 2017, 2016 and 2015.

## 9. Equity Method Investments

### *NANTibody*

In 2013, the Company acquired IgDraSol Inc. ("IgDraSol"), a private company focused on the development of oncologic agents for the treatment of cancer, from a third party unrelated to the NantWorks, LLC ("NantWorks") affiliated entities for 3 million shares of the Company's common stock and \$380,000 of cash for a total purchase price of \$29.1 million. This transaction included the acquisition of IgDraSol's lead compound, Cynviloq™, a micellar diblock copolymeric paclitaxel formulation drug product.

In May 2015, the Company entered into an agreement with NantPharma, LLC ("NantPharma"), a NantWorks company, pursuant to which the Company sold to NantPharma all of its equity interests in IgDraSol, which continued to hold the rights to Cynviloq™. Pursuant to the agreement, NantPharma paid the Company an upfront fee of \$90.1 million, of which \$60.0 million was required to be used by the Company to fund two joint ventures, as described below.

In April 2015, the Company and NantCell, a subsidiary of NantWorks, LLC ("NantWorks"), a private company owned by Dr. Patrick Soon-Shiong, established a new entity called Immunotherapy NANTibody, LLC ("NANTibody") as a stand-alone biotechnology company with \$100.0 million initial joint funding. NantCell owns 60% of the equity interest of NANTibody and agreed to contribute \$60.0 million to NANTibody. The Company owns 40% of NANTibody and in July 2015, the Company had NantPharma, LLC ("NantPharma") contribute its portion of the initial joint funding of \$40.0 million to NANTibody from the proceeds of the sale of IgDraSol, Inc. ("IgDraSol"). Additionally, the Company and NantCell were allowed to appoint three and two representatives, respectively, to NANTibody's five-member Board of Directors. NANTibody will focus on accelerating the development of multiple immunology mAbs for the treatment of cancer, including but not limited to anti-PD-1, anti-PD-L1, anti-CTLA4mAbs, and other immune-check point antibodies as well as ADCs and bispecific antibodies.

NANTibody had been formed to advance pre-clinical and clinical immunology assets contributed by the Company and NantCell. The Company continues to hold 40% of the outstanding equity of NANTibody and NantCell holds the remaining

60%. Until July 2, 2017, NANTibody held approximately \$100.0 million of cash and cash equivalents, and the Company recorded its investment in NANTibody at approximately \$40.0 million. As an equity method investment, the Company's ratable portion of 40% of money expended for the development of intellectual property assets held by NANTibody would be reflected within income (loss) on equity method investments in its statement of operations. As a result of limited spending at NANTibody, the cash on hand at NANTibody remained at approximately at \$100.0 million since the inception of the NANTibody joint venture until July 2, 2017. Further, the Company's equity method investment in NANTibody remained at approximately \$40.0 million until July 2, 2017.

The financial statements of NANTibody are not received sufficiently timely for the Company to record its portion of earnings or loss in the current financial statements and therefore the Company reports its portion of earnings or loss on a quarter lag.

In February 2018, NANTibody notified the Company that on July 2, 2017, NANTibody acquired all of the outstanding equity of IgDraSol in exchange for \$90.1 million in cash. NANTibody purchased IgDraSol from NantPharma, LLC, which is controlled by NantWorks, an entity with a controlling interest in NantCell and NantPharma.

Although the Company has had a designee serving on the Board of Directors of NANTibody since the formation of NANTibody in April 2015, and although the Company has held 40% of the outstanding equity of NANTibody since NANTibody's formation, neither the Company nor its director designee was given any advance notice of NANTibody's purchase of IgDraSol or of any board meeting or action to approve such purchase. As such, the Company's designee on NANTibody's Board of Directors was not given an opportunity to consider or vote on the transaction as a director and the Company was not given an opportunity to consider or vote on the transaction in its position as a significant (40%) equity holder of NANTibody.

As a result of the July 2, 2017 purchase of IgDraSol, NANTibody's cash and cash equivalents were reduced from \$99.6 million as of June 30, 2017 to \$9.5 million as of September 30, 2017, and NANTibody's contributed capital was reduced from \$100.0 million as of June 30, 2017 to \$10.0 million as of September 30, 2017, to effect the transfer of IgDraSol from NantPharma to NANTibody. No additional information was provided to the Company to explain why NANTibody's total assets as of September 30, 2017 were reduced by approximately \$90.1 million. The Company requested, but did not receive, additional information from NANTibody for purposes of supporting the value of IgDraSol, including any information regarding clinical advancements in the entity since the sale of IgDraSol by the Company in May 2015.

Prior to the communication of the transfer of IgDraSol from NantPharma to NANTibody, the Company relied on the cash and cash equivalents of NANTibody for purposes of determining the value of its investment in NANTibody, which capital was expended by NANTibody to acquire IgDraSol on July 2, 2017. As a result of the transfer of IgDraSol, the Company reassessed the recoverability of its equity method investment in NANTibody as of July 2, 2017. In doing so, the Company considered the expected outcomes for the intellectual property assets held by NANTibody as of July 2, 2017. As a result of the lack of evidence of any development activity associated with any of the assets held in NANTibody, given the passage of time since the formation of the joint venture, many competitive products from other drug developers worldwide have advanced and/or commercialized for the targeted disease indications of the assets held in NANTibody, and given the Company's minority interest in NANTibody (the investee), the Company concluded that it does not have the ability to recover the carrying amount of the investment and an other-than-temporary decline in the value of the investment had occurred. Accordingly, an impairment was recorded to the Company's equity method investment in NANTibody for the three and nine months ended September 30, 2017. The fair value of the Company's investment in NANTibody was measured at fair value on July 2, 2017 using significant unobservable inputs (Level 3) due to the determination of fair value requiring significant judgment, including the potential outcomes of the intellectual property assets held by NANTibody. For these reasons, fair value was determined by applying the Company's 40% equity interest in NANTibody to the remaining cash and cash equivalents, which resulted in an impairment of \$36.0 million. The impairment resulted in a revised carrying value of the Company's investment in NANTibody of \$3.7 million which approximates its ratable 40% ownership of the cash maintained by NANTibody expected to be used for future research and development.

NANTibody recorded net loss of \$1.1 million and \$0.6 million for the twelve months ended September 30, 2017 and 2016, respectively. The Company recorded its portion of loss from NANTibody in (loss) income on equity investments on its consolidated statements of operations for the twelve months ended December 31, 2017 and 2016. As of September 30, 2017, NANTibody had \$9.9 million in current assets, \$591 thousand in current liabilities, and no noncurrent assets or noncurrent liabilities. As of September 30, 2016, NANTibody had \$100.7 million in current assets and \$242 thousand in current liabilities and no noncurrent assets or noncurrent liabilities.

## **NantStem**

In July 2015, the Company and NantBioScience, a subsidiary of NantWorks, established a new entity called NantCancerStemCell, LLC (“NantStem”) as a stand-alone biotechnology company with \$100.0 million initial joint funding. As initially organized, NantBioScience was obligated to make a \$60.0 million cash contribution to NantStem for a 60% equity interest in NantStem, and the Company was obligated to make a \$40.0 million cash contribution to NantStem for a 40% equity interest in NantStem. Fifty percent of these contributions were funded in July 2015 and the remaining amounts were to be made by no later than September 30, 2015. The Company had NantPharma contribute its portion of the initial joint funding of \$20.0 million to NantStem from the proceeds of the sale of IgDraSol. Pursuant to a Side Letter dated October 13, 2015, the NantStem joint venture agreement was amended to relieve the Company of the obligation to contribute the second \$20.0 million payment, and its ownership interest in NantStem was reduced to 20%. NantBioScience’s funding obligations were unchanged. The Side Letter was negotiated at the same time the Company issued a call option on shares of NantKwest that it owned to Cambridge, a related party to NantBioScience.

In the fourth quarter of 2015, the Company determined it had an other-than-temporary decline in the value of NantStem and recognized a loss of \$4.0 million in loss on equity investments on its consolidated statement of operations for the year ended December 31, 2015. There was no loss related to other-than-temporary impairment recognized for the equity investment for the year ended December 31, 2016.

The Company is accounting for its interest in NantStem as an equity method investment, due to the significant influence the Company has over the operations of NantStem through its board representation and 20% voting interest. The Company’s investment in NantStem is reported in equity method investments on its consolidated balance sheets and its share of NantStem’s loss is recorded in loss on equity investments on its consolidated statement of operations. As of December 31, 2017 and 2016, the carrying value of the Company’s investment in NantStem was approximately \$18.7 million and \$18.5 million, respectively.

The financial statements of NantStem are not received sufficiently timely for the Company to record its portion of earnings or loss in the current financial statements and therefore the Company reports its portion of earnings or loss on a quarter lag.

NantStem recorded net income of \$0.7 million and \$0.9 million for the twelve months ended September 30, 2017 and 2016, respectively. The Company recorded its portion of gain from NantStem in gain on equity investments on its consolidated statements of operations for the twelve months ended December 31, 2017 and 2016. As of September 30, 2017, NantStem had \$82.5 million in current assets and no current liabilities and no noncurrent assets or noncurrent liabilities. As of September 30, 2016, NantStem had \$81.7 million in current assets and no current liabilities and no noncurrent assets or noncurrent liabilities.

## **Yuhan Agreement**

In March 2016, the Company and Yuhan Corporation, a South Korea company (“Yuhan”), entered into an agreement to form a joint venture company called ImmuneOncia Therapeutics, LLC (“ImmuneOncia”) to develop and commercialize a number of immune checkpoint antibodies against undisclosed targets for both hematological malignancies and solid tumors. Under the terms of the joint venture agreement, Yuhan contributed an initial investment of \$10.0 million to ImmuneOncia, and the Company granted ImmuneOncia an exclusive license to one of its immune checkpoint antibodies for specified countries while retaining the rights for the U.S., European and Japanese markets, as well as global rights for ImmuneOncia to two additional antibodies that will be selected by ImmuneOncia from a group of pre-specified antibodies from the Company’s immuno-oncology antibody portfolio. Yuhan owns 51% of ImmuneOncia, while the Company owns 49%.

The Company is accounting for its interest in ImmuneOncia as an equity method investment, due to the significant influence the Company has over the operations of ImmuneOncia through its board representation and 49% voting interest while not sharing joint control with Yuhan. The Company’s investment in ImmuneOncia is reported in equity method investments on its condensed consolidated balance sheets and its share of ImmuneOncia’s loss is recorded in loss on equity investments on its condensed consolidated statement of operations. As of December 31, 2017 and 2016, the carrying value of the Company’s investment in ImmuneOncia was approximately \$6.8 million and \$9.5 million, respectively. The difference between the Company’s investment in ImmuneOncia and the Company’s 49% interest in the net assets of ImmuneOncia was approximately \$1.0 million at December 31, 2017.

ImmuneOncia recorded net loss of \$5.4 million for the twelve months ended December 31, 2017. The Company recorded its portion (49% equity interest) of loss from ImmuneOncia in loss on equity investments on its consolidated statement of operations for the twelve months ended December 31, 2017. As of December 31, 2017, ImmuneOncia had \$7.4



million in current assets, \$129 thousand in current liabilities, \$8.8 million in noncurrent assets, and \$33 thousand noncurrent liabilities. As of December 31, 2016, no material activity had occurred subsequent to the Company's initial investment.

In April 2016, Yuhan purchased \$10.0 million of shares of Common Stock, and warrants as part of the Company's private placement offering.

### ***Celularity Transaction***

On November 1, 2016, the Company entered into a nonbinding term sheet (the "Term Sheet") with TNK and Celularity, Inc., a research and development company ("Celularity"), setting forth the terms and conditions by which the Company or TNK, along with one or more third parties, would contribute certain assets to Celularity. The Term Sheet outlined that contingent upon the execution of a definitive agreement among the parties, concurrently with asset contributions to Celularity to be made by one or more third parties, TNK would contribute to Celularity certain chimeric antigen receptor ("CAR") constructs for use in placenta-derived cells and cord blood-derived cell, and the Company would receive equity in Celularity.

In connection with the execution of the Term Sheet, on November 1, 2016, the Company loaned \$5.0 million to Celularity, Inc. pursuant to a promissory note issued by Celularity to the Company, as amended (as so amended, the "Celularity Note"). Pursuant to the terms of the Celularity Note, the loan would be due and payable in full on the earlier of November 1, 2017 and the occurrence of an event of default under the Celularity Note (the "Maturity Date"). In the event that Celularity met certain minimum financing conditions prior to the Maturity Date, all outstanding amounts under the Celularity Note would be forgiven. On May 31, 2017, the Company loaned an additional \$2.0 million to Celularity pursuant to the terms of the Celularity Note. On June 14, 2017, the Company loaned an additional \$1.0 million to Celularity, and the Company loaned an additional \$2.0 million to Celularity on July 6, 2017.

On June 12, 2017, the Company, TNK and Celularity entered into a Contribution Agreement (the "Contribution Agreement") pursuant to which, among other things, the Company and TNK agreed to license certain intellectual property rights related to their proprietary CAR constructs and related CARs to Celularity. Per the terms of the Contribution Agreement, the transaction was contingent upon, among other things, Celularity meeting minimum financing conditions similar to those required per the Celularity Note. In exchange for the Company's contribution under the Contribution Agreement and the forgiveness of the Celularity Note, the Company was to receive Series A preferred shares of Celularity equal to 25% of Celularity's outstanding shares of capital stock calculated on a fully-diluted basis.

On August 15, 2017, Celularity successfully completed the minimum financing conditions outlined in the Celularity Note and Contribution Agreement through the issuance of Series A preferred shares. As a result, the transactions contemplated by the Contribution Agreement closed and, on such date, among other things, (a) Celularity issued Series A preferred shares to TNK, (b) the Company, TNK and Celularity entered into a License and Transfer Agreement (the "License Agreement"), and (c) the Celularity Note was forgiven by the Company. Pursuant to the License Agreement (i) TNK and the Company agreed to provide to Celularity (1) their CAR constructs and related CARs for use worldwide in combination with placenta-derived cells and/or cord blood-derived cells for the treatment of any disease or disorder except that the anti-CD38 CAR constructs and related CARs may also be used in adult cells for the treatment of multiple myeloma unless TNK exercises its termination rights for the use with adult cells, and (2) their know-how relating to the foregoing, (ii) TNK and the Company granted to Celularity a limited, perpetual, transferable and sub-licensable license and covenant not to sue with respect to certain of their patents and other intellectual property rights, and (iii) Celularity agreed to pay to TNK 50% of the first \$200 million and 20% thereafter of any upfront and milestone payments that Celularity receives in connection with any sub-license of a combination of anti-CD38 CAR constructs and either placenta-driven cells and/or cord blood-derived cells or adult cells.

From November 1, 2016 through August 15, 2017, the Company accounted for the Celularity Note as an equity method investment in Celularity in accordance with FASB Topic 323, *Investments-Equity Method and Joint Ventures* ("ASC 323"). As of August 14, 2017, the carrying value of the Company's equity method investment in Celularity was \$8.8 million. Because Celularity completed the minimum financing conditions outlined in the Celularity Note and Contribution Agreement, on August 15, 2017, TNK received Series A preferred shares in an amount equivalent to a 25% ownership interest in Celularity on an as-converted basis and the Celularity Note was forgiven. Upon issuance of the Series A Preferred shares for 25% ownership interest in Celularity, in accordance with ASC 323, the Company modified its investment in Celularity as a cost method investment because it was determined the Series A Preferred shares were not in-substance common stock.

The Company determined that the exchange of the Celularity Note and the 25% ownership interest in Celularity is a nonmonetary exchange within the scope of ASC 845, *Nonmonetary Transactions*, and was accounted for at fair value. The carrying value of the Company's investment in Celularity is \$125.0 million at August 15, 2017 and December 31, 2017.

The Company has assessed the accounting for the License Agreement under ASC 605-25, *Revenue Recognition - Multiple Element Arrangements*, and determined that the deliverables under the License Agreement should be accounted for as multiple units of accounting. The deliverables identified in the License Agreement consist of (1) delivered CAR constructs and related CARs, and (2) undelivered CAR constructs, if and when the Company discovers them. Per the License Agreement, the Company is neither obligated to provide substantive future support for the delivered technology, nor obligated to pursue the discovery of additional undiscovered CAR constructs. The Company has determined that the undelivered CAR constructs are of nominal value due to, among other things, (1) the uncertainty of discovery of a CAR construct with appropriate characteristics as well as (2) the extreme uncertainty of the commercialization of a compound that has yet to be discovered. Accordingly, the Company recognized revenue during the three months ended September 30, 2017 of approximately \$116.2 million associated with the License Agreement.

On September 26, 2017, the Company entered into a joint development agreement with Celularity whereby the Company agreed to provide research services to Celularity through June 30, 2018 in exchange for upfront payment of \$5.0 million. The revenue related to the joint development agreement of \$5.0 million will be recognized over the length of the service agreement as services are performed. The Company recorded \$1.7 million of sales and services revenues under the joint development agreement for the year ended December 31, 2017.

The financial statements of Celularity are not received sufficiently timely for the Company to record its portion of earnings or loss in the current financial statements and therefore the Company reports its portion of earnings or loss on a quarter lag under the equity method.

Celularity incurred operating expense of approximately \$4.1 million for the nine months ended June 30, 2017 in its interim financial results. The Company recorded its portion of loss from Celularity in loss on equity investments on its condensed consolidated statement of operations until its conversion to cost method investment on August 15, 2017.

### **Shanghai Three**

On March 7, 2016, TNK agreed to issue to SiniWest Holdings, Inc. (“SiniWest Holdings”) \$4.0 million in shares of TNK Class A Stock, subject to certain circumstances, to be issued upon a financing resulting in gross proceeds (individually or in the aggregate) to TNK of at least \$10.0 million and a \$1.0 million upfront cash payment in exchange for SiniWest Holdings transferring certain assets to TNK, including SiniWest Holdings’ 25% interest in Shanghai Three-Alliance Biotech Co. LTD, a China based company (“Shanghai Three”). The Company is accounting for its interest in Shanghai Three as an equity method investment, due to the significant influence the Company has over the operations of Shanghai Three through its 25% voting interest. The Company’s investment in Shanghai Three is reported in equity method investments on the condensed consolidated balance sheets and its share of Shanghai Three’s income or loss is recorded in income (loss) on equity investments on the condensed consolidated statement of operations. As of December 31, 2017 and 2016, the carrying value of the Company’s investment in Shanghai Three was approximately \$3.8 million and \$2.8 million, respectively.

The financial statements of Shanghai Three are not received sufficiently timely for the Company to record its portion of earnings or loss in the current financial statements and therefore the Company reports its portion of earnings or loss on a quarter lag.

Shanghai Three incurred no operating expenses for the twelve months ended September 30, 2017 and 2016. As of December 31, 2017, Shanghai Three had approximately \$0.4 million in current assets, \$5.3 million in noncurrent assets, \$2.8 million in current liabilities, and \$2.0 million in noncurrent liabilities. As of December 31, 2016, Shanghai Three had approximately \$0.5 million in current assets, \$5.1 million in noncurrent assets, \$3.0 million in current liabilities, and \$2.0 million in noncurrent liabilities.

### **3SBio Term Sheet**

In June 2016, the Company and TNK entered into a binding term sheet with Shenyang Sunshine Pharmaceutical Company Ltd (“3SBio”), a China based company, to form a joint venture to develop and commercialize proprietary immunotherapies, including those developed from, including or using TNK’s CAR-T technology targeting carcinoembryonic antigen (“CEA”) positive cancers. Due diligence and negotiations between 3SBio and the Company for the definitive agreement(s) are currently ongoing.

Under the terms of the agreement 3SBio will contribute an initial investment of \$10.0 million to the joint venture and TNK will grant the joint venture an exclusive license to the CEA CAR-T technology and two additional CARs for cellular therapy for the Greater China market, including Mainland China, Hong Kong and Macau. 3SBio will own 51% of the joint

venture while TNK will own 49%. As of December 31, 2017, funding and operations of the joint venture had not yet begun, as a result no investment has been recorded as of December 31, 2017.

In June 2016, 3SBio purchased \$10.0 million of Common Stock and warrants as part of the Company's private placement offering.

#### **Fair Value of Equity Method Investment**

The Company periodically evaluates the carrying value of our equity method investments, when events and circumstances indicate that the carrying amount of an asset may not be recovered. The Company determines the fair value of its equity method investments to evaluate whether impairment losses shall be recorded using Level 3 inputs. These investments include the Company's holdings in privately held biotechnology companies that are not exchange traded and therefore not supported with observable market prices. However, these investments are valued by reference to their net asset values that can be market supported and unobservable inputs including future cash flows. During 2017, the Company determined the carrying value of its NANTibody equity method investment exceeded its fair value.

#### **10. Goodwill and Intangible Assets**

As of December 31, 2017 and 2016, the Company had goodwill of \$38.3 million and \$41.5 million, respectively. The Company performed a qualitative test for goodwill impairment as of December 31, 2017. Based upon the results of the qualitative testing the Company concluded that it is more-likely-than-not that the fair values of the Company's goodwill was in excess of its carrying value and therefore performing the first step of the two-step impairment test was unnecessary. No goodwill impairment was recognized for the years ended December 31, 2017 and 2016.

The following is a summary of changes in the Company's recorded goodwill during the year ended December 31, 2016 (in thousands):

|   | <b>Amount</b> |
|---|---------------|
| Balance as of December 31, 2016           | \$ 41,548     |
| Scilex Acquisition Adjustment             | (4,645)       |
| Goodwill Acquired from Virttu Acquisition | \$ 1,395      |
| Balance as of December 31, 2017           | \$ 38,298     |

The Company's intangible assets, excluding goodwill, include acquired license and patent rights, core technologies, customer relationships and acquired in-process research and development. Amortization for the intangible assets that have finite useful lives is generally recorded on a straight-line basis over their useful lives. A summary of the Company's identifiable intangible assets as of December 31, is as follows (in thousands):

|  | <b>December 31, 2017</b>     |                                 |                         |
|--|------------------------------|---------------------------------|-------------------------|
|  | <b>Gross Carrying Amount</b> | <b>Accumulated Amortization</b> | <b>Intangibles, net</b> |
| Customer relationships                       | \$ 1,585                     | \$ 1,091                        | \$ 494                  |
| Acquired technology                          | 3,410                        | 709                             | 2,701                   |
| Acquired in-process research and development | 37,660                       | —                               | 37,660                  |
| Patent rights                                | 32,720                       | 2,562                           | 30,158                  |
| Total intangible assets                      | \$ 75,375                    | \$ 4,362                        | \$ 71,013               |
|  | <b>December 31, 2016</b>     |                                 |                         |
|  | <b>Gross Carrying Amount</b> | <b>Accumulated Amortization</b> | <b>Intangibles, net</b> |
| Customer relationships                       | \$ 1,585                     | \$ 801                          | \$ 784                  |
| Acquired technology                          | 3,410                        | 533                             | 2,877                   |
| Acquired in-process research and development | 25,404                       | —                               | 25,404                  |
| Patent rights                                | 36,120                       | 419                             | 35,701                  |
| Total intangible assets                      | \$ 66,519                    | \$ 1,753                        | \$ 64,766               |

As of December 31, 2017, the remaining weighted average life for identifiable intangible assets is 15 years.

Patent rights are stated at cost and amortized on a straight-line basis over the estimated useful lives of the assets, determined to be approximately fifteen years or nineteen years from the date of transfer of the rights to the Company. Amortization expense for the years ended December 31, 2017 and 2016 was \$2,143 thousand and \$405 thousand, respectively, which has been included in intangibles accumulated amortization.

Acquired technology is stated at cost and amortized on a straight-line basis over the estimated useful lives of the assets, determined to be approximately nineteen years from the date of acquisition of the technology in December 2013. Amortization expense for the years ended December 31, 2017 and 2016 was \$176 thousand and \$176 thousand, respectively, which has been included in intangibles accumulated amortization.

Customer relationships are stated at cost and amortized on a straight-line basis over the estimated useful lives of the assets and are generally determined to be approximately five years from the date of acquisition. Amortization expense for the years ended December 31, 2017 and 2016 was \$291 thousand and \$264 thousand, respectively, which has been included in intangibles accumulated amortization.

Acquired in-process research and development is stated at cost and may be immediately expensed if there is no alternative future use. Otherwise, the acquired in-process research and development is reviewed annually for impairment or more frequently as changes in circumstance or the occurrence of events suggest that the remaining value may not be recoverable.

Estimated future amortization expense related to intangible assets at December 31, 2017 is as follows (in thousands):

| Years Ending December 31, | Amount    |
|---------------------------|-----------|
| 2018                      | \$ 3,697  |
| 2019                      | 3,807     |
| 2020                      | 3,807     |
| 2021                      | 5,002     |
| 2022                      | 5,002     |
| Thereafter                | 49,698    |
| Total                     | \$ 71,013 |

## 11. Significant Agreements and Contracts

### *License Agreement with Les Laboratoires Servier*

On July 11, 2016, the Company announced a license and collaboration agreement with Les Laboratoires Servier, SAS, a corporation incorporated under the laws of France, and Institut de Recherches Internationales Servier, a company duly organized and existing under the laws of France (individually and collectively, "Servier") for the development, manufacture and commercialization of products using the Company's fully human immuno-oncology anti-PD-1mAb STI-A1110 and will provide support for Servier's initial development efforts. Pursuant to the financial terms of the agreement, the Company received a non-refundable up-front payment of \$27.4 million in July of 2016, which had been recorded as deferred revenue in the Company's consolidated balance sheet and could potentially also have received various payments based on commercial sales milestones related to annual sales levels. The Company deferred the upfront payment and recognized the upfront payment over the expected period of performance of three years. Effective November 6, 2017, the Servier License Agreement was terminated based on mutually agreed upon terms pursuant to the Servier License Agreement. As a result, the remaining unrecognized revenue of approximately \$16.7 million associated with license fees under the Servier License Agreement was recognized and reflected in the Company's fourth quarter 2017 results. During the twelve months ended December 31, 2017, the Company recognized \$23.6 million in license fee revenue pursuant to the agreement.

### *License Agreement with Mabtech Limited*

In August 2015, the Company entered into an exclusive licensing agreement to develop and commercialize multiple prespecified biosimilar and biobetter antibodies from Mabtech Limited. Under the terms of the agreement, the Company will develop and market these four, late-stage clinical biosimilar or biobetter antibodies based on Erbitux®, Remicade®, Xolair® and Simulect® for the North American, European and Japanese markets. The Company made an initial license payment of \$10.0 million and in February 2016, paid an additional \$10.0 million license payment, both of which were recognized as acquired in-process research and development expense in the consolidated statements of operations as the Company determined there was no alternative future use for the license.

In June 2016, the Company agreed to accelerate and pay a \$30.0 million milestone license payment which has been recognized as acquired in-process research and development expense in the consolidated statements of operations, in exchange for the purchase by Mabtech Limited in June 2016, of \$10.0 million of Common Stock and warrants.

In December 2017, the Company agreed to accelerate and pay \$25.0 million milestone license payment which has been recognized as acquired in-process research and development expense in the consolidated statements of operations. The amended agreement includes additional milestone payments totaling \$125.0 million payable following the completion of the technology transfer from Mabtech Limited and for payables to extend the license agreement. The remaining anniversary payments are due on December 31, 2018 and 2019. The Company is not obligated to extend the license agreement. Accordingly, the additional future milestone payments have not yet been accrued as of December 31, 2017.

#### ***Immunotherapy Research Collaboration Agreement with Roger Williams Medical Center***

In April 2016, the Company entered into an immunotherapy research collaboration agreement with Roger Williams Medical Center to provide certain clinical trial, research and manufacturing services. Under the terms of the agreement, Roger Williams Medical Center will perform pre-clinical and clinical research related to the development and delivery of CAR-T immunotherapies. In exchange, the Company granted Roger Williams Medical Center \$6.0 million in shares of TNK Class A Stock, subject to adjustment in certain circumstances, to be issued upon a financing resulting in gross proceeds (individually or in the aggregate) to TNK of at least \$20.0 million. The Company determined the fair value of this obligation was \$3.4 million as of the April of 2016 agreement effective date, and the amount was recognized as prepaid expense and other and acquisition consideration payable in the condensed consolidated balance sheet. The Company will recognize the upfront payment over the expected performance period of five years. During each of the quarters ended December 31, 2017 and 2016, the Company recognized approximately \$170 thousand in pre-clinical research and development expense pursuant to the agreement. During the twelve months ended December 31, 2017 and 2016, the Company recognized approximately \$679 thousand and \$453 thousand in pre-clinical research and development expense pursuant to the agreement, respectively.

#### ***License Agreement with NantCell***

In April 2015, the Company and NantCell entered into a license agreement. Under the terms of the agreement the Company granted an exclusive license to NantCell covering patent rights, know-how, and materials related to certain antibodies, ADCs and two CAR-TNK products. NantCell agreed to pay a royalty not to exceed five percent (5%) to the Company on any net sales of products (as defined) from the assets licensed by the Company to NantCell. In addition to the future royalties payable under this agreement, NantCell paid an upfront payment of \$10.0 million to the Company and issued 10 million shares of NantCell common stock to the Company valued at \$100.0 million based on a recent equity sale of NantCell common stock to a third party. As of December 31, 2017, the Company had not yet provided all of the items noted in the agreement, including research services for and on behalf of NantCell, and therefore has recorded the entire upfront payment and value of the equity interest received as deferred revenue. Specifically, only a portion of the materials associated with the licensed assets have been delivered while the majority of the licensed assets remain undelivered and the related research activities are still to be performed. The Company will recognize the upfront payment and the value of the equity interest received over the period beginning with the commencement of the last item delivered. The Company's ownership interest in NantCell does not provide the Company with control or the ability to exercise significant influence; therefore the \$100.0 million investment is carried at cost in the consolidated balance sheets and evaluated for other-than-temporary impairment on a quarterly basis.

#### ***License Agreement with The Scripps Research Institute***

In January 2010, the Company entered into a license agreement (the "TSRI License") with The Scripps Research Institute ("TSRI"). Under the TSRI License, TSRI granted the Company an exclusive, worldwide license to certain TSRI patent rights and materials based on quorum sensing for the prevention and treatment of *Staphylococcus aureus* ("Staph") infections, including Methicillin-resistant Staph. In consideration for the license, the Company: (i) issued TSRI a warrant for the purchase of common stock, (ii) agreed to pay TSRI a certain annual royalty commencing in the first year after certain patent filing milestones are achieved, (iii) agreed to pay a royalty on any sales of licensed products by the Company or its affiliates and a royalty for any revenues generated by the Company through its sublicense of patent rights and materials licensed from TSRI under the TSRI License. The TSRI License requires the Company to indemnify TSRI for certain breaches of the agreement and other matters customary for license agreements. The parties may terminate the TSRI License at any time by mutual agreement. In addition, the Company may terminate the TSRI License by giving 60 days' notice to TSRI and TSRI may terminate the TSRI License immediately in the event of certain breaches of the agreement by the Company or upon the Company's failure to undertake certain activities in furtherance of commercial development goals. Unless terminated earlier by either or both parties, the term of the TSRI License will continue until the final expiration of all claims covered by the patent rights licensed under the agreement. For the years ended December 31, 2017, 2016 and 2015, the Company recorded \$0 thousand, \$106 thousand and \$123 thousand in patent prosecution and maintenance costs associated with the TSRI License, respectively. All such costs have been included in general and administrative expenses.

## **NIH Grants**

In June 2014, the NIAID awarded the Company a Phase II Small Business Technology Transfer (“STTR”) grant (the “Staph Grant III Award”) to support the advanced preclinical development of human bispecific antibody therapeutics to prevent and treat *Staphylococcus aureus* (“*S. aureus*” or “Staph”) infections, including methicillin-resistant *S. aureus* (“MRSA”). The project period for the Staph Grant III Award covered a two-year period which commenced in June 2014, which was subsequently extended by one year, with total funds available of approximately \$1.0 million per year for up to two years. The Staph Grant III Award was not extended beyond June 30, 2017 and the remaining amounts for the award have been recorded as of December 31, 2017. During each of the quarters ended December 31, 2017 and 2016, the Company recorded \$0 and \$107 thousand of revenue associated with the Staph Grant III Award, respectively. During the twelve months ended December 31, 2017 and 2016, the Company recorded \$206 thousand and \$699 thousand of revenue associated with the Staph Grant III Award, respectively.

## **Termination of Binding Term Sheet Regarding Acquisition of Semnur Pharmaceuticals, Inc.**

On August 15, 2016, the Company's subsidiary, Scintilla Pharmaceuticals, Inc. (“Scintilla”) and Semnur Pharmaceuticals, Inc. (“Semnur”) entered into a binding term sheet (the “Semnur Binding Term Sheet”) setting forth the terms and conditions by which Scintilla would, through a subsidiary, purchase all of the issued and outstanding equity of Semnur. On October 6, 2017, the Semnur Binding Term Sheet was terminated without additional consideration, effective immediately. The Company paid \$6.9 million associated with the development activities since the inception of the Semnur Binding Term Sheet through December 31, 2017.

## **12. Loan and Security Agreement and Convertible Notes**

In September 2013, the Company entered into a \$5.0 million loan and security agreement with two banks pursuant to which: (i) the lenders provided the Company a term loan which was funded at closing, (ii) the Company repaid its then outstanding equipment loan balance of \$762 thousand, and (iii) the lenders received a warrant to purchase an aggregate 31,250 shares of the Company's common stock at an exercise price of \$8.00 per share exercisable for seven years from the date of issuance. The value of the warrants, totaling \$215 thousand, was recorded as debt discount and additional paid-in capital.

In March 2014, the Company entered into an amended and restated loan and security agreement, increasing the September 2013 facility to \$12.5 million from \$5.0 million, with the same two banks. Such loan was funded at closing and was secured by a lien covering substantially all of the Company's assets, excluding intellectual property, which is subject to a negative pledge. In October 2014, the Company entered into a second amendment to its amended and restated loan and security agreement to extend the interest only payments on the outstanding amount of the loan from October 1, 2014 to May 1, 2015, after which equal monthly payments of principal and interest are due until the loan maturity date of September 30, 2017. The amended and restated loan interest rate is 7.95% per annum, and the Lenders received additional warrants to purchase an aggregate of 34,642 shares of the Company's common stock at an exercise price of \$12.99 per share, exercisable for seven years from the date of issuance. The value of the warrants, totaling \$322 thousand, was recorded as debt discount and additional paid-in capital.

On the November 22, 2016, the Company paid off all obligations owing under, and terminated, the amended and restated loan and security agreement, as amended (the “Terminated Loan Agreement”). In connection with the repayment and discharge of indebtedness, the Company was required to pay prepayment fees of approximately \$49 thousand, as required by the terms of the Terminated Loan Agreement. The secured interests under the Terminated Loan Agreement were terminated in connection with the Company's discharge of indebtedness.

## **Loan and Security Agreement with Hercules Capital, Inc.**

On November 23, 2016, the Company and certain of its domestic subsidiaries (together with the Company, the “Borrowers”) entered into a Loan and Security Agreement (the “Loan Agreement”) with Hercules Capital, Inc. (“Hercules”), as a lender and agent for several banks and other financial institutions or entities from time to time party to the Loan Agreement (collectively, the “Lenders”) for a term loan of up to \$75.0 million, subject to funding in multiple tranches (the “Term Loan”). The Term Loan will mature on December 1, 2020. The proceeds of the Term Loan will be used for general corporate purposes and coincided with the repayment of the outstanding debt financing arrangement with Oxford Finance LLC and Silicon Valley Bank.

The first tranche of \$50.0 million was funded upon execution of the Loan Agreement on November 23, 2016. Under the terms of the Loan Agreement, the Borrowers may, but are not obligated to, request additional funds of up to \$25.0 million which are available until June 30, 2018, subject to approval by Hercules' Investment Committee. Pursuant to the terms of the third amendment to the Loan Agreement entered into on March 15, 2017, the Company paid Hercules \$1.5 million for a portion of the backend fee. Pursuant to the terms of the fourth amendment to the Loan Agreement entered into on March 23, 2017 (the "Fourth Amendment"), the Company repaid Hercules, without repayment penalty, \$20.0 million of the outstanding principal and unpaid interest accrued thereon on March 23, 2017. The Fourth Amendment also provided for the following: (1) Hercules reduced the minimum amount of unrestricted cash that the Company must maintain under the Loan Agreement, and (2) the parties agreed to change the date by which the Company must achieve a fundraising milestone.

The Loan Agreement contains customary affirmative and restrictive covenants and representations and warranties, including financial reporting obligations and significant limitations on dividends, indebtedness, liens (including a negative pledge on intellectual property and other assets), collateral, investments, distributions, transfers, mergers or acquisitions, taxes, corporate changes, deposit accounts, and subsidiaries. Additionally, the Loan Agreement contains covenants requiring the Borrowers (i) to achieve certain fundraising requirements by certain dates and (ii) to maintain \$20.0 million of unrestricted cash prior to achieving its corporate and fundraising milestones. The Company's public offering for net proceeds of \$43.1 million satisfied the fundraising requirements and fundraising milestone.

Pursuant to the terms of the seventh amendment to the Loan Agreement entered into on November 6, 2017 (the "Seventh Amendment"), (i) the Company repaid Hercules, without repayment penalty, \$10.0 million of the outstanding principal and unpaid interest accrued thereon on November 6, 2017, and (ii) Hercules agreed to reduce the minimum amount of unrestricted cash that the Company must maintain under the Loan Agreement from \$20.0 million to \$8.0 million.

On December 21, 2017, the Company paid off all obligations owing under, and terminated, the Loan Agreement. The secured interests under the Terminated Loan Agreement were terminated in connection with the Company's discharge of indebtedness thereunder.

In connection with the Loan Agreement, the Company issued Hercules a warrant, dated November 23, 2016 (the "Hercules Warrant"), to purchase up to 460,123 shares of Common Stock, at an initial exercise price of \$4.89, subject to adjustment as provided in the Hercules Warrant. The Hercules Warrant is initially exercisable for 306,748 shares of common stock of the Company, and may automatically become exercisable for additional shares of common stock on such dates (if any) based upon the funding amounts of Tranche II or Tranche III of the Term Loan that may be extended to the Borrowers. The Hercules Warrant will terminate, if not earlier exercised, on the earlier of November 23, 2023 and the closing of certain merger or other transactions in which the consideration is cash, stock of a publicly-traded acquirer or a combination thereof.

In connection with the extinguishment of the Loan Agreement on December 21, 2017, a loss of \$4.3 million on the extinguishment of debt was recorded representing the difference between the reacquisition price of debt and the net carrying amount of the loan as of December 21, 2017.

#### ***Securities Purchase Agreement in Private Placement***

On December 11, 2017, the Company entered into a Securities Purchase Agreement (the "Securities Purchase Agreement" or "Note SPA") with certain accredited investors (collectively, the "Purchasers"). Pursuant to the Securities Purchase Agreement, on December 21, 2017, the Company issued and sold to the Purchasers, in a private placement transaction (the "Private Placement"), (1) convertible promissory notes in an aggregate principal amount of \$50,000,000 (the "Notes"), which will accrue simple interest at a rate equal to 5.0% per annum and mature upon the earlier to occur of (a) December 21, 2022, and (b) the date of the closing of a change in control (the "Maturity Date"), and (2) warrants (the "Warrants") to purchase an aggregate of 12,121,210 shares of our common stock.

At any time and from time to time before the Maturity Date, each Purchaser shall have the option to convert any portion of the outstanding principal amount of such Purchaser's Note that is equal to or greater than the lesser of: (1) \$4,000,000, and (2) the then-outstanding principal amount of such Purchaser's Note into shares of Common Stock at a price per share of \$2.26875, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions. Accrued but unpaid interest on the Notes shall be paid in cash semi-annually in arrears on or prior to the 30th day of June and 31st day of December of each calendar year commencing with the year ending December 31, 2018. If a Purchaser elects to convert any of the principal amount of their Note, then all accrued but unpaid interest on such portion of the principal amount shall become due and payable in cash. The Notes contain restrictive covenants and event of default provisions that are customary for transactions of this type.

Each Warrant has an exercise price of \$2.61 per share, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions, will become exercisable on June 20, 2018, has a term of five and a half years and is exercisable on a cash basis, unless there is not an effective registration statement covering the resale of the shares issuable upon exercise of the Warrants, in which case the Warrants shall also be exercisable on a cashless exercise basis.

See Note 3 for discussion of the Company's policies for accounting for debt with detachable warrants. In connection with the issuance of the Notes and Warrants, the Company recorded a debt discount of approximately \$44.8 million based on an allocation of proceeds to the Warrants of approximately \$12.7 million and a beneficial conversion feature of approximately \$32.1 million, before issuance costs. The Company accounts for the debt at amortized cost and amortizes the debt discount to interest expense using the effective interest method over the expected term of the Notes.

The fair value of the Notes was estimated using a valuation model with Level 2 inputs including the stock price volatility, risk-free interest rate, and debt yield. As of December 31, 2017, the estimated fair value of the Notes was approximately \$89.5 million, compared to the carrying value of \$5.2 million, as a result of unamortized debt discount. A substantial portion of the market value of the Company's debt in excess of the outstanding principal amount relates to the conversion premium on the Notes.

Convertible debt and unamortized discount balances are as follows (in thousands):

|   |    |              |
|---|----|--------------|
| Principal amount                              | \$ | 50,000       |
| Debt discount - warrant                       |    | (12,669)     |
| Debt discount - beneficial conversion feature |    | (32,062)     |
| Capitalized debt issuance costs               |    | (84)         |
| Accretion of debt issuance costs and other    |    | —            |
| Accretion of debt discount                    |    | 26           |
| Balance at December 31, 2017                  | \$ | <u>5,211</u> |

Future minimum payments under the convertible notes agreement are as follows (in thousands):

**Year Ending December 31,**

|   |    |               |
|---|----|---------------|
| 2018  | \$ | 2,366         |
| 2019  |    | 2,500         |
| 2020  |    | 2,500         |
| 2021  |    | 2,500         |
| 2022  |    | 2,500         |
| 2023  |    | 50,134        |
| Total future minimum payments               |    | <u>62,500</u> |
| Unpaid interest                             |    | (12,500)      |
| Unamortized debt discount                   |    | (44,705)      |
| Unamortized capitalized debt issuance costs |    | (84)          |
| Total minimum payment                       | \$ | <u>5,211</u>  |
| Current portion                             |    | —             |
| Long-term debt                              | \$ | <u>5,211</u>  |

**13. Stockholders' Equity**

**2009 Non-Employee Director Grants**

In September 2009, prior to the adoption of the 2009 Stock Incentive Plan (the "2009 Plan"), the Company's board of directors approved the reservation and issuance of 8,000 nonstatutory stock options to the Company's non-employee directors. The outstanding options vested on the one year anniversary of the vesting commencement date in October 2010, and are



exercisable for up to 10 years from the grant date. No further shares may be granted under this plan and, as of December 31, 2017, 3,200 options with a weighted-average exercise price of \$1.12 were outstanding.

### 2009 Stock Incentive Plan

In October 2009, the Company's stockholders approved the 2009 Stock Incentive Plan. In July 2017, the Company's stockholders approved, among other items, the amendment and restatement of the 2009 Stock Incentive Plan (as amended and restated, the "Stock Plan") to increase the number of shares of the Company's common stock authorized to be issued pursuant to the Stock Plan to 11,260,000. Such shares of the Company's common stock are reserved for issuance to employees, non-employee directors and consultants of the Company. The Stock Plan provides for the grant of incentive stock options, non-incentive stock options, stock appreciation rights, restricted stock awards, unrestricted stock awards, restricted stock unit awards and performance awards to eligible recipients. Recipients of stock options shall be eligible to purchase shares of the Company's common stock at an exercise price equal to no less than the estimated fair market value of such stock on the date of grant. The maximum term of options granted under the Stock Plan is ten years. Employee option grants generally vest 25% on the first anniversary of the original vesting commencement date, with the balance vesting monthly over the remaining three years. The vesting schedules for grants to non-employee directors and consultants will be determined by the Company's Compensation Committee. Stock options are generally not exercisable prior to the applicable vesting date, unless otherwise accelerated under the terms of the applicable stock plan agreement.

The following table summarizes stock option activity as of December 31, 2017, 2016 and 2015, and the changes for the years then ended (in thousands, except for share amounts):

|                                  | Options Outstanding | Weighted-Average Exercise Price | Aggregate Intrinsic Value |
|----------------------------------|---------------------|---------------------------------|---------------------------|
| Outstanding at December 31, 2014 | 2,231,800           | \$ 6.34                         | \$ 8,323                  |
| Options Granted                  | 1,378,600           | \$ 12.03                        |                           |
| Options Canceled                 | (376,072)           | \$ 6.84                         |                           |
| Options Exercised                | (276,712)           | \$ 6.14                         |                           |
| Outstanding at December 31, 2015 | 2,957,616           | \$ 8.95                         | \$ 4,506                  |
| Options Granted                  | 2,034,050           | \$ 6.34                         |                           |
| Options Canceled                 | (544,098)           | \$ 8.77                         |                           |
| Options Exercised                | (114,692)           | \$ 4.71                         |                           |
| Outstanding at December 31, 2016 | 4,332,876           | \$ 7.86                         | \$ 427                    |
| Options Granted                  | 3,200,100           | \$ 1.83                         |                           |
| Options Canceled                 | (1,189,576)         | \$ 8.41                         |                           |
| Options Exercised                | —                   | \$ —                            |                           |
| Outstanding at December 31, 2017 | 6,343,400           | \$ 4.74                         | \$ 6,290                  |

The aggregate intrinsic value of options exercised during the years ended December 31, 2017, 2016 and 2015 were \$0, \$194 thousand and \$2,411 thousand, respectively. The Company uses the Black-Scholes valuation model to calculate the fair value of stock options. The fair value of employee stock options was estimated at the grant date using the following assumptions:

|  | Years Ended December 31, |           |           |
|--|--------------------------|-----------|-----------|
|  | 2017                     | 2016      | 2015      |
| Weighted-average grant date fair value | \$ 1.28                  | \$ 5.86   | \$ 12.03  |
| Dividend yield                         | —                        | —         | —         |
| Volatility                             | 81%                      | 75%       | 75%       |
| Risk-free interest rate                | 1.92%                    | 1.49%     | 1.67%     |
| Expected life of options               | 6.1 years                | 6.1 years | 6.1 years |

The assumed dividend yield was based on the Company's expectation of not paying dividends in the foreseeable future. Due to the Company's limited historical data, the estimated volatility incorporates the historical and implied volatility of comparable companies whose share prices are publicly available. The risk-free interest rate assumption was based on the U.S. Treasury's rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the award being valued. The weighted average expected life of options was estimated using the average of the contractual term and the weighted average vesting term of the options.

The total employee and director stock-based compensation recorded as operating expenses was \$4,423 thousand, \$4,354 thousand and \$5,198 thousand for the years ended December 31, 2017, 2016 and 2015, respectively.

The total unrecognized compensation cost related to unvested employee and director stock option grants as of December 31, 2017 was \$7,717 thousand and the weighted average period over which these grants are expected to vest is 2.9 years.

The Company records equity instruments issued to non-employees as expense at their fair value over the related service period as determined in accordance with the authoritative guidance and periodically revalues the equity instruments as they vest. Stock-based compensation expense related to non-employee consultants recorded as operating expenses was \$228 thousand, \$198 thousand, and \$1,481 thousand for the years ended December 31, 2017, 2016 and 2015, respectively.

### **Common Stock Reserved for Future Issuance**

Common stock reserved for future issuance consists of the following at December 31, 2017:

|  |            |
|--|------------|
| Common stock warrants outstanding under the underwriters agreement               | 182,600    |
| Common stock warrants outstanding under the loan and security agreement          | 65,892     |
| Common stock warrants outstanding under the Hercules securities agreement        | 306,748    |
| Common stock warrants outstanding under the convertible notes                    | 12,121,210 |
| Common stock warrants outstanding under private placements                       | 4,153,620  |
| Common stock options outstanding under the Non-Employee Director Plan            | 3,200      |
| Authorized for future grant or issuance under the 2009 Stock Incentive Plan      | 10,782,096 |
| Issuable under BDL acquisition agreement   | 309,916    |
| Issuable under Scilex acquisition agreement                                      | 1,381,346  |
| Issuable under Virttu acquisition agreement                                      | 3,603,604  |
| Issuable under assignment agreement based upon achievement of certain milestones | 80,000     |
|  | 32,990,232 |

### **2017 Stock Option Plan**

In June 2017, the Company's subsidiary, Scilex, adopted the Scilex 2017 Stock Option Plan, reserved 4.0 million shares of Scilex common stock and awarded 1.0 million options to certain Company personnel, directors and consultants under such plan. Stock options granted under this plan typically vest 1/4th of the shares on the first anniversary of the vesting commencement date and 1/48th of the remaining options vest each month thereafter. As of December 31, 2017, 0.8 million options were outstanding.

### **2015 Stock Option Plans**

In May 2015, the Company's subsidiary, TNK, adopted the TNK 2015 Stock Option Plan and reserved 10.0 million shares of TNK class A common stock and awarded 3.6 million options to certain Company personnel, directors and consultants under such plan. In November 2015, TNK awarded 0.5 million options to certain Company personnel. Stock options granted under this plan typically vest a portion immediately upon grant and the remaining options over two to four years or monthly over four years from the grant date and have a contractual term of ten years. As of December 31, 2017, 1.6 million shares were canceled. As of December 31, 2017, 1.4 million options were outstanding.

In May 2015, TNK granted a warrant to the Company's CEO to purchase 9.5 million shares of TNK class B common stock which have 10 to 1 voting rights. Warrant shares totaling 4.0 million are exercisable evenly over forty months and the

remaining warrant shares are exercisable if certain defined events occur within four years from date of issuance at an initial exercise price of \$0.01 per share. This warrant was canceled in its entirety effective August 29, 2017.

In May 2015, the Company's subsidiary, LA Cell, adopted the LA Cell 2015 Stock Option Plan and reserved 10.0 million shares of LA Cell class A common stock and awarded 2.9 million options to certain Company personnel, directors and consultants under such plan. Stock options granted under this plan typically vest a portion immediately upon grant and the remaining options over two to four years or monthly over four years from the grant date and have a contractual term of ten years. As of December 31, 2017, 1.5 million shares were canceled. As of December 31, 2017, 0.6 million options were outstanding.

In May 2015, LA Cell granted a warrant to the Company's CEO to purchase 9.5 million shares of LA Cell class B common stock which have 10 to 1 voting rights. Warrant shares totaling 4.0 million are exercisable evenly over forty months and the remaining warrant shares are exercisable if certain defined events occur within four years from date of issuance at an initial exercise price of \$0.01 per share. This warrant was canceled in its entirety effective August 29, 2017.

In October 2015, the Company's subsidiary, Concoris Biosystems, Corp., ("CBC"), adopted the CBC 2015 Stock Option Plan and reserved 10.0 million shares of CBC class A common stock and awarded 1.8 million options to certain Company personnel, directors and consultants under such plan. Stock options granted under this plan typically vest a portion immediately upon grant and the remaining options over two to four years or monthly over four years from the grant date and have a contractual term of ten years. As of December 31, 2017, 1.6 million shares were canceled. As of December 31, 2017, 0.1 million options were outstanding.

In October 2015, CBC granted a warrant to the Company's CEO to purchase 9.5 million shares of CBC class B common stock which have 10 to 1 voting rights. Warrant shares totaling 4.0 million are exercisable evenly over forty months and the remaining warrant shares are exercisable if certain defined events occur within four years from date of issuance at an initial exercise price of \$0.25 per share. This warrant was canceled in its entirety effective August 29, 2017.

In October 2015, the Company's subsidiary, Scintilla, adopted the Scintilla 2015 Stock Option Plan and reserved 10.0 million shares of Scintilla class A common stock and awarded 2.1 million options to certain Company personnel, directors and consultants under such plan. Stock options granted under this plan typically vest a portion immediately upon grant and the remaining options over two to four years or monthly over four years from the grant date and have a contractual term of ten years. As of December 31, 2017, 0.8 million shares were canceled. As of December 31, 2017, 0.1 million options were outstanding.

In October 2015, Scintilla granted a warrant to the Company's CEO to purchase 9.5 million shares of Scintilla class B common stock which have 10 to 1 voting rights. Warrant shares totaling 4.0 million are exercisable evenly over forty months and the remaining warrant shares are exercisable if certain defined events occur within four years from date of issuance at an initial exercise price of \$0.01 per share. This warrant was canceled in its entirety effective August 29, 2017.

In October 2015, the Company's subsidiary, Sorrento Biologics, Inc. ("Biologics"), adopted the Biologics 2015 Stock Option Plan and reserved 10.0 million shares of Biologics class A common stock and awarded 2.6 million options to certain Company personnel, directors and consultants under such plan. Stock options granted under this plan typically vest a portion immediately upon grant and the remaining options over two to four years or monthly over four years from the grant date and have a contractual term of ten years. As of December 31, 2017, 1.3 million shares were canceled. As of December 31, 2017, 75 thousand options were outstanding.

In October 2015, Biologics granted a warrant to the Company's CEO to purchase 9.5 million shares of Biologics class B common stock which have 10 to 1 voting rights. Warrant shares totaling 4.0 million are exercisable evenly over forty months and the remaining warrant shares are exercisable if certain defined events occur within four years from date of issuance at an initial exercise price of \$0.01 per share. This warrant was canceled in its entirety effective August 29, 2017.

On August 29, 2017, the options and warrants were canceled in accordance with the terms of a settlement agreement and, as a result, unrecognized compensation expense of \$281 thousand associated with these previously issued shares was accelerated and recognized upon cancellation.

The total director stock-based compensation recorded as operating expenses by the Company for TNK, LA Cell, CBC, Scintilla and Biologics for the year ended December 31, 2017 and 2016 was \$0 and \$166 thousand, respectively. Total unrecognized stock-based compensation expense related to unvested director stock option and warrant grants for these entities as of December 31, 2017 was \$0, and the weighted-average period over which these grants are expected to vest is

approximately 3.5 years. The Company records equity instruments issued to non-employees as expense at their fair value over the related service period as determined in accordance with the authoritative guidance and periodically revalues the equity instruments as they vest. Stock based compensation expense related to non-employee consultants recorded as operating expenses by the Company for TNK, LA Cell, CBC, Scintilla and Biologics for the year ended December 31, 2017 and 2016 was \$156 thousand and \$189 thousand, respectively.

The weighted-average assumptions used in the Black-Scholes option and warrant pricing model used by TNK, LA Cell, CBC, Scintilla and Biologics to determine the fair value of stock option grants for directors and non-employee consultants were as follows: expected dividend yield – 0%, risk-free interest rate – 1.39% to 2.24%, expected volatility – 76% to 77%, and expected term of 4.0 to 6.1 years.

#### **2014 Stock Option Plan**

In May 2014, the Company's subsidiary, Ark Animal Health, Inc. ("Ark"), adopted the Ark 2014 Stock Option Plan and reserved and awarded 600,000 options to certain directors and consultants under such plan. Stock options granted under such plan typically vest a portion immediately upon grant and the remaining options over one year from the grant date and will have a contractual term of ten years. Effective August 29, 2017, options to purchase an aggregate of 135,000 shares were canceled. As of December 31, 2017, 88,000 options were outstanding.

The total director and consultant stock-based compensation recorded as operating expenses by the Company for Ark for the years ended December 31, 2017 and 2016 was \$0 and \$0, respectively. No unrecognized stock-based compensation expense remains related to stock option grants as of December 31, 2017.

#### **14. Derivative Liability**

On October 13, 2015, the Company wrote a call option to Cambridge, on up to 2.0 million shares of NantKwest common stock held by the Company (the "Option Agreement"). As of December 31, 2015, the Company held approximately 5.6 million shares of common stock of NantKwest, par value \$0.0001 per share, which was classified as available-for-sale and reported in its consolidated financial statements as marketable securities. The Option Agreement gave Cambridge the right to purchase up to 2.0 million shares at a price of \$15.295 per share from time to time in the first quarter of 2016. There was no contractual option premium associated with this Option Agreement. The Option Agreement was a derivative as defined in ASC Topic 815 and was recognized at fair value every reporting period the Option Agreement is in effect, with changes in fair value recognized in current operations. For the year ended December 31, 2015, the Company recorded a loss of \$3.4 million on the derivative liability. As of December 31, 2015, a derivative liability of \$5.5 million was recorded on the Company's consolidated balance sheets. The fair value of the Company's derivative liability at December 31, 2015 was a Level 3 measurement.

The call option expired unexercised on March 31, 2016 and the Company recorded a gain of \$5.5 million upon the cancellation of the derivative liability.

As of December 31, 2017, no derivative liability was recorded on the Company's consolidated balance sheets.

#### **15. Commitments and Contingencies**

##### **Litigation**

In the normal course of business, the Company may be named as a defendant in one or more lawsuits. The Company is not a party to any outstanding material litigation and management is currently not aware of any legal proceedings that, individually or in the aggregate, are deemed to be material to the Company's financial condition or results of operations.

##### **Derivative Action Litigation**

On September 8, 2016, Yvonne Williams filed an action both derivatively and on behalf of a purported class of stockholders in the Court of Chancery of the State of Delaware (the "Court") against each of the members of the Henry Ji, William S. Marth, Kim D. Janda, Jaisim Shah, David H. Deming, and Douglas Ebersole (the "Prior Board"); George Ng, the Company's Executive Vice President, Chief Administrative Officer, and Chief Legal Officer; Jeffrey Su, the Company's Executive Vice President & Chief Operating Officer; and the Company as nominal defendant, alleging: (1) breach of fiduciary duty with respect to the formation of, and certain options and warrants issued by, certain of the Company's subsidiaries to Dr. Ji

and members of the Prior Board; (2) breach of fiduciary duty with respect to the Company's prior announcement that it had entered into a voting agreement with Yuhan Corporation in connection with a transaction through which it purchased \$10 million of shares of our common stock and warrants (the "Williams Action"). On November 14, 2016, the Company filed motions to dismiss or in the alternative stay the Williams Action. George Ng and Jeffrey Su were dismissed as defendants by plaintiff during the briefing on the motions. The Court denied the motions on June 28, 2017.

On October 25, 2017, Yvonne Williams filed a Supplemental and Amended Class Action and Derivative Complaint which re-added George Ng as a defendant, added Eragon Ventures, LLC as a defendant, and added certain claims challenging transactions whereby Eragon Ventures, LLC agreed to purchase certain stock in the Company's subsidiary, LA Cell, Inc. Following a mediation held on November 16, 2017, the parties agreed that day to a term sheet reflecting a settlement of the Williams Action, which agreement was memorialized in a Stipulation and Agreement of Settlement executed on December 22, 2017 and filed with the Court. The settlement and plaintiff's counsel's request for an award of attorneys' fees in the amount of \$5 million have been submitted to the Court for approval. The Court has set a hearing on the request for approval of the settlement for April 3, 2018 and the Company has caused notice to be provided concerning the settlement and settlement hearing. Objections to the settlement or the requested award of attorneys' fees were due no later than March 5, 2018. The Company has objected to the amount of fees being requested by plaintiff's counsel and has suggested that a fee award of \$850,000 would be appropriate. As a result, the Company recorded its best estimate of the potential liability associated with the legal proceeding which the Company expects to be covered by insurance.

If the Court approves the settlement, this case will be dismissed with prejudice. The settlement consists of non-monetary consideration, such as the cancellation of certain subsidiary shares of stock that were obtained by defendants pursuant to options previously exercised by defendants. Accordingly, the Company does not anticipate any monetary loss with respect to the Williams Action other than for potential payment of the amount of fees and costs that may be awarded to plaintiff's counsel by the Court. With respect to such fees as may be awarded, the Company believes that all such amounts should be covered by the Company's director and officer insurance policies.

### ***Immunomedics Litigation***

On June 26, 2015, Immunomedics, Inc. ("Immunomedics") filed a complaint in the United States District Court for the District of New Jersey (the "Immunomedics Action") against the Board of Directors of Roger Williams Medical Center, Dr. Richard P. Junghans, Dr. Steven C. Katz, the Office of the Board of Advisors of Tufts University School of Medicine, and one or more individuals or entities to be identified later. This complaint (the "Initial Complaint") alleged, among other things: (1) breach of contract; (2) breach of covenant of good faith and fair dealing; (3) tortious interference with prospective economic gain; (4) tortious interference with contracts; (5) misappropriation; (6) conversion; (7) bailment; (8) negligence; (9) vicarious liability; and (10) patent infringement. Overall, the allegations in the Initial Complaint were generally directed to an alleged material transfer agreement dated December 2008 and Immunomedics' alleged request for the return of certain alleged research material, as well as the alleged improper use and conversion of such research materials outside the scope of the material transfer agreement.

On October 22, 2015, Immunomedics filed an amended complaint (the "First Amended Complaint"), which, among other things, no longer named the Board of Directors of Roger Williams Medical Center and The Office of the Board of Advisors of Tufts University School of Medicine as defendants. Roger Williams Medical Center and Tufts Medical Center were added as new defendants. On January 14, 2016, Immunomedics filed a second amended complaint (the "Second Amended Complaint"), which, among other things, no longer named Tufts Medical Center as a defendant. In addition, the Second Amended Complaint contained allegations directed to two additional alleged material transfer agreements dated September 1993 and May 2010, respectively, and also added an allegation of unjust enrichment. The Second Amended Complaint also no longer asserted claims for (1) breach of covenant of good faith and fair dealing; (2) misappropriation; (3) bailment; (4) negligence; and (5) vicarious liability.

On October 12, 2016, Immunomedics filed a third amended complaint (the "Third Amended Complaint"), which added the Company, TNK, BDL and CARgenix as defendants. TNK is a subsidiary of the Company and purchased BDL and CARgenix in August 2015. The Third Amended Complaint includes, among other things, allegations against the Company, TNK, BDL and CARgenix regarding (1) conversion; (2) tortious interference; and (3) unjust enrichment. On December 2, 2016, the Company, TNK, BDL, and CARgenix filed a motion to dismiss Immunomedics's complaint against them for lack of personal jurisdiction. On January 25, 2017, the District of New Jersey granted this motion, and the Company, TNK, BDL and CARgenix were dismissed as defendants from the case. Although dismissed from the case, under various agreements, TNK has certain indemnification obligations to Roger Williams Medical Center, Dr. Richard P. Junghans and Dr. Steven C. Katz that may be implicated by the case. In addition, the possibility exists that Immunomedics could attempt to file suit against the Company and/or TNK in a different jurisdiction. The Immunomedics Action remains pending in the District of New Jersey against defendants Roger Williams Medical Center, Dr. Junghans, and Dr. Katz. A trial date has not yet been set. The Company

believes that the Immunomedics Action is without merit, and will vigorously defend itself against this and any further actions. However, should Immunomedics prevail against the Company, Roger Williams Medical Center or other defendants, certain patent rights optioned, owned and/or licensed by the Company could be at risk of invalidity or enforceability, or the litigation could otherwise adversely impact the Company's ownership or other rights in certain intellectual property. At this point in time, the Company is unable to determine whether any loss will occur with respect to the Immunomedics Action or to estimate the range of such potential loss; therefore, no amount of loss has been accrued by the Company as of the date of filing of this Annual Report on Form 10-K.

## Operating Leases

The Company currently leases in San Diego, California approximately 43,000 square feet of corporate office and laboratory space, approximately 6,350 square feet of laboratory and office space at a second location and approximately 1,405 square feet of office space at a third location. The Company's lease agreements in San Diego, as amended, for its corporate office and laboratory space, its second laboratory and office space and its third office space, expire in December 2026, November 2025 and September 2020, respectively. The Company leases an additional 1,405 square feet of office space in California and an additional 2,734 square feet in Pennsylvania. The Company also leases 25,381 square feet of office and laboratory space in Suzhou, China, which lease expires in June 30, 2019. The Company leases 2,312 square feet of office, laboratory, and storage space in Scotland, which lease expires in March 2021.

Additionally, the Company entered into a new lease in San Diego, California for approximately 76,700 square feet of additional corporate office and laboratory space as well as approximately 36,400 square feet for offices, facilities for cGMP fill and finish and storage space. The lease began in February of 2017 and expires in December 2020.

For all leased properties the Company has provided a total security deposit of \$1,482 thousand to secure its obligations under the various leases, which has been included in prepaid and other assets.

Minimum future non-cancelable annual operating lease obligations are as follows for the years ending December 31 (in thousands):

|            |           |               |
|------------|-----------|---------------|
| 2018       | \$        | 5,304         |
| 2019       |           | 5,287         |
| 2020       |           | 5,315         |
| 2021       |           | 4,949         |
| 2022       |           | 5,004         |
| Thereafter |           | 15,399        |
|            | <u>\$</u> | <u>41,258</u> |

Rental expense paid for the years ended December 31, 2017, 2016 and 2015 under the above leases totaled \$3,237 thousand, \$2,054 thousand and \$1,630 thousand, respectively.

<sup>1</sup>Although dismissed from the case, under various agreements, TNK has certain indemnification obligations to Roger Williams Medical Center, Dr. Richard P. Junghans and Dr. Steven C. Katz that may be implicated by the case. In addition, the possibility exists that Immunomedics could attempt to file suit against the Company and/or TNK in a different jurisdiction.

## 16. Income Taxes

The components of the provision expense (benefit) were as follows for the years ended December 31, 2017, 2016 and 2015 (in thousands):

|                  | 2017               | 2016            | 2015             |
|------------------|--------------------|-----------------|------------------|
| <b>Current:</b>  |                    |                 |                  |
| Federal          | \$ (366)           | \$ (1,785)      | \$ 2,500         |
| State            | 14                 | (600)           | 621              |
| Foreign          | 30                 | —               | —                |
|                  | <u>(322)</u>       | <u>(2,385)</u>  | <u>3,121</u>     |
| <b>Deferred:</b> |                    |                 |                  |
| Federal          | (33,178)           | 3,554           | 32,378           |
| State            | (2,538)            | (2,065)         | 815              |
|                  | <u>\$ (35,716)</u> | <u>\$ 1,489</u> | <u>\$ 33,193</u> |
| <b>Totals</b>    | <u>\$ (36,038)</u> | <u>\$ (896)</u> | <u>\$ 36,314</u> |

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The components of the Company's net deferred tax liabilities and related valuation allowance are as follows as of December 31, 2017 and 2016 (in thousands):

|  | 2017               | 2016               |
|--|--------------------|--------------------|
| <b>Deferred tax assets:</b>                  |                    |                    |
| Amortization of intangibles                  | \$ 21,862          | \$ 32,032          |
| Deferred revenue                             | 34,754             | 44,754             |
| Tax credit carryforwards                     | 10,160             | 5,693              |
| Net operating loss carryforwards             | 21,172             | 6,237              |
| Stock based compensation                     | 1,743              | 3,898              |
| Accrued expenses and other                   | 1,877              | 1,558              |
| <b>Total deferred tax assets</b>             | <u>91,568</u>      | <u>94,172</u>      |
| Less valuation allowance                     | (43,405)           | (81,039)           |
| <b>Total deferred tax assets</b>             | <u>48,163</u>      | <u>13,133</u>      |
| <b>Deferred tax liabilities:</b>             |                    |                    |
| Amortization of intangibles                  | (15,225)           | (25,433)           |
| Depreciation                                 | (757)              | (1,530)            |
| Investment in common stock                   | (47,716)           | (39,408)           |
| <b>Total deferred tax liabilities</b>        | <u>(63,698)</u>    | <u>(66,371)</u>    |
| <b>Net deferred tax assets / liabilities</b> | <u>\$ (15,535)</u> | <u>\$ (53,238)</u> |

The reconciliation between U.S. federal income taxes at the statutory rate and the Company's provision for income taxes are as follows for the years ended December 31 (in thousands):

|  | 2017               | 2016            |
|--|--------------------|-----------------|
| Income tax expense (benefit) at federal statutory rate | \$ (8,725)         | \$ (23,357)     |
| State, net of federal tax benefit                      | (834)              | (1,522)         |
| Other permanent differences                            | 1,290              | 2,882           |
| Incentive stock compensation                           | 1,025              | 767             |
| Transaction costs                                      | 408                | —               |
| Other  | 715                | 120             |
| Return to provision adjustment                         | (42)               | (16)            |
| Acquired in-process research and development           | 71                 | (2,360)         |
| Change in Federal rate                                 | 10,006             | —               |
| Change in State rate                                   | 810                | (172)           |
| Research tax credits                                   | (4,051)            | (2,318)         |
| Uncertain tax positions                                | 1,027              | (1,836)         |
| Prior year true-ups and carrybacks                     | (1,095)            | 4,133           |
| Stock compensation true-up                             | 1,788              | —               |
| Change in valuation allowance                          | (38,431)           | 22,783          |
| Income tax provision                                   | <u>\$ (36,038)</u> | <u>\$ (896)</u> |

The Company has evaluated the available evidence supporting the realization of its gross deferred tax assets, including the amount and timing of future taxable income, and has determined that it is more likely than not that the deferred tax assets will not be realized. Due to such uncertainties surrounding the realization of the domestic deferred tax assets, the Company maintains a valuation allowance of \$43.4 million against its deferred tax assets as of December 31, 2017. Realization of the deferred tax assets will be primarily dependent upon the Company's ability to generate sufficient taxable income prior to the expiration of its net operating losses.

As of December 31, 2017, the Company had net operating loss carryforward of approximately \$72.5 million and \$55.9 million for federal and state income tax purposes, respectively. These may be used to offset future taxable income and will begin to expire in varying amounts in 2034 for federal income tax purposes and 2029 to 2037 for state income tax purposes. The Company also has research and development and orphan drug credits of approximately \$8.9 million and \$4.3 million for federal and state income taxes purposes, respectively. The federal credits may be used to offset future tax and will begin to expire in varying amounts in 2029 to 2037. The state credits may be used to offset future tax, such credits carryforward indefinitely.

Internal Revenue Code Section 382 rules apply to limit a corporation's ability to utilize existing net operating loss and tax credit carryforwards once the corporation experiences an ownership change as defined in Section 382. The Company has undergone an ownership change in a prior year. For the year ended December 31, 2017, there was no impact of such limitations on the income tax provision. Due to the existence of the valuation allowance, it is not expected that any possible limitation will have an impact on the results of operations or financial position of the Company.

The Company is subject to taxation in the U.S. and California jurisdictions and potentially, foreign jurisdictions outside the U.S., in conjunction with its transactions and activities. Currently, years ending December 31, 2015 and 2016 are under examination by a state tax authority. The Company's tax years starting in December 31, 2007 through December 31, 2017 are open and subject to examination by the U.S. and state taxing authorities due to the carryforward of utilized net operating losses and research and development credits.

The Company adopted the provisions of ASC Topic 740 regarding uncertain tax positions on January 1, 2009. Under ASC Topic 740, the impact of an uncertain income tax position taken on a tax return must be recognized at the largest amount that is cumulatively "more likely than not" to be sustained upon audit by relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained.

A reconciliation of the beginning and ending amount of unrecognized tax expense (benefits) is as follows (in thousands):



|  | <b>Amount</b>   |
|--|-----------------|
| Unrecognized tax benefits balance at December 31, 2016 | \$ 2,389        |
| Increase related to current year tax positions         | 1,436           |
| Increase related to prior year tax positions           | 58              |
| Settlements  | —               |
| Lapse in statute of limitations                        | —               |
| Unrecognized tax benefits balance at December 31, 2017 | <u>\$ 3,883</u> |

Included in the balance of unrecognized tax benefits at December 31, 2017, are \$90 thousand that, if recognized, would affect the effective tax rate.

The Company's policy is to recognize interest and penalties related to income tax matters in income tax expense. No interest has been recognized as of and for the period ended December 31, 2017.

The Company believes that no material amount of the liabilities for uncertain tax positions will expire within 12 months of December 31, 2017.

### **U.S. Tax Reform**

The Tax Cut and Jobs Act ("Tax Act") was enacted on December 22, 2017. The Tax Act reduces the U.S. federal corporate tax rate from 35% to 21%, as well as making several other significant changes to the tax law, effective January 1, 2018. Pursuant to the Securities and Exchange Commission Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (SAB 118), given the amount and complexity of the changes in tax law resulting from the Tax Act, the Company has not finalized the accounting for the income tax effects of the Tax Act. This includes the provisional amounts recorded related to the re-measurement of the deferred taxes and the change to our valuation allowance. The impact of the Tax Act may differ from this estimate, during the one-year measurement period due to, among other things, further refinement of the Company's calculation, changes in interpretations and assumptions the Company has made, guidance that may be issued and actions the Company may take as a result of the Tax Act.

The Company's accounting for the following elements of the Tax Act is incomplete. However, the Company was able to make reasonable estimates of certain effects and therefore, has recorded provisional amounts as follows:

#### **Revaluation of Deferred Tax Assets and Liabilities**

We have remeasured our deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally 21% plus state and local tax. The Company recorded a provisional decrease related to our deferred tax assets and liabilities of \$10.0 million as a result of the tax rate decrease, with a corresponding adjustment to tax expense for the year ended December 31, 2017.

#### **Valuation Allowances**

The Company must assess whether its valuation allowance analyses for deferred tax assets are affected by various aspects of the Tax Act (e.g., deemed repatriation of deferred foreign income, future GILTI inclusions, new categories of foreign tax credits). Since, as discussed herein, the Company has recorded provisional amounts related to certain portions of the Tax Act, any corresponding determination of the need for or change in a valuation allowance is also provisional. The Company's decrease in its valuation allowance by \$38.4 million was substantially attributable to the Tax Act and its effects on our deferred tax assets.

### **17. Related Party Agreements and Other**

During the year ended December 31, 2015, the Company entered into a joint venture called Immunotherapy NANTibody, LLC, with NantCell, a subsidiary of NantWorks. In July 2015, the Company contributed its portion of the initial joint funding of \$40.0 million to the NANTibody joint venture. The Company and NantCell have also entered into a license agreement pursuant to which the Company received a \$10.0 million upfront license payment and \$100.0 million of vested NantCell common stock.

During the year ended December 31, 2015, the Company entered into a joint venture called NantCancerStemCell, LLC, with NantBioScience, a wholly-owned subsidiary of NantWorks. In connection with negotiated changes to the structure of NantStem the Company issued a call option on shares of NantKwest that it owned to Cambridge, a related party to the Company and to NantBioScience. In April 2015, the Company purchased 1.0 million shares of NantBioScience common stock for \$10.0 million.

In March 2016, the Company and Yuhan entered into an agreement to form a joint venture company called ImmuneOncia Therapeutics, LLC, to develop and commercialize a number of immune checkpoint antibodies against undisclosed targets for both hematological malignancies and solid tumors. As of December 31, 2016, the carrying value of the Company's investment in ImmuneOncia Therapeutics, LLC was approximately \$9.5 million. During the three months ended June 30, 2016, Yuhan purchased \$10.0 million of Common Stock and warrants.

In June 2016, the Company and TNK entered into a joint venture agreement with 3SBio to develop and commercialize proprietary immunotherapies, including those developed from, including or using TNK's CAR-T technology targeting CEA positive cancers. In June 2016, 3SBio purchased \$10.0 million of Common Stock and warrants.

In May 2015, the Company entered into a stock sale and purchase agreement with NantPharma, a private company owned by NantWorks pursuant to which the Company sold its equity interests in IgDraSol, its wholly-owned subsidiary and holder of the rights to Cynviloq for an upfront payment of \$90.05 million and potential regulatory and sales milestones of up to \$1.2 billion.

On November 8, 2016, the Company entered into the Scilex Purchase Agreement, pursuant to which the Company acquired from the Scilex Stockholders approximately 72% of the outstanding capital stock of Scilex, which remains a stand-alone company. Dr. Henry Ji, the Company's President and Chief Executive Officer and a member of the Company's Board of Directors, and George K. Ng, the Company's Vice President, Chief Administrative Officer and Chief Legal Officer, were stockholders of Scilex prior to the acquisition transaction.

On August 15, 2017, the transactions contemplated by the Contribution Agreement closed. Dr. Henry Ji, the Company's Chairman of the Board, President and Chief Executive Officer, Jaisim Shah, a member of the Company's Board of Directors and David Deming, a member of the Company's Board of Directors, were previously appointed as members of the board of directors of Celularity.

#### **18. 401(k) Plan**

The Company maintains a defined contribution 401(k) plan available to eligible employees. Employee contributions are voluntary and are determined on an individual basis, limited to the maximum amount allowable under federal tax regulations. The Company made matching contributions to the 401(k) plan totaling \$658 thousand, \$424 thousand and \$237 thousand, for the years ended December 31, 2017, 2016 and 2015, respectively.

#### **19. Quarterly Financial Data (Unaudited)**

The following table sets forth selected quarterly data for the years presented, in thousands, except per share data.

|   | Quarter Ended<br>December 31, | Quarter Ended<br>September 30, | Quarter Ended<br>June 30, | Quarter Ended<br>March 31, | Year Ended<br>December 31, |
|---|-------------------------------|--------------------------------|---------------------------|----------------------------|----------------------------|
| <b>2017</b>                                     |                               |                                |                           |                            |                            |
| Revenues  | \$ 20,407                     | \$ 121,910 <sup>1</sup>        | \$ 4,665                  | \$ 4,874                   | \$ 151,856                 |
| Operating costs and expenses                    | \$ 55,205                     | \$ 24,993                      | \$ 18,123                 | \$ 28,200                  | \$ 126,521                 |
| Net income (loss) attributable to Sorrento      | \$ 48,444                     | \$ (2,061)                     | \$ (14,187)               | \$ (23,064)                | \$ 9,132                   |
| Net income (loss) per share - basic             | \$ 0.60                       | \$ (0.03)                      | \$ (0.20)                 | \$ (0.45)                  | \$ 0.13                    |
| Net income (loss) per share - diluted           | \$ 0.58                       | \$ (0.03)                      | \$ (0.20)                 | \$ (0.45)                  | \$ 0.13                    |
| Weighted-average shares - basic                 | 80,486                        | 76,887                         | 70,302                    | 50,886                     | 69,742                     |
| Weighted-average shares - diluted               | 82,996                        | 76,888                         | 70,302                    | 50,886                     | 70,381                     |
|   | Quarter Ended<br>December 31, | Quarter Ended<br>September 30, | Quarter Ended<br>June 30, | Quarter Ended<br>March 31, | Year Ended<br>December 31, |
| <b>2016</b>                                     |                               |                                |                           |                            |                            |
| Revenues  | \$ 4,019                      | \$ 2,243                       | \$ 902                    | \$ 988                     | \$ 8,152                   |
| Operating costs and expenses                    | \$ 21,823                     | \$ 14,491                      | \$ 45,613                 | \$ 23,002                  | \$ 104,929                 |
| Net income (loss) attributable to Sorrento      | \$ (17,859)                   | \$ 15,891                      | \$ (43,305)               | \$ (15,650)                | \$ (60,923)                |
| Net income (loss) per share - basic and diluted | \$ (0.30)                     | \$ 0.24                        | \$ (0.93)                 | \$ (0.41)                  | \$ (1.21)                  |
| Weighted-average shares - basic                 | 58,634                        | 66,193                         | 46,498                    | 37,965                     | 50,360                     |
| Weighted-average shares - diluted               | 58,634                        | 66,527                         | 46,498                    | 37,965                     | 50,360                     |

<sup>1</sup>Quarter-over-quarter increase primarily due to revenue recognized from the intangibles transferred to Celularity as a result of closing the Contribution Agreement in 2017.

The quarters ended March 31, 2016, June 30, 2016, and September 30, 2016 have been restated to correct the effects of an immaterial error in the interim periods related to the re-measurement of acquisition consideration payable.

As a result of the restatement, an adjustment of \$2.7 million to gain on contingent liabilities has been reflected in operating costs and expenses in the above table for the three months ended March 31, 2016. As a result of the adjustment, operating costs and expenses decreased from \$25.7 million to \$23.0 million, net loss decreased from \$18.4 million to \$15.7 million, and net loss per share decreased from (\$0.48) to (\$0.41) for the quarter ended March 31, 2016. The adjustment includes the effects of a \$991 thousand adjustment related to the prior year as discussed in footnote 3.

As a result of the restatement, an adjustment of \$1.7 million to gain on contingent liabilities and \$0.1 million of research and development expenses have been reflected in operating costs and expenses in the above table for the three months ended June 30, 2016. As a result of the adjustment, operating costs and expenses decreased from \$47.3 million to \$45.6 million, Net loss decreased from \$44.9 million to \$43.3 million, and net loss per share decreased from (\$0.97) to (\$0.93) for the quarter ended June 30, 2016. The financial results for the six months ended June 30, 2016 reflect the impact of the adjustment, which resulted in a decrease in operating costs and expenses from \$73.0 million to \$68.6 million, a decrease in net loss attributable to the Company from \$63.3 million to \$59.0 million, and a decrease in net loss per share from (\$1.50) to (\$1.40) for the six months ended June 30, 2016.

As a result of the restatement, an adjustment of \$1.7 million of a gain on contingent liabilities and \$0.2 million of research and development expenses have been reflected in operating costs and expenses in the above table for the three months ended September 30, 2016. As a result of the adjustment, operating costs and expenses decreased from \$16.0 million to \$14.5 million, Net income increased from \$14.4 million to \$15.9 million, and net loss per share increased from \$0.22 to \$0.24 for the quarter ended September 30, 2016. The financial results for the nine months ended September 30, 2016 reflect the impact of the adjustment, which resulted in a decrease in operating costs and expenses from \$89.0 million to \$83.1 million, a decrease in net loss attributable to the Company from \$48.9 million to \$43.1 million, and a decrease in net loss per share from \$(1.03) to (\$0.91) for the nine months ended September 30, 2016.

## 20. Earnings Per Share

For the years ended December 31, 2017, 2016, and 2015, basic earnings per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is calculated to give effect to all dilutive securities, using the treasury stock method.

The following table sets forth the reconciliation of basic and diluted earnings per share for the years ended December 31, 2017, 2016 and 2015 (in thousands):

|   | Years Ended December 31, |           |           |
|---|--------------------------|-----------|-----------|
|   | 2017                     | 2016      | 2015      |
| Net Income (Loss)   | 9,132                    | (60,923)  | (45,811)  |
| Net Income Adjusted for Tax-Effect of Interest on Convertible Notes           | (71)                     | —         | —         |
| Adjusted Net Income   | 9,061                    | (60,923)  | (45,811)  |
| Denominator for Basic Earnings Per Share                                      | 69,742                   | 50,360    | 36,909    |
| Effect of Dilutive Securities:  |                          |           |           |
| Stock Options   | 8                        | —         | —         |
| Convertible Notes   | 604                      | —         | —         |
| Convertible Notes - Warrants  | 27                       | —         | —         |
| Denominator for Diluted Earnings per Share – Adjusted for Dilutive Securities | 70,381                   | 50,360    | 36,909    |
| Dilutive Earnings Per Share   | \$ 0.13                  | \$ (1.21) | \$ (1.24) |

The potentially dilutive stock options that would have been excluded because the effect would have been antidilutive for years ended December 31, 2017, 2016, and 2015 were 6.3 million, 4.3 million, and 3.0 million, respectively. The potentially dilutive warrants that would have been excluded because the effect would have been antidilutive for years ended December 31, 2017, 2016, and 2015 were 4.7 million, 7.7 million, and 2.0 million, respectively. Basic and diluted per share amounts are computed independently in the consolidated statements of income. Therefore, the sum of per share components may not equal the per share amounts presented.

## 21. Subsequent Events

### **Regulatory Approval for ZTlido™ (lidocaine topical system 1.8%)**

On February 28, 2018, the FDA approved ZTlido™ (lidocaine topical system) 1.8% for the relief of pain associated with post-herpetic neuralgia. Scilex is currently in preparations for a commercial launch of ZTlido™ (lidocaine topical system) 1.8% and exploring potential partnerships for the product. As a result of the FDA approval, pursuant to the Stock Purchase Agreement, dated November 8, 2016, among the Company and a majority of the stockholders of Scilex (the “Scilex Stockholders”), the Company became obligated to deliver to certain of the Scilex Stockholders cash and shares of Common Stock with a total value of approximately \$38.2 million. In satisfaction of this obligation, the Company issued 1,381,346 shares of Common Stock to the Scilex Stockholders and paid the Scilex Stockholders an aggregate of \$24.5 million in cash. The Company obtained a short-term loan from an unaffiliated third party to satisfy a portion of the cash payment to the Scilex Stockholders and repaid the loan obligation in full by March 16, 2018 by utilizing proceeds of equity issuances from the ATM Facility.

| (in \$ thousands)                               | Fiscal Year Ended December, 31 |                 |                |                 |                 |                |
|---|--------------------------------|-----------------|----------------|-----------------|-----------------|----------------|
|   | 2017                           | 2016            | 2015           | 2014            | 2013            | 2012           |
| Pretax Income (Loss) from Continuing Operations | 15,315                         | (65,268)        | (9,719)        | (36,359)        | (21,911)        | (4,845)        |
| Fixed Charges (per below)                       | 5,201                          | 1,712           | 1,651          | 1,628           | 254             | -              |
| Interests Capitalized                           | -                              | -               | -              | -               | -               | -              |
| <b>Earnings</b>                                 | <b>20,516</b>                  | <b>(63,556)</b> | <b>(8,068)</b> | <b>(34,731)</b> | <b>(21,657)</b> | <b>(4,845)</b> |
| Interests and Other Financial Charges           | 4,980                          | 1,615           | 1,651          | 1,628           | 254             | -              |
| Interests Portion of Rental Expense             | 221                            | 97              | -              | -               | -               | -              |
| Fixed Charges                                   | 5,201                          | 1,712           | 1,651          | 1,628           | 254             | -              |
| <b>Ratio of Earnings to Fixed Charges</b>       | <b>3.9</b>                     | <b>(37.1)</b>   | <b>(4.9)</b>   | <b>(21.3)</b>   | <b>(85.3)</b>   | <b>-</b>       |

## Subsidiaries of Sorrento Therapeutics, Inc.

| Name  | State or<br>Jurisdiction<br>of Incorporation or<br>Organization |
|---|---|
| Concertis Biosystems, Corp.                   | Delaware  |
| Sorrento Therapeutics, Inc. Hong Kong Limited | Hong Kong, China  |
| Ark Animal Health, Inc.                       | Delaware  |
| TNK Therapeutics, Inc.                        | Delaware  |
| LA Cell, Inc.                                 | Delaware  |
| Sorrento Biologics, Inc.                      | Delaware  |
| Scintilla Pharmaceuticals, Inc.               | Delaware  |
| BioServ Corporation                           | Delaware  |
| Scilex Pharmaceuticals Inc.                   | Delaware  |
| Levena Biopharma US, Inc.                     | Delaware  |
| SiniWest Holding Corp.                        | Delaware  |
| CARgenix Holdings LLC                         | Rhode Island  |
| BDL Products, Inc.                            | Delaware  |
| Levena San Diego Corp.                        | Delaware  |
| Coentre Technologies LLC                      | Colorado  |
| Concertis, Inc.                               | Delaware  |
| Levena Suzhou Biopharma Co., Ltd.             | People's Republic of China                                      |
| Sorrento Therapeutics (Shanghai) Co., Ltd.    | People's Republic of China                                      |
| Nanjing Levena Biopharma Co. Ltd.             | People's Republic of China                                      |
| SNAN Holdco LLC                               | Delaware  |
| Virtu Biologics Limited                       | England and Wales   |

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statement Nos. 333-163670, 333-195487, 333-198307 and 333-213130 on Form S-8 and Registration Statement Nos. 333-192025, 333-212302, 333-214897, 333-217673, 333-220822 and 333-221443 on Form S-3 of our reports dated March 16, 2018, relating to the consolidated financial statements and financial statement schedule of Sorrento Therapeutics, Inc. and subsidiaries (the “Company”) (which report expresses an unqualified opinion and includes an explanatory paragraph relating to substantial doubt about the Company’s ability to continue as a going concern), and the effectiveness of Company’s internal control over financial reporting (which report expresses an adverse opinion on the effectiveness of the Company’s internal control over financial reporting because of material weaknesses), appearing in this Annual Report on Form 10-K of the Company for the year ended December 31, 2017.

/s/ DELOITTE & TOUCHE LLP

San Diego, California  
March 16, 2018

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in Registration Statement Nos. 333-163670, 333-195487, 333-198307 and 333-213130 on Form S-8 and Registration Statement Nos. 333-192025, 333-212302, 333-214897, 333-21673, 333-220822 and 333-221443 on Form S-3 of our report dated March 14, 2016, relating to the consolidated financial statements of Sorrento Therapeutics, Inc. and Subsidiaries, for the year ended December 31, 2015, which appears in this Form 10-K.

/s/ Mayer Hoffman McCann P.C.  
San Diego, California  
March 16, 2018



**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER**  
**Pursuant to Rule 13a-14(a) adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Henry Ji, certify that:

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

/s/ Henry Ji, Ph.D.

Henry Ji, Ph.D.  
Chairman of the Board of Directors, Chief Executive Officer and President  
(Principal Executive Officer)

Dated: March 16, 2018

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER**  
**Pursuant to Rule 13a-14(a) adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Dean Ferrigno, certify that:

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

/s/ Dean Ferrigno

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Dean Ferrigno  
*Chief Accounting Officer*  
(Principal Financial and Accounting Officer)

Dated: March 16, 2018

## CERTIFICATIONS

Each of the undersigned, in his capacity as the principal executive officer and principal financial officer of Sorrento Therapeutics, Inc. (the "Company"), as the case may be, hereby certifies, pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), that, to the best of his knowledge:

1. This Annual Report on Form 10-K for the period ended December 31, 2017 fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and
2. The information contained in this Annual Report fairly presents, in all material respects, the financial condition and results of operations of the Company for the period covered by this Annual Report.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission ("SEC") or its staff upon request.

This certification accompanies the Form 10-K to which it relates, is not deemed filed with the SEC and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Exchange Act (whether made before or after the date of this Annual Report), irrespective of any general incorporation language contained in such filing.

**IN WITNESS WHEREOF**, the undersigned have set their hands hereto as of the 16th day of March 2018.

/S/ HENRY JI, PH.D.

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Henry Ji, Ph.D.  
*Chairman of the Board of Directors, Chief Executive Officer and President*  
(Principal Executive Officer)

/S/ DEAN FERRIGNO

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Dean Ferrigno  
*Chief Accounting Officer*  
(Principal Financial and Accounting Officer)