

IRONWOOD PHARMACEUTICALS INC

Form 10-Q

May 10, 2012

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

OR

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

For the transition period from _____ to _____

Commission file number: 001-34620

IRONWOOD PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

02142
(Zip Code)

(617) 621-7722

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of May 1, 2012, there were 75,387,167 shares of Class A common stock outstanding and 31,828,007 shares of Class B common stock outstanding.

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IRONWOOD PHARMACEUTICALS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2012

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****Ironwood Pharmaceuticals, Inc.****Condensed Consolidated Balance Sheets****(In thousands, except share and per share amounts)****(unaudited)**

	March 31,		December 31,
	2012		2011
Assets			
Current assets:			
Cash and cash equivalents	\$ 131,612	\$	87,282
Available-for-sale securities	70,496		76,734
Accounts receivable	109		74
Related party accounts receivable, net			578
Prepaid expenses and other current assets	4,048		2,899
Total current assets	206,265		167,567
Restricted cash	7,647		7,647
Property and equipment, net	35,140		33,625
Other assets	124		138
Total assets	\$ 249,176	\$	208,977
Liabilities and Stockholders Equity			
Current liabilities:			
Accounts payable	\$ 1,996	\$	6,436
Related party accounts payable, net	1,175		
Accrued research and development costs	7,958		7,010
Accrued expenses	11,598		11,122
Current portion of capital lease obligations	271		233
Current portion of deferred rent	4,350		4,042
Current portion of deferred revenue	24,935		36,291
Total current liabilities	52,283		65,134
Capital lease obligations, net of current portion	435		422
Deferred rent, net of current portion	11,964		12,435
Deferred revenue, net of current portion	20,348		21,130
Commitments and contingencies (Note 7)			
Stockholders equity:			

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Preferred stock, \$0.001 par value, 75,000,000 shares authorized, no shares issued and outstanding at March 31, 2012 and December 31, 2011

Class A common stock, \$0.001 par value, 500,000,000 shares authorized and 75,316,558 and 61,801,770 shares issued and outstanding at March 31, 2012 and December 31, 2011, respectively

75

62

Class B common stock, \$0.001 par value, 100,000,000 shares authorized and 31,675,966 and 38,914,080 shares issued and outstanding at March 31, 2012 and December 31, 2011, respectively

32

39

Additional paid-in capital

632,029

542,141

Accumulated deficit

(467,993)

(432,392)

Accumulated other comprehensive income

3

6

Total stockholders' equity

164,146

109,856

Total liabilities and stockholders' equity

\$

249,176

\$

208,977

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

Table of Contents**Ironwood Pharmaceuticals, Inc.****Condensed Consolidated Statements of Comprehensive Income (Loss)****(In thousands, except share and per share amounts)****(unaudited)**

	Three Months Ended	
	March 31,	
	2012	2011
Collaborative arrangements revenue	\$ 12,248	\$ 10,237
Operating expenses:		
Research and development	29,510	19,555
General and administrative	18,374	9,224
Total operating expenses	47,884	28,779
Loss from operations	(35,636)	(18,542)
Other income (expense):		
Interest expense	(14)	(16)
Interest and investment income	49	154
Other income	3	3
Other income (expense), net	35	141
Net loss	(35,601)	(18,401)
Other comprehensive income (loss):		
Unrealized gain (loss) on short-term investments	(3)	51
Other comprehensive income (loss)	(3)	51
Comprehensive loss	\$ (35,604)	\$ (18,350)
Net loss per share basic and diluted	\$ (0.34)	\$ (0.19)
Weighted average number of common shares used in net loss per share basic and diluted	103,751,060	99,075,187

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

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

	Three Months Ended	
	March 31,	
	2012	2011
Cash flows from operating activities:		
Net loss	\$ (35,601)	\$ (18,401)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,680	2,133
Loss on disposal of property and equipment	1	
Share-based compensation expense	3,721	2,698
Accretion of discount/premium on investment securities	309	727
Changes in assets and liabilities:		
Accounts receivable	543	(1,289)
Restricted cash		2,833
Prepaid expenses and other current assets	(1,149)	1,021
Other assets	14	23
Accounts payable and accrued expenses	(2,227)	(2,962)
Accrued research and development costs	948	(88)
Deferred revenue	(12,138)	(10,013)
Deferred rent	(163)	(595)
Net cash used in operating activities	(43,062)	(23,913)
Cash flows from investing activities:		
Purchases of available-for-sale securities	(23,339)	(39,436)
Sales and maturities of available-for-sale securities	29,265	68,111
Purchases of property and equipment	(4,642)	(3,468)
Proceeds from sale of property and equipment	4	
Net cash provided by investing activities	1,288	25,207
Cash flows from financing activities:		
Proceeds from issuance of common stock	85,228	
Proceeds from exercise of stock options	945	675
Payments on borrowings	(69)	(76)
Net cash provided by financing activities	86,104	599
Net increase in cash and cash equivalents	44,330	1,893
Cash and cash equivalents, beginning of period	87,282	44,321
Cash and cash equivalents, end of period	\$ 131,612	\$ 46,214
Supplemental cash flow disclosures:		
Cash paid for interest	\$ 12	\$ 15
Purchases under capital leases	\$ 120	\$ 325

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

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Nature of Business

Ironwood Pharmaceuticals, Inc. (the Company) is an entrepreneurial pharmaceutical company that discovers, develops and intends to commercialize differentiated medicines that improve patients' lives. The Company's lead product candidate is linaclotide, a guanylate cyclase type-C agonist (GCCA) being developed for the treatment of patients with irritable bowel syndrome with constipation (IBS-C) and chronic constipation (CC). In August 2011, the Company and its U.S. collaboration partner, Forest Laboratories, Inc. (Forest) submitted a New Drug Application (NDA) to the U.S. Food and Drug Administration (FDA) for linaclotide for the treatment of IBS-C and CC. In February 2012, the FDA informed the Company and Forest that it will not schedule an advisory committee meeting in connection with its review of the NDA. In April 2012, the FDA extended its standard ten-month review period by three months, so the FDA Prescription Drug User Fee Act (PDUFA) target action date is now in September 2012.

In September 2011, the Company's European partner, Almirall, S.A. (Almirall) submitted a Market Authorization Application (MAA) to the European Medicines Agency (EMA) for linaclotide for the treatment of patients with IBS-C, and Almirall continues to work with the EMA in its review.

The Company's Japanese partner, Astellas Pharma Inc. (Astellas), continues to develop linaclotide for the treatment of patients with IBS-C in Japan and certain other Asian countries. The Company continues to assess alternatives to bring linaclotide to IBS-C and CC sufferers in the parts of the world outside of its partnered territories, which include China.

The Company also continues to assess lifecycle management opportunities for linaclotide in order to ensure that it is maximizing the drug's potential value. Based on its preliminary efforts to date, the Company anticipates that these activities will include the exploration of the potential for linaclotide in the pediatric population as well as in other gastrointestinal indications.

The Company also has a pipeline focused on both research and development of early development candidates and discovery research in multiple therapeutic areas, including gastrointestinal disease, Central Nervous System (CNS) disorders, respiratory disease and cardiovascular disease.

The Company was incorporated in Delaware on January 5, 1998. On April 7, 2008, the Company changed its name from Microbia, Inc. to Ironwood Pharmaceuticals, Inc. The Company currently operates in one reportable business segment—human therapeutics.

The Company has generated an accumulated deficit as of March 31, 2012 of approximately \$468.0 million since inception. In February 2010, the Company completed its initial public offering of Class A common stock and raised a total of approximately \$203.2 million in net proceeds. Additionally, in February 2012, the Company sold 6,037,500 shares of its Class A common stock through a firm commitment, underwritten public offering and raised a total of approximately \$85.2 million in net proceeds (Note 8).

2. Summary of Significant Accounting Policies

Unaudited Interim Financial Statements

The accompanying condensed consolidated financial statements and the related disclosures as of March 31, 2012 and for the three months ended March 31, 2012 and 2011 are unaudited and have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) and the applicable rules and regulations of the Securities and Exchange Commission (SEC) for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company s Annual Report on Form 10-K filed with the SEC on February 29, 2012. The December 31, 2011 condensed consolidated balance sheet included herein was derived from the audited financial statements as of that date, but does not include all disclosures including notes required by GAAP for complete financial statements.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments of a normal recurring nature considered necessary to present fairly the Company s financial position as of March 31, 2012 and results of its operations and its cash flows for the three months ended March 31, 2012 and 2011. The interim results for the three months ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of Ironwood Pharmaceuticals, Inc. and its wholly owned subsidiaries, Ironwood Pharmaceuticals Securities Corporation and Ironwood Pharmaceuticals GmbH. All intercompany transactions and balances are eliminated in consolidation.

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

Use of Estimates

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

Cash and Cash Equivalents

The Company considers all highly liquid investment instruments with a remaining maturity when purchased of three months or less to be cash equivalents. Investments qualifying as cash equivalents primarily consist of money market funds. The carrying amount of cash equivalents approximates fair value. The amount of cash equivalents included in cash and cash equivalents was approximately \$128.3 million and \$77.2 million at March 31, 2012 and December 31, 2011, respectively.

Available-for-Sale Securities

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

The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest and investment income. To determine whether an other-than-temporary impairment exists, the Company considers whether it

has the ability and intent to hold the investment until a market price recovery, and whether evidence indicating the recoverability of the cost of the investment outweighs evidence to the contrary. There were no other-than-temporary impairments for the three months ended March 31, 2012 and 2011.

Concentrations of Credit Risk

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

Accounts receivable, including related party accounts receivable, primarily consist of amounts due under the collaboration agreement with Forest and license agreements with Almirall and Astellas (Note 4) for which the Company does not obtain collateral. Accounts receivable from Forest and Almirall are presented as related party accounts receivable on the condensed consolidated balance sheets as both entities own common stock of the Company.

At March 31, 2012 and December 31, 2011, accounts receivable from Forest, net of any payables due Forest, accounted for approximately 0% and 86%, respectively, of the Company's total accounts receivable. At March 31, 2012 and December 31, 2011, Almirall accounted for approximately 0% and 2%, respectively, of the Company's total accounts receivable. At March 31, 2012 and December 31, 2011, Astellas accounted for approximately 100% and 11%, respectively, of the Company's total accounts receivable.

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

The percentages of revenue recognized from significant customers of the Company in the three months ended March 31, 2012 and 2011 are included in the following table:

Collaborative Partner:	Three Months Ended	
	2012	March 31, 2011
Forest	45%	53%
Almirall	48%	37%
Astellas	7%	10%

For the three months ended March 31, 2012 and 2011, no additional customers accounted for more than 10% of the Company's revenue.

Revenue Recognition

The Company's revenue is generated through collaborative research and development and licensing agreements. The terms of these agreements contain multiple deliverables which may include (i) licenses, (ii) research and development activities, including participation on a joint development committee, and (iii) the manufacture of active pharmaceutical ingredient (API) and development materials for the collaborative partner which are reimbursed at a contractually determined rate. To date, the Company's collaborative research and development and licensing agreements have included only the license to develop and commercialize linaclotide, the Company's GCCA. Non-refundable payments to the Company under these agreements may include (i) up-front license fees, (ii) payments for research and development activities, (iii) payments for the manufacture of API and development materials, (iv) payments based upon the achievement of certain milestones, and (v) royalties on product sales.

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

At March 31, 2012, the Company had collaboration and license agreements with Forest, Almirall and Astellas. Refer to Note 4, Collaboration and License Agreements, for additional discussion of these agreements.

Agreements Entered into Prior to January 1, 2011

For arrangements that include multiple deliverables, the Company follows the provisions of the Accounting Standards Codification (ASC) Topic 605-25, *Revenue Recognition Multiple-Element Arrangements* (ASC 605-25), in accounting for these agreements. Under ASC 605-25, the Company is required to identify the deliverables included within the agreement and evaluate which deliverables represent separate units of accounting. Collaborative research and development and licensing agreements that contain multiple deliverables are divided into separate units of accounting if certain criteria are met, as follows:

- Delivered element(s) has value to the collaborator on a standalone basis,
- There is objective and reliable evidence of the fair value of the undelivered obligation(s), and
- If the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially within the Company's control.

The Company allocates arrangement consideration among the separate units of accounting either on the basis of each unit's respective fair value or using the residual method, and applies the applicable revenue recognition criteria to each of the separate units. If the separation criteria are not met, revenue of the combined unit of accounting is recorded based on the method appropriate for the last delivered item. The Company recognizes revenue when there is persuasive evidence that an arrangement exists, services have been rendered or delivery has occurred, the price is fixed or determinable, and collection is reasonably assured.

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

Up-Front License Fees

The Company recognizes revenue from nonrefundable, up-front license fees on a straight-line basis over the contracted or estimated period of performance, which is typically the period over which the research and development is expected to occur or manufacturing services are expected to be provided. Accordingly, the Company is required to make estimates regarding the drug development and commercialization timelines for drugs and drug candidates being developed pursuant to the applicable agreement. The determination of the length of the period over which to recognize the revenue is subject to judgment and estimation and can have an impact on the amount of revenue recognized in a given period. The Company generally assesses the estimated period of performance to approximate the research and development term due to the Company's continuing involvement in the performance of research and development activities. Typically the research and development term begins at the inception of the collaboration or license agreement and concludes when the Company's significant research and development obligations under the agreement have ended. Quarterly, the Company reassesses its period of substantial involvement over which the Company amortizes its up-front license fees and makes adjustments as appropriate. During the three months ended March 31, 2012, the Company's estimates regarding the period of performance under its collaborative research and development and licensing agreements did not change; however, they have changed in the past and may change in the future. In the event that a license were to be terminated, the Company would recognize as revenue any portion of the up-front fee that had not previously been recorded as revenue, but was classified as deferred revenue at the date of such termination.

Up-front payments on a license are deferred if the relevant facts and circumstances dictate that the license does not have standalone value to the partner. Factors considered in this determination include the research capabilities of the partner and the availability of peptide research expertise in the general marketplace. In addition, the Company considers whether the collaborator can use the license for its intended purpose without the receipt of the remaining deliverables, and whether the value of the license is dependent on the undelivered items and whether there are other vendors that can provide the undelivered item.

Milestones

At the inception of each arrangement that includes milestone payments, the Company evaluates whether each milestone is substantive and at risk to both parties on the basis of the contingent nature of the milestone. This evaluation includes an assessment of whether (a) the consideration is commensurate with either (1) the entity's performance to achieve the milestone, or (2) the enhancement of the value of the delivered item(s) as a result of a specific outcome resulting from the entity's performance to achieve the milestone, (b) the consideration relates solely to past performance, and (c) the consideration is reasonable relative to all of the deliverables and payment terms within the arrangement. The Company evaluates factors such as the scientific, clinical, regulatory, commercial and other risks that must be overcome to achieve the respective milestone, the level of effort and investment required and whether the milestone consideration is reasonable relative to all deliverables and payment terms in the arrangement in making this assessment.

Prior to January 1, 2011, in those circumstances where a substantive milestone was achieved, collection of the related receivable is reasonably assured and the Company had remaining obligations to perform under the collaboration arrangement, the Company recognized as revenue on the date the milestone was achieved an amount equal to the applicable percentage of the performance period that had elapsed as of the date the milestone was achieved, with the balance being deferred and recognized on a straight-line basis over the remaining period of performance. Effective January 1, 2011, the Company adopted Accounting Standards Update (ASU) No. 2010-17, *Revenue Recognition Milestone Method* (ASU 2010-17) on a prospective basis. Under ASU 2010-17, in those circumstances where a substantive milestone is achieved and collection of the related receivable is reasonably assured, the Company recognizes revenue related to the milestone in its entirety in the period in which the milestone is achieved. Milestone payments received prior to the adoption of ASU 2010-17 have continued to be recognized over the remaining period of performance. Milestones that are not considered substantive are recognized on a straight-line basis over the remaining period of performance.

Substantive milestones are due to the Company upon NDA approval of linaclotide in the U.S., upon the initiation of a Phase 3 study for linaclotide in Japan, upon the filing and approval of the Japanese equivalent of an NDA with the relevant regulatory authority in Japan. Refer to Note 4 for details on the specific milestones in each of the Company's agreements.

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

Other

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

The Company receives research and development funding under the Forest collaboration agreement and considers the nature and contractual terms of the arrangement and the nature of the Company's business operations to determine whether research and development funding will result in collaborative revenues or an offset to research and development expenses. Additionally, the Company considers the factors or indicators within this arrangement to determine whether reporting transactions under the Company's collaboration agreements on a gross or net basis is appropriate. The Company records revenue transactions gross in the condensed consolidated statements of comprehensive income (loss) if it is deemed the principal in the transaction, which includes being the primary obligor and having the risks and rewards of ownership.

For certain of the Company's arrangements, particularly the license agreement with Almirall, it is required that taxes be withheld on its payments. The Company has adopted a policy to recognize revenue net of these tax withholdings.

Agreements Entered into or Materially Modified on or after January 1, 2011

Effective January 1, 2011, the Company adopted ASU No. 2009-13, *Multiple-Deliverable Revenue Arrangements* (ASU 2009-13), on a prospective basis. ASU 2009-13 amends ASC 605-25 to provide updated revenue recognition guidance on whether multiple deliverables in an arrangement exist, how multiple deliverables in an arrangement should be separated and how the arrangement consideration should be allocated. More specifically, the revised guidance eliminates the requirement to establish vendor-specific objective evidence of fair value or third-party evidence of fair value of undelivered elements in order to separate a deliverable. Additionally, ASU 2009-13 eliminates the use of the residual method by requiring revenues to be allocated using the relative selling price method. Under the relative selling price method, arrangement consideration is allocated to each separate unit of accounting based on the relative selling price of each deliverable. The estimated selling price of each deliverable is determined using the following hierarchy of values (i) vendor-specific objective evidence of selling price, (ii) third-party evidence of selling price, and (iii) best estimate of the selling price (BESP). The BESP reflects the Company's best estimate of what the selling price would be if the deliverable was regularly sold on a standalone basis. Since January 1, 2011, the Company has not entered into any material agreements or material modifications to existing agreements that would be accounted for pursuant to this updated guidance. If the Company enters into or materially modifies an agreement with multiple deliverables, this updated guidance could have a material effect on the Company's consolidated financial statements in future periods.

Research and Development Costs

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

Research and development expenses are comprised of costs incurred in performing research and development activities, including salary and benefits; share-based compensation expense; laboratory supplies and other direct expenses; facilities expenses; overhead expenses; contractual services, including clinical trial and related clinical manufacturing expenses, including supply chain development; and other outside expenses.

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

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

Share-Based Compensation

Share-based compensation is recognized as an expense in the financial statements based on the grant date fair value. Compensation expense recognized primarily relates to stock awards, restricted stock and stock options granted, modified, repurchased or cancelled on or after January 1, 2006. For awards that vest based on service conditions, the Company uses the straight-line method to allocate compensation expense to reporting periods. The grant date fair value of options granted is calculated using the Black-Scholes option-pricing model, which requires the use of subjective assumptions including volatility, expected term and the fair value of the underlying common stock, among others.

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

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

Net Loss Per Share

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

Income Taxes

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

Management of the Company has evaluated the positive and negative evidence bearing upon the realizability of its deferred tax assets. Management has considered the Company's history of operating losses and concluded, in accordance with the applicable accounting standards, that it is more likely than not that the Company will not realize the benefit of its deferred tax assets. Accordingly, the deferred tax assets have been fully reserved at March 31, 2012 and December 31, 2011. Management reevaluates the positive and negative evidence on a quarterly basis.

The Company accounts for uncertain tax positions recognized in the condensed consolidated financial statements by prescribing a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Impairment of Long-Lived Assets

The Company regularly reviews the carrying amount of its long-lived assets to determine whether indicators of impairment may exist, which warrant adjustments to carrying values or estimated useful lives. If indications of impairment exist, projected future undiscounted cash flows associated with the asset are compared to the carrying amount to determine whether the asset's value is recoverable. If the carrying value of the asset exceeds such projected undiscounted cash flows, the asset will be written down to its estimated fair value. There were no indicators of impairment at March 31, 2012 or December 31, 2011.

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

Segment Information

Operating segments are components of an enterprise for which separate financial information is available and is evaluated regularly by the Company's chief operating decision-maker in deciding how to allocate resources and in assessing performance. The Company currently operates in one reportable business segment—human therapeutics.

New Accounting Pronouncements

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

Recently Adopted Accounting Standards

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04). ASU 2011-04 amends ASC 820, *Fair Value Measurement*, to ensure that fair value has the same meaning in GAAP and International Financial Reporting Standards (IFRS) and improves the comparability of the fair value measurement and disclosure requirements in GAAP and IFRS. ASU 2011-04 applies to all entities that measure assets, liabilities or instruments classified in shareholder's equity at fair value, or provide fair value disclosures for items not recorded at fair value. ASU 2011-04 results in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, ASU 2011-04 changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, ASU 2011-04 will not result in a change in the application of the requirements in ASC 820. Some of the requirements in ASU 2011-04 clarify the FASB's intent about the applica