

Sorrento Therapeutics, Inc.
Form 10-Q
August 06, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2014

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 000-52228

SORRENTO THERAPEUTICS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

33-0344842
(I.R.S. Employer
Identification Number)

6042 Cornerstone Ct. West,

Suite B

San Diego, California 92121

(Address of Principal Executive Offices)

(858) 210-3700

(Registrant's Telephone Number, Including Area Code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See 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 ☐

☐ (Do not check if a smaller reporting

Non-accelerated filer ☐ 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 ☒.

The number of shares of the issuer's common stock, par value \$0.0001 per share, outstanding as of August 1, 2014 was 28,532,850.

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Sorrento Therapeutics, Inc.

(a Development Stage Company)

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements.****SORRENTO THERAPEUTICS, INC.****(A DEVELOPMENT STAGE COMPANY)****CONSOLIDATED BALANCE SHEETS**

(In thousands, except for share amounts)

	June 30, 2014 (Unaudited)	December 31, 2013 (Audited)
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 50,155	\$ 31,667
Grants and accounts receivable, net	576	394
Prepaid expenses and other	705	571
Total current assets	51,436	32,632
Property and equipment, net	2,349	2,440
Intangibles, net	32,149	33,321
Goodwill	24,041	24,041
Other	345	148
Total assets	\$ 110,320	\$ 92,582

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	\$ 1,267	\$ 2,154
Accrued payroll and related	1,608	1,663
Current portion of deferred compensation	951	904
Accrued expenses	476	385
Current portion of debt	2,608	374
Total current liabilities	6,910	5,480
Long-term debt	9,442	4,431
Deferred compensation	1,591	1,497
Deferred tax liabilities	14,248	14,248
Deferred rent and other	105	117

Commitments and contingencies

Stockholders' equity:

Preferred stock, \$0.0001 par value; 100,000,000 shares authorized and no shares issued and outstanding

Common stock, \$0.0001 par value; 750,000,000 shares authorized and 28,532,850 and 23,028,100 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively

	3	2
Additional paid-in capital	129,429	99,668
Deficit accumulated during the development stage	(51,408)	(32,861)

Total stockholders' equity	78,024	66,809
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Total liabilities and stockholders' equity	\$ 110,320	\$ 92,582
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See accompanying notes

Table of Contents**SORRENTO THERAPEUTICS, INC.****(A DEVELOPMENT STAGE COMPANY)****CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

(In thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,		Period from January 25, 2006 (Inception) through June 30, 2014
	2014	2013	2014	2013	
Revenues:					
Grant	\$ 84	\$ 142	\$ 182	\$ 276	\$ 2,206
Sales and services	691		1,569		1,577
Collaboration and reimbursable research and development costs					223
Total revenues	775	142	1,751	276	4,006
Operating costs and expenses:					
Cost of sales and services revenues	510		1,073		1,077
Research and development	5,309	2,141	11,416	3,540	28,636
Acquired in-process research and development		1,210	209	1,210	6,195
General and administrative	2,361	1,508	5,746	2,757	16,634
Intangible amortization	586		1,172		1,976
Total operating costs and expenses	8,766	4,859	19,616	7,507	54,518
Loss from operations	(7,991)	(4,717)	(17,865)	(7,231)	(50,512)
Interest expense	(468)	(22)	(691)	(32)	(944)
Interest income	5	2	9	4	48
Net loss	\$ (8,454)	\$ (4,737)	\$ (18,547)	\$ (7,259)	\$ (51,408)
Net loss per share basic and diluted	\$ (0.33)	\$ (0.35)	\$ (0.77)	\$ (0.56)	
Weighted average number of shares during the period basic and diluted	25,341	13,443	24,202	12,881	

See accompanying notes

Table of Contents**SORRENTO THERAPEUTICS, INC.****(A DEVELOPMENT STAGE COMPANY)****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY****(Unaudited)**

(In thousands, except for share amounts)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Deficit Accumulated During the Development Stage	Total
Balance, January 25, 2006 (Inception)		\$	\$	\$	\$
Issuance of common stock to founders	4,077,493	1			1
Net loss				(76)	(76)
Balance, December 31, 2006	4,077,493	1		(76)	(75)
Net loss				(16)	(16)
Balance, December 31, 2007	4,077,493	1		(92)	(91)
Net loss				(26)	(26)
Balance, December 31, 2008	4,077,493	1		(118)	(117)
Issuance of restricted common stock to consultants	336,930				
Issuance of common stock for cash at \$0.98 per share, net of issuance costs of \$26	2,360,611		2,274		2,274
Issuance of common stock for cash at \$1.12 per share	1,785,375		2,000		2,000
Issuance of common stock in connection with the Merger	442,958		100		100
Costs associated with the Merger			(169)		(169)
Stock-based compensation			55		55
Net loss				(942)	(942)
Balance, December 31, 2009	9,003,367	1	4,260	(1,060)	3,201
Collection of note receivable					
Issuance of common stock for cash at \$3.50 per share, net of issuance costs of \$160	1,028,686		3,440		3,440
Stock-based compensation			251		251
Net loss				(1,808)	(1,808)
Balance, December 31, 2010	10,032,053	1	7,951	(2,868)	5,084

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Repurchase of common stock	(44,166)				
Issuance of common stock in connection with the exercise of stock options	6,000		13		13
Issuance of common stock for cash at \$4.00 per share, net of issuance costs of \$29	500,000		1,971		1,971
Reduction of stock issuance costs accrued in December 2010			80		80
Stock-based compensation			298		298
Net loss				(3,237)	(3,237)
Balance, December 31, 2011	10,493,887	1	10,313	(6,105)	4,209
Issuance of common stock in connection with the exercise of stock options	10,800		36		36
Issuance of common stock for cash at \$4.00 per share, net of issuance costs of \$66	1,500,000		5,934		5,934
Stock-based compensation			863		863
Net loss				(4,845)	(4,845)
Balance, December 31, 2012	12,004,687	1	17,146	(10,950)	6,197
Issuance of common stock in connection with the exercise of stock options	7,300		17		17
Issuance of common stock for cash at \$4.50 per share, net of issuance costs of \$64	1,426,406		6,354		6,354
Issuance of common stock with assignment agreement	10,000		40		40
Issuance of common stock in connection with IgDraSol merger at \$9.25 per share	3,006,641		27,811		27,811
Issuance of common stock in connection with Sherrington acquisition at \$8.48 per share	200,000		1,698		1,698
Issuance of common stock warrants in connection with loan and security agreement			215		215
Issuance of common stock in connection with ConcorTis merger at \$8.48 per share	1,331,978		11,295		11,295
Issuance of common stock for convertible note holders at \$7.25 per share	256,119		1,857		1,857
Issuance of common stock for cash at \$7.25 per share, net of issuance costs of \$3,254	4,772,500	1	31,346		31,347
Issuance of common stock in lieu of cash legal fees	12,469		100		100
Stock-based compensation			1,789		1,789
Net loss				(21,911)	(21,911)
Balance, December 31, 2013	23,028,100	2	99,668	(32,861)	66,809
Issuance of common stock for research agreement	25,000		209		209
Issuance of common stock warrants in connection with amended loan and security agreement			322		322
Stock-based compensation			2,533		2,533
Issuance of common stock for cash at \$5.25 per share, net of issuance costs of \$2,071	5,479,750	1	26,697		26,698

Net loss					(18,547)	(18,547)
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Balance, June 30, 2014	28,532,850	\$	3	\$	129,429	\$	(51,408)	\$	78,024
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See accompanying notes

Table of Contents**SORRENTO THERAPEUTICS, INC.****(A DEVELOPMENT STAGE COMPANY)****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

(In thousands)

	Six Months Ended June 30,		Period from January 25, 2006 (Inception) through June 30, 2014
	2014	2013	
Operating activities			
Net loss	\$ (18,547)	\$ (7,259)	\$ (51,408)
Adjustments to reconcile net loss to net cash used for operating activities:			
Depreciation and amortization	1,567	329	3,331
Stock-based compensation	2,533	430	5,789
Acquired in-process research and development	209		2,113
Non-cash interest expense	208	16	213
Provision for doubtful accounts	9		9
Changes in operating assets and liabilities:			
Grants and accounts receivable	(191)	(13)	(154)
Prepaid expenses and other	(369)	(396)	(920)
Accounts payable	(955)	296	100
Accrued expenses and other liabilities	24	300	133
Net cash used for operating activities	(15,512)	(6,297)	(40,794)
Investing activities			
Purchases of property and equipment	(198)	(178)	(2,340)
Purchase of intangible assets		(50)	(511)
Cash acquired in connection with Mergers			533
Net cash used for investing activities	(198)	(228)	(2,318)
Financing activities			
Proceeds from issuance of common stock, net of issuance costs and repurchases	26,698	6,354	79,851
Proceeds from exercise of stock options		7	66
Net payment of deferred compensation			(1,000)
Borrowings under long-term debt	7,500	827	14,350

Net cash provided by financing activities	34,198	7,188	93,267
Net change in cash and cash equivalents	18,488	663	50,155
Cash and cash equivalents at beginning of period	31,667	5,091	
Cash and cash equivalents at end of period	\$ 50,155	\$ 5,754	\$ 50,155
Supplemental disclosure:			
Cash paid during the period for:			
Income taxes	\$ 6	\$ 1	\$ 12
Interest	\$ 387	\$ 9	\$ 511

See accompanying notes

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SORRENTO THERAPEUTICS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014

(In thousands, except for share amounts)

1. Nature of Operations, Summary of Significant Accounting Policies and Business Activities

Nature of Operations and Basis of Presentation

Sorrento Therapeutics, Inc. (NASDAQ: SRNE), together with its wholly-owned subsidiaries (collectively, the Company) is a biopharmaceutical company focused on the discovery, acquisition, development and commercialization of proprietary drug therapeutics for addressing significant unmet medical needs in the U.S., Europe and additional international markets. The Company's primary therapeutic focus is oncology, including the treatment of chronic cancer pain, but is also developing therapeutic products for other indications, including immunology and infectious diseases. The Company's pipeline consists of its lead oncology product candidate Cynviloq, a micellar paclitaxel formulation, resiniferatoxin (or RTX), a non-opiate, ultra potent and selective agonist of the TRPV-1 receptor for intractable pain in end-stage disease, as well as fully human therapeutic antibodies derived from its proprietary G-MAB® library platform and antibody drug conjugates, or ADCs, and recombinant intravenous immunoglobulin, or rIVIG. In addition, the Company generates revenues from sales and services from the sale of customized reagents and providing professional services.

As of June 30, 2014, 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. Accordingly, the Company is considered to be in the development stage.

The accompanying interim consolidated financial statements have been prepared by the Company, without audit, in accordance with the instructions to Form 10-Q and, therefore, do not necessarily include all information and footnotes necessary for a fair statement of its financial position, results of operations and cash flows in accordance with United States generally accepted accounting principles (GAAP). The accompanying consolidated financial statements include the accounts of the Company's wholly-owned subsidiaries; IgDraSol, Inc., or IgDraSol; Sherrington Pharmaceuticals, Inc., or Sherrington; Concortis Biosystems, Corp., or Concortis; Ark Animal Health, Inc., or Ark; and Sorrento Therapeutics, Inc. Hong Kong Limited, or Sorrento Hong Kong, which was registered effective December 4, 2012. Sherrington and Sorrento Hong Kong had no operating activity through June 2014. All intercompany balances and transactions have been eliminated in consolidation.

The balance sheet at December 31, 2013 is derived from the audited consolidated balance sheet at that date which is not presented herein.

In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments, which are only normal and recurring, necessary for a fair statement of financial position, results of operations and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013. Operating results for interim periods are not expected to be indicative of operating results for the Company's 2014 fiscal year.

Liquidity

The Company anticipates that it will continue to incur net losses into the foreseeable future as it: (i) conducts its bioequivalence, or BE, registration trial relates to Cynviloq and prepares for its New Drug Application filing anticipated in 2015, (ii) advances RTX into clinical trials and potentially pursues other human indications, (iii) funds Ark activities in anticipation of Ark securing stand-alone financing, (iv) continues to identify and advance a number of potential mAb and ADC drug candidates into preclinical and clinical development activities, (v) continues development of, and seeks regulatory approvals for, its product candidates, and begin to commercialize any approved products, and (vi) expands corporate infrastructure, including the costs associated with being a NASDAQ listed public company.

In May 2014, the Company closed an underwritten public offering of 4,765,000 shares of common stock, at \$5.25 per share, and in June 2014, closed the full exercise of the over-allotment option granted to the representative of the underwriters to purchase an additional 714,750 shares of its common stock, with total gross proceeds of \$28.8 million, before underwriting discounts and commissions and other offering expenses payable by the Company.

In March 2014, the Company entered into an amended and restated loan and security agreement, increasing the September 2013 facility to \$12,500 from \$5,000, with the same two banks, which was funded at closing. The interest rate on the amended and restated loan is 7.95% per annum. The Company will make interest only payments on the outstanding amount of the loan on a monthly basis until October 1, 2014, after which equal monthly payments of principal and interest are due until the Term Loan maturity date of September 30, 2017. In the event the Company raises \$30 million of net equity or proceeds from a collaboration, if any, the interest only period will be extended by six months. See Note 5. Management believes the Company has the ability to meet all obligations due over the course of the next twelve months.

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The Company plans to continue 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. The Company filed a universal shelf registration statement on Form S-3 with the Securities and Exchange Commission (SEC), which was declared effective by the SEC in July 2013. The Shelf Registration Statement provides the Company the ability to offer up to \$100 million of securities, including equity and other securities as described in the registration statement. After the May 2014 underwritten offering (see Note 6), the Company has the ability to offer up to \$36.6 million of additional securities. Pursuant to the 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. If the Company is unable to secure adequate additional funding, the Company may be forced to make reductions in spending, extend payment terms with suppliers, liquidate assets where possible, and/or suspend or curtail planned programs. In addition, if the Company does not meet its payment obligations to third parties as they come due, it may be subject to litigation claims. Even if the Company is successful in defending against these claims, litigation could result in substantial costs and be a distraction to management. Any of these actions could materially harm the Company's business, results of operations, and future prospects.

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.

Use of Estimates

The preparation of consolidated financial statements in conformity with 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's financial instruments consist of cash and cash equivalents, grants and accounts receivable, prepaid expenses and other assets, accounts payable and accrued expenses. Fair value estimates of these instruments are made at a specific point in time, based on relevant market information. These estimates may be subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. As of June 30, 2014 and December 31, 2013, the carrying amount of cash and cash equivalents, grants and accounts receivable, prepaid expenses and other assets, accounts payable and accrued liabilities are generally considered to be representative of their respective fair values because of the short-term nature of those instruments.

Grants and Accounts Receivable

Grants receivable at June 30, 2014 and December 31, 2013 represent amounts due under several federal contracts with the National Institute of Allergy and Infectious Diseases, or NIAID, a division of the National Institutes of Health, or 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 June 30, 2014 and December 31, 2013 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 June 30, 2014 and December 31, 2013, the allowance for doubtful accounts was \$9 and \$0, 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.

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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.

Patent rights are stated at cost and depreciated on a straight-line basis over the estimated useful lives of the assets, determined to be approximately nineteen years from the date of transfer of the rights to the Company in April 2013. Amortization expense for the three months ended June 30, 2014 and 2013 and for the period from inception (January 25, 2006) (Inception) through June 30, 2014 was \$1, \$1 and \$6, respectively. Amortization expense for the six months ended June 30, 2014 and 2013 was \$2 and \$2, respectively, all such costs have been included in intangibles amortization.

License rights are stated at cost and depreciated on a straight-line basis over the estimated useful lives of the assets, determined to be approximately fifteen years from the date of acquisition of the rights in September 2013. Amortization expense for the three and six months ended June 30, 2014 and for the period from Inception through June 30, 2014 was \$475, \$950 and \$1,536, respectively, which has been included in intangibles amortization.

Acquired technology is stated at cost and depreciated 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 three and six months ended June 30, 2014 and for the period from Inception through June 30, 2014 was \$44, \$88 and \$94, respectively, which has been included in intangibles amortization.

Customer relationships are stated at cost and depreciated on a straight-line basis over the estimated useful lives of the assets, determined to be approximately five years from the date of acquisition in December 2013. Amortization expense for the three and six months ended June 30, 2014 and for the period from Inception through June 30, 2014 was \$66, \$132 and \$141, respectively, which has been included in intangibles amortization.

Impairment of Long-Lived Assets

The Company evaluates its long-lived 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 the 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 June 30, 2014.

Goodwill

Goodwill represents the excess of purchase price over fair value of net assets acquired in a business combination accounted for by the acquisition method of accounting and is not amortized, but subject to impairment testing at least annually or when a triggering event is identified that could indicate a potential impairment. We test our goodwill annually, or quarterly when events or changes in circumstances warrant, for impairment in the fourth quarter of each year. We are organized as a single reporting unit and perform impairment testing by comparing the carrying value of the reporting unit to the market value of the Company. No impairment to the carrying value of this goodwill has been

identified from Inception through June 30, 2014.

Revenue Recognition

The Company's inception to date grant revenues are generated primarily from three NIH and two U.S. Department of Treasury (or U.S. Treasury) grant awards and a feasibility study agreement, or the Collaboration Agreement entered into with a third party in July 2010, and from revenues generated from sales and services from the sale of customized reagents and providing professional services. The revenue from the NIH and U.S. Treasury grant awards are 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.

The revenue from the Collaboration Agreement was derived from the completion of certain development services and the reimbursement of certain development costs incurred to provide such development services. Revenue from upfront, nonrefundable service fees are recognized when earned, as evidenced by written acknowledgement from the collaborator, or other persuasive evidence that all service deliverables have been achieved, provided that the service deliverables are substantive and their achievability was not reasonably assured at the inception of the Collaboration Agreement. Any amounts received prior to satisfying the Company's revenue recognition criteria are recorded as deferred revenue.

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Revenues from sales and services are generated from the sale of customized reagents and providing professional services. Reagents are used for preparing ADCs, these reagents include industrial standard cytotoxins, linkers, and linker-toxins. The professional 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.

The Company is obligated to accept from customers the return of products sold that are damaged or don't 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.

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, are 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.

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.

Income Taxes

The provisions of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 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 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 no 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. The Company evaluates the recoverability of the deferred tax assets annually. As of June 30, 2014, the Company maintained a full valuation allowance against its deferred tax assets.

Stock-based Compensation

The Company accounts for stock-based compensation in accordance with FASB ASC Topic 718, 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 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 their estimated fair value as they vest.

Net Loss per Share

Net loss per share is presented as both basic and diluted net loss per share. Basic net loss per share excludes any dilutive effects of options, shares subject to repurchase and warrants. Diluted net loss per share includes the impact of potentially dilutive securities. No dilutive effect was calculated for the three and six months ended June 30, 2014 and 2013 as the Company reported a net loss for each respective period and the effect would have been anti-dilutive. The Company had outstanding common share equivalents of 1,854,626 and 455,000 at June 30, 2014 and 2013, respectively.

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Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. The Company is required to record all components of comprehensive loss in the consolidated financial statements in the period in which they are recognized. Net income (loss) and other comprehensive loss, including foreign currency translation adjustments and unrealized gains and losses on investments, are reported, net of their related tax effect, to arrive at comprehensive loss. For the three and six months ended June 30, 2014 and 2013, the comprehensive loss was equal to the net loss.

New Accounting Standards

In May 2014, Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2014-09 "Revenue from Contracts with Customers" (Topic 606). The guidance of this Update effects any entities that either issues contracts with customers or transfer goods or services or enters into contracts for the transfer of non-financial assets. The core principal of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in the amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. To achieve those core principals, the ASU specifies steps that the entity should apply for revenue recognition. The guidance also specifies the accounting for some costs to obtain or fulfill the contract with customer and disclosure requirements to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU No. 2014-09 is effective for annual reporting period beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The Company is currently evaluating the potential impact that adoption may have on its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-10 "Development Stage Entities" (Topic 915). The objective of the ASU is to improve financial reporting by reducing the cost and complexity of associated with the incremental reporting requirements for development stage entities. The ASU removes all incremental financial reporting requirements from U.S. GAAP for development stage entities, including the inception-to-date information and certain other disclosures. The ASU also eliminates an exception provided to development stage entities in Topic 810 "Consolidation" for determining whether an entity is a variable interest entity on the basis of amount of investment equity at risk. For public business entities, those amendments are effective for annual reporting periods beginning after December 15, 2014, and interim periods therein. Earlier adoption is permitted for any annual or interim period for which financial statements have not yet been issued. The Company will adopt Topic 915 effective with the filing of its Form 10-Q as of and for the three and nine months ended September 30, 2014.

In June 2014, the FASB issued ASU No. 2014-12 "Compensation - Stock Compensation" (Topic 718). The ASU provides guidance for accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. That is the case when an employee is eligible to retire or otherwise terminate employment before the end of the period in which a performance target could be achieved and still be eligible to vest in the award if and when the performance target is achieved. The amendment requires a performance target that affects vesting and that could be achieved after requisite service period be treated as a performance condition. Compensation cost should be recognized in the period in which it becomes probable that such performance condition would be achieved and should represent the compensation cost attributable to the periods for which the requisite service has already been rendered. Those amendments are effective for annual reporting periods beginning after December 15, 2015, and interim periods therein. The Company will adopt ASU No. 2014-12 on January 1, 2016. The Company is currently evaluating the potential impact that adoption may have on its consolidated financial statements.

2. Significant Agreements and Contracts

License Agreement with The Scripps Research Institute

In January 2010, the Company entered into a license agreement, or the TSRI License, with The Scripps Research Institute, or 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 three months ended June 30, 2014 and 2013 and for the period from inception (January 25, 2006)(Inception) through June 30, 2014, the Company recorded \$49, \$4 and \$249 in patent prosecution and maintenance costs associated with the TSRI License, respectively. For the six months ended June 30, 2014 and 2013, the Company recorded \$56 and \$7 in patent prosecution and maintenance costs associated with the TSRI License, respectively. All such costs have been included in general and administrative expenses.

The fair value of the warrants to purchase Company common stock, issued in connection with the TSRI License, of \$18 was determined using the Black-Scholes valuation model with the following weighted-average assumptions: risk-free interest rate of 2.48%, no dividend yield, expected term of 10 years, and volatility of 102%. Such fair value has been included in general and administrative expenses for the period from Inception through June 30, 2014.

NIH Grants

In May 2010, the NIAID awarded the Company an Advanced Technology Small Business Technology Transfer Research grant to support the Company's program to generate and develop novel antibody therapeutics and vaccines to combat Staph infections, including Methicillin-resistant Staph, or the Staph Grant award. The project period for the Phase I Staph Grant award covered a two-year period which commenced in June 2010 and ended in May 2012, with a total grant award of \$600. The Company recorded revenue associated with the grant as the related costs and expenses were incurred. During the period from Inception through June 30, 2014, the Company recorded \$600 of revenue associated with the Staph Grant award.

In July 2011, the NIAID awarded the Company a second Advanced Technology Small Business Technology Transfer Research grant to support the Company's program to generate and develop antibody therapeutics and vaccines to combat *C. difficile* infections, or the *C. difficile* Grant award. The project period for the Phase I *C. difficile* Grant award covered a two-year period which commenced in June 2011 and ended in June 2013, with the total grant award of \$600. During the three months ended June 30, 2014 and 2013 and for the period from Inception through June 30, 2014, the Company recorded \$0, \$67 and \$593 of revenue associated with the *C. difficile* Grant award, respectively. During the six months ended June 30, 2014 and 2013, the Company recorded \$0 and \$144 of revenue associated with the *C. difficile* Grant award, respectively.

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In June 2012, the NIAID awarded the Company a third Advanced Technology Small Business Technology Transfer Research grant to support the Company's program to generate and develop novel human antibody therapeutics to combat Staph infections, including Methicillin-resistant Staph, or the Staph Grant II award. The project period for the Phase I grant covers a two-year period which commenced in June 2012, with a total grant award of \$600. During the three months ended June 30, 2014 and 2013 and for the period from Inception through June 30, 2014, the Company recorded \$52, \$75 and \$587 of revenue associated with the Staph Grant II award, respectively. During the six months ended June 30, 2014 and 2013 the Company recorded \$150 and \$132 of revenue associated with the Staph Grant II award, respectively.

In June 2014, the NIAID awarded the Company a Phase II Small Business Technology Transfer Research (STTR) grant 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), or the Staph Grant III award. The project period for this Phase II grant covers 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 three and six months ended June 30, 2014 and for the period from Inception through June 30, 2014, the Company recorded \$32 of revenue associated with the Staph Grant III award.

In June 2014, the Company was awarded a Phase I STTR grant entitled Anti-Pseudomonas Immunotherapy and Targeted Drug Delivery from the NIAID. This grant will 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 this Phase I grant covers a two-year period which commences in July 2014, with total funds available of approximately \$300 per year for up to 2 years.

In July 2014, the Company was awarded a Phase I Small Business Technology Transfer Research (STTR) grant from the National Cancer Institute (NCI), a division of the National Institute of Health (NIH), entitled Targeting of Myc-Max Dimerization for the Treatment of Cancer. This grant will 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 this Phase I grant covers a one-year period which commences in August 2014, with total funds available of approximately \$225.

3. Mergers and Acquisitions

On September 9, 2013, the Company exercised its option to acquire IgDraSol whereby IgDraSol became a wholly-owned subsidiary and the Company acquired all rights to Cynviloq. Pursuant to the merger agreement, the Company issued 3,006,641 shares of common stock to IgDraSol stockholders and paid \$382 in cash. [Upon the later achievement of a specified regulatory milestone, the Company will issue an additional 1,306,272 shares of common stock to former IgDraSol stockholders. The Company's lead compound is Cynviloq, a micellar paclitaxel formulation drug product. Cynviloq is currently approved and marketed in several countries, including South Korea for MBC and NSCLC under the trade name Genexol-PM®. The Company licensed exclusive distribution rights for Cynviloq in North America, the 27 countries of the European Union, and Australia, from Samyang Biopharmaceuticals Corporation, a South Korean corporation.

On October 9, 2013, the Company entered into an Agreement and Plan of Merger and Reorganization and acquired privately-held Sherrington in exchange for 200,000 shares of its common stock, for an aggregate purchase price of \$1,698 which was recognized as acquired in-process research and development expense. Sherrington is focused on the development of a treatment for intractable pain in end-stage disease. RTX is a novel, non-opiate, small molecule that

permanently eliminates pain experienced by end-stage cancer patients when directly interacting with the nerve cells. RTX is currently being tested in an investigator-sponsored Phase I/II clinical trial under a Cooperative Research and Development Agreement. To date, 10 patients with terminal cancer pain have been treated at the NIH. The Company intends to launch additional trials to rapidly advance clinical development of the drug in patients with terminal cancer pain.

On December 19, 2013, the Company completed its Agreement and Plan of Merger and acquired privately-held Concorthis. Upon closing, the Company issued an aggregate of 1,331,978 shares of its common stock to the Concorthis shareholders. Certain Concorthis employees and consultants received \$1,000 in compensation for the year ending December 31, 2013, and are to receive annual deferred compensation payments totaling \$1,000 on December 31 for each of the years ending 2014, 2015, and 2016. The net present value of the deferred compensation payments was calculated using the effective interest method, and is included in the purchase price. The total transaction is valued at \$14.7 million. Concorthis, now a wholly-owned subsidiary, has proprietary cytotoxic payloads as well as C-lock® and K-lock® conjugation technologies that allow for site-specific toxin conjugation to the antibody. These next generation technologies may improve the overall stability and potency of the ADCs. First-generation conjugation technologies lead to inconsistent drug-antibody ratios, which result in a heterogeneous mixture of ADCs. This variability has been a constraining factor in unlocking the full therapeutic potential for current-generation ADCs. The ADC technology complements the Company's existing development programs, particularly its G-MAB® antibody library and related monoclonal antibodies. Concorthis uses its proprietary technologies to provide various customized reagents as well as drug conjugation services to customers in the pharmaceutical industry.

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The IgDraSol, Sherrington and Concortis acquisitions have been accounted for in accordance with the acquisition method of accounting under FASB ASC Topic 805, *Business Combinations* (Topic 805). Topic 805 requires, among other things, that identifiable assets acquired and liabilities assumed be recognized at their fair values which are based in part on third party appraisals as of the Acquisition Date. Under the acquisition method of accounting, the purchase consideration was allocated to the assets acquired, including tangible assets and other identifiable intangible assets and liabilities assumed, based on their estimated fair market values on the date of acquisition. Any excess purchase price after the initial allocation to identifiable net tangible and identifiable intangible assets was assigned to goodwill. These completed acquisitions have been accounted for as purchases and the results of operations have been included in the consolidated financial statements since their respective dates of acquisition.

The following unaudited pro forma consolidated financial information summarizes the combined results of operations for the Company as though the IgDraSol, Sherrington and Concortis acquisitions occurred as of January 1, 2013. The unaudited pro forma financial information for all periods presented also includes the business combination accounting effects resulting from these acquisitions including amortization charges from acquired intangible assets. The unaudited pro forma financial information as presented below is for informational purposes only and does not purport to be indicative of the results of operations for future periods or the results what actually would have been realized had the entities been a single entity during these periods. The unaudited pro forma combined results are presented in thousands, except share and per share information.

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2013	
	As Reported	2013 Pro Forma	2014 As Reported	Pro Forma
Total Revenues	\$ 775	\$ 961	\$ 1,751	\$ 1,561
Loss from operations	\$ (7,991)	\$ (4,938)	\$ (17,865)	\$ (12,981)
Net loss	\$ (8,454)	\$ (5,044)	\$ (18,547)	\$ (13,179)
Net loss per share basic and diluted	\$ (0.33)	\$ (0.28)	\$ (0.77)	\$ (0.76)

4. Goodwill

In connection with the acquisitions of IgDraSol, Sherrington and Concortis, the Company generated goodwill of \$24,041.

5. Loan and Security Agreement

In September 2013, the Company entered into a \$5,000 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, 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, 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 \$12,500 from \$5,000, with the same two banks. Such loan was funded at closing and is secured by a lien covering substantially all of the Company's assets, excluding intellectual property, which is subject to a negative pledge. The Company will make interest only payments on the outstanding amount of the loan on a

monthly basis until October 1, 2014, after which equal monthly payments of principal and interest are due until the loan maturity date of September 30, 2017. In the event the Company raises \$30 million of net equity or proceeds from a collaboration, if any, the interest only period will be extended by six months. The amended and restated loan: (i) interest rate is 7.95% per annum, and (ii) provided the Lenders 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, was recorded as debt discount and additional paid-in capital.

At the Company's option, it may prepay all of the outstanding principal balance, subject to certain pre-payment fees ranging from 1% to 3% of the prepayment amount. In the event of a final payment of the loans under the loan agreement, either in the event of repayment of the loan at maturity or upon any prepayment, the Company is obligated to pay the amortized portion of the final fee of \$781.

The Company is also subject to certain affirmative and negative covenants under the loan agreement, including limitations on its ability to: undergo certain change of control events; convey, sell, lease, license, transfer or otherwise dispose of any equipment financed by loans under the loan agreement; create, incur, assume, guarantee or be liable with respect to indebtedness, subject to certain exceptions; grant liens on any equipment financed under the loan agreement; and make or permit any payment on specified subordinated debt. In addition, under the loan agreement, subject to certain exceptions, the Company is required to maintain with the lender its primary operating, other deposit and securities accounts.

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Long-term debt and unamortized discount balances are as follows (in thousands):

Face value of amended and restated loan	\$ 12,500
Fair value of all warrants	(536)
Accretion of debt discount	86
Balance at June 30, 2014	\$ 12,050

Future minimum payments under the amended and restated loan and security agreement are as follows:

Year Ending December 31,	
2014	\$ 1,347
2015	4,697
2016	4,697
2017	4,304
Total future minimum payments	15,045
Unamortized interest	(2,546)
Debt discount	(449)
Total minimum payment	12,050
Current portion	(2,608)
Long-term debt	\$ 9,442

6. Stockholders Equity**Common Stock**

Between February 2006 and March 2009 the Company issued 4,414,423 shares of common stock to founders in conjunction with the founding of the Company and to certain consultants for total proceeds of approximately \$1.

In June 2009, the Company issued 2,360,611 shares of common stock at \$0.98 per share for aggregate gross proceeds of \$2,300 in a private placement transaction. Related stock issuance costs totaled \$26.

In September 2009, and in connection with the Merger, the Company: (i) issued 1,785,375 shares of common stock, in a private placement transaction, at \$1.12 per share for aggregate gross proceeds of \$2,000, (ii) issued 442,958 shares of common stock to the former stockholders of QuikByte, and (iii) incurred costs associated with the Merger totaling \$169.

In December 2010, the Company issued 1,028,686 shares of common stock, in a private placement transaction, at \$3.50 per share for aggregate gross proceeds of \$3.6 million. Related stock issuance costs were estimated at \$160. In 2011, the Company reduced its stock issuance costs accrued in 2010 by \$80.

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In December 2011, the Company entered into a Stock Purchase Agreement and issued 500,000 shares of common stock, in a private placement transaction, at \$4.00 per share for aggregate gross proceeds of \$2,000. In May 2012, pursuant to the Stock Purchase Agreement, as amended and restated, the Company issued 1,500,000 shares of common stock, in a private placement transaction, at \$4.00 per share for aggregate gross proceeds of \$6,000.

In January 2013, the Company entered into the assignment agreement and issued 10,000 shares of common stock valued at \$40.

In March 2013, the Company entered into a Stock Purchase Agreement and issued 1,426,406 shares of common stock, in a private placement transaction, at \$4.50 per share for aggregate gross proceeds of \$6,418.

On October 30, 2013, the Company closed an underwritten public offering of 4,150,000 shares of common stock, at \$7.25 per share, and closed the full exercise of the over-allotment option granted to the representative of the underwriters to purchase an additional 622,500 shares of its common stock, with total gross proceeds of \$34.6 million, before underwriting discounts and commissions and other offering expenses of \$3,254 payable by the Company. The common stock began trading on The NASDAQ Capital Market on October 25, 2013 under the symbol **SRNE**.

In January 2014, the Company entered into a research agreement and issued 25,000 shares of common stock valued at \$209.

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In May 2014, the Company closed an underwritten public offering of 4,765,000 shares of common stock, at \$5.25 per share, and in June 2014, closed the full exercise of the over-allotment option granted to the representative of the underwriters to purchase an additional 714,750 shares of its common stock, with total gross proceeds of \$28.8 million, before underwriting discounts and commissions and other offering expenses of \$2,071 payable by the Company.

Purchase Warrants

Concurrent with the October 30, 2013 offering, the Company agreed to issue and sell to the underwriters a warrant (Underwriters Warrant) for the purchase of an aggregate of 182,600 shares of common stock, for a nominal amount. The Underwriters Warrant agreement is exercisable, in whole or in part, commencing on a date which is one (1) year after the effective date of the Registration Statement and expiring on the five-year anniversary of the effective date of the Registration Statement at an initial exercise price per share of common stock of \$9.0625, which is equal to 125% of the initial public offering price of \$7.25 per share.

Convertible Promissory Notes

In October 2013, the Company issued an aggregate \$1,850 principal amount of Notes that bear interest at 7% per annum. Concurrently with the closing of the public offering, such Notes and related accrued interest totaling \$7 automatically converted into 256,119 shares of common stock.

Stock Incentive Plans

2009 Equity Incentive Plan

In February 2009, prior to the Merger, the Company's Board of Directors approved the 2009 Equity Incentive Plan, or the EIP, under which 400,000 shares of common stock were reserved for issuance to employees, non-employee directors and consultants of the Company. In March 2009, the Company issued 296,154 restricted common stock awards to certain consultants for aggregate gross proceeds of less than \$1, of which the Company repurchased 44,166 unvested shares of restricted common stock for a nominal amount in January 2011. The restricted shares vest monthly over four years and all remaining shares were fully vested as of June 30, 2014. No further shares are available for grant under the EIP.

2009 Non-Employee Director Grants

In September 2009, prior to the adoption of the 2009 Stock Incentive 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 June 30, 2014, 3,200 options were outstanding.

2009 Stock Incentive Plan

In October 2009, the Company's stockholders approved the 2009 Stock Incentive Plan. In June 2014, the Company's stockholders approved, among other items, the amendment and restatement of the 2009 Stock Incentive Plan, or the Stock Plan, to increase the number of common stock authorized to be issued pursuant to the Stock Plan to 3,760,000. 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 will generally vest 25% on each anniversary of the original vesting date over four 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. Unvested shares of the Company's common stock issued in connection with an early exercise however, may be repurchased by the Company upon termination of the optionee's service with the Company.

During the six months ended June 30, 2014 and 2013, the Company's Board of Directors awarded 768,000 and 42,800 options to certain employees and consultants, respectively. As of June 30, 2014 and 2013, 2,142,566 and 899,000 shares were available for grant under the Stock Plan, respectively. See Note 8.

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The Company uses the Black-Scholes valuation model to calculate the fair value of stock options. Stock based compensation expense is recognized over the vesting period using the straight-line method. The fair value of employee stock options was estimated at the grant date using the following assumptions:

	Six months ended June 30,	
	2014	2013
Dividend yield		
Volatility	78%	109%
Risk-free interest rate	1.94%	1.07%
Expected life of options	6.1 years	6.1 years

The weighted average grant date fair value per share of employee stock options granted during the six months ended June 30, 2014 and 2013 was \$10.82 and \$4.25, respectively.

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 United States 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 stock-based compensation recorded as operating expenses was \$286, \$153 and \$4,094 for the three months ended June 30, 2014 and 2013 and for the period from Inception through June 30, 2014, respectively. The total employee stock-based compensation recorded as operating expenses was \$2,130 and \$297 for the six months ended June 30, 2014 and 2013, respectively.

As of June 30, 2014, unrecognized compensation cost related to the options was \$5,347 which will be recognized over 3.2 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 applicable 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 \$344, \$29 and \$1,695 for the three months ended June 30, 2014 and 2013 and for the period from Inception through June 30, 2014, respectively. Stock-based compensation expense related to non-employee consultants recorded as operating expenses was \$403 and \$133 for the six months ended June 30, 2014 and 2013, respectively.

7. Income Taxes

The Company maintains deferred tax assets that 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. These deferred tax assets include net operating loss carryforwards, research credits and capitalized research and development. The net deferred tax asset has been fully offset by a valuation allowance because of the Company's history of losses. Utilization of operating losses and credits may be subject to substantial annual limitation due to ownership change provisions of the Internal Revenue Code of 1986, as amended, and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization.

8. Related Party Agreements and Other Ark

License and Development Agreement

On June 18, 2014, the Company and Ark entered into a License and Development Agreement (LDA) whereby the Company granted Ark a license to develop and commercialize RTX for animal use only, in exchange for the issuance to the Company of 10,000,000 shares of Ark common stock valued at \$13,100, representing 100% of the outstanding shares of Ark common stock. Such intercompany transactions have been eliminated in consolidation.

Transition Services Agreement

On June 18, 2014, the Company entered into a Transition Services Agreement (TSA) with Ark which became effective retroactively to April 1, 2014. Under the TSA, the Company has provided and/or has made available to Ark various administrative, financial, legal, insurance, facility, information technology, laboratory, real estate and other services to be provided by, or on behalf of, the Company, together with such other services as reasonably requested by Ark. In consideration for such services, Ark will pay fees to the Company for the services provided, and those fees will generally be in amounts intended to allow the Company to recover all of its direct and indirect costs incurred in providing such services. The personnel performing services under the TSA are employees and/or independent contractors of the Company and are not under the direction or control of Ark. These personnel costs are based upon the actual percentages of time spent by Company personnel performing services for Ark under the TSA. In addition, Ark will reimburse the Company for direct out-of-pocket costs incurred by the Company for third party services provided to Ark. Through June 30, 2014, the Company has recorded \$507 of costs associated with activities contemplated under the TSA.

In order for the Company to be reimbursed by Ark for activities provided under the TSA, Ark must be successful in raising financing on a stand-alone basis. There can be no assurance that Ark will be successful in securing third party financing.

Loan and Security Agreement

On June 18, 2014, the Company and Ark entered into a Loan and Security Agreement (Loan Agreement) pursuant to which the Company agreed to lend Ark, as amended in August 2014, up to \$1,000 for working capital purposes. Advances under the Loan Agreement bear interest at six percent (6%) per annum. Outstanding advances mature on the earlier of: (i) following the consummation of any public or private offering of securities in which Ark receives gross proceeds of at least \$5,000, (ii) an event of default under the Loan Agreement, or (iii) June 18, 2015. In connection with the Loan Agreement, the Company has a security interest in all of Ark's assets, including Ark's intellectual property, until the loan is repaid in full. During the period from Ark's inception in February 2014 through June 30, 2014, the Company paid for certain general, administrative and research and development expenses totaling \$507. The intercompany balances associated with these transactions have been eliminated in consolidation.

2014 Stock Option Plan

In May 2014, Ark adopted the Ark 2014 Stock Option Plan and reserved and awarded 600,000 options to certain employees and consultants under such plan. Stock options granted under such plan typically vest after four years of continuous service from the grant date and will have a contractual term of ten years. No further shares may be granted under this plan and, as of June 30, 2014, 600,000 options were outstanding.

The total employee and consultant stock-based compensation recorded as operating expenses for the three months ended June 30, 2014 and for the period from Ark's inception (February 27, 2014) through June 30, 2014 was \$289. Total unrecognized stock-based compensation expense related to unvested stock option grants as of June 30, 2014 was \$41, and the weighted-average period over which these grants are expected to vest is one year.

The weighted-average assumptions used in the Black-Scholes option pricing model used to determine the fair value of stock option grants were as follows: expected dividend yield 0%, risk-free interest rate 1.94% to 2.60%, expected volatility 75% to 78%, and expected term of 6.08 to 10 years.

2014 Equity Incentive Plan

In May 2014, Ark adopted the 2014 Equity Incentive Plan. Under this plan Ark may grant equity awards which include stock options, restricted stock units and stock appreciation rights. Ark has reserved for future issuance 1,000,000 shares of common stock issuable pursuant to this plan. The plan's share reserve, as defined, will automatically increase each year commencing on January 1, 2015, in an amount equal to 3.0% of the total number of shares outstanding on the last day of the preceding calendar year. No equity awards have been issued under the plan as of June 30, 2014.

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

This Quarterly Report on Form 10-Q contains forward-looking statements about our expectations, beliefs or intentions regarding our potential product offerings, business, financial condition, results of operations, strategies or prospects. You can identify forward-looking statements by the fact that these statements do not relate strictly to historical or current matters. Rather, forward-looking statements relate to anticipated or expected events, activities, trends or results as of the date they are made and are often identified by the use of words such as assumes, plans, anticipate, believe, continue, could, estimate, expect, intend, may, might, or will, and similar expressions or variations. Because forward-looking statements relate to matters that have not yet occurred, these statements are inherently subject to risks and uncertainties that could cause our actual results to differ materially from any future results expressed or implied by the forward-looking statements. Many factors could cause our actual activities or results to differ materially from the activities and results anticipated in forward-looking statements. These factors include

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those described under the caption Risk Factors included elsewhere in this Quarterly Report on Form 10-Q and in our other filings with the Securities and Exchange Commission, or the SEC. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances occurring after the date of such statements.

Overview

We are a development stage biopharmaceutical company engaged in the discovery, acquisition, development and commercialization of proprietary drug therapeutics for addressing significant unmet medical needs in the U.S., Europe and additional international markets. Our primary therapeutic focus is oncology, including the treatment of chronic cancer pain, but we are also developing therapeutic products for other indications, including immunology and infectious diseases. We currently have two clinical development programs underway: (i) our lead oncology drug product candidate Cynviloq, is a micellar diblock copolymeric paclitaxel formulation, and (ii) RTX, a non-opiate, ultra potent and selective agonist of the TRPV-1 receptor for intractable pain in end-stage disease.

Our pipeline also includes preclinical fully human therapeutic antibodies, including our fully human anti-PD-L1 and anti-PD-1 monoclonal antibodies, or Abs, derived from our proprietary G-MAB[®] library platform, antibody drug conjugates, or ADCs, and recombinant intravenous immunoglobulin, or rIVIG. Our objective is to develop two classes of antibody drug products, therapeutic antibodies and ADCs: (i) First in Class, and/or (ii) Best in Class, which may offer greater efficacy and/or fewer adverse events or side effects as compared to existing drugs.

Through June 30, 2014, we identified and further developed a number of potential drug product candidates across various therapeutic areas, and intend to select several lead product candidates to further advance into preclinical development activities in 2014. It is too early to assess which of these candidates, if any, will merit further evaluation in clinical trials. Our libraries were designed to facilitate the rapid identification and isolation of highly specific, antibody therapeutic product candidates that are fully-human and that bind to disease targets appropriate for antibody therapy. We built our initial antibody expression and production capabilities to enable us to make sufficient product material to conduct preclinical safety and efficacy testing in animal models.

Although we intend to retain ownership and control of some product candidates by advancing the development, we will also consider partnerships with pharmaceutical or biopharmaceutical companies in order to balance the risks associated with drug discovery and development and maximize our stockholders' returns. Our partnering objectives include generating revenue through license fees, milestone-related development fees and royalties by licensing rights to our product candidates.

Recent Developments

Underwritten Public Offering. In May 2014, we closed an underwritten public offering of 4,765,000 shares of common stock, at \$5.25 per share, and in June 2014, closed the full exercise of the over-allotment option granted to the representative of the underwriters to purchase an additional 714,750 shares of our common stock, with total gross proceeds of \$28.8 million, before underwriting discounts and commissions and other offering expenses payable by us.

Related Party Agreements with Wholly-Owned Subsidiary Ark Animal Health, Inc.

License and Development Agreement. On June 18, 2014, we entered into a License and Development Agreement (LDA) with our wholly-owned subsidiary Ark Animal Health, Inc. (Ark) whereby we granted Ark a license to develop and commercialize RTX for animal use only, in exchange for the issuance to us 10,000,000 shares of Ark common stock valued at \$13,100, representing 100% of the outstanding shares of Ark common stock. Such intercompany

transactions have been eliminated in consolidation.

Transition Services Agreement. On June 18, 2014, we entered into a Transition Services Agreement (TSA) with Ark which became effective retroactively to April 1, 2014. Under the TSA, we have provided and/or have made available to Ark various administrative, financial, legal, insurance, facility, information technology, laboratory, real estate and other services to be provided by, or on our behalf, together with such other services as reasonably requested by Ark. In consideration for such services, Ark will pay fees to us for the services provided, and those fees will generally be in amounts intended to allow us to recover all of our direct and indirect costs incurred in providing such services. The personnel performing services under the TSA are employees and/or independent contractors of ours and are not under the direction or control of Ark. These personnel costs are based upon the actual percentages of time spent by our personnel performing services for Ark under the TSA. In addition, Ark will reimburse us for direct out-of-pocket costs incurred by us for third party services provided to Ark. As of June 30, 2014, we have recorded \$507 of costs associated with activities contemplated under the TSA. Such intercompany transactions have been eliminated in consolidation. In order for us to be reimbursed by Ark for activities provided under the TSA, Ark must be successful in raising financing on a stand-alone basis. There can be no assurance that Ark will be successful in securing third party financing.

Loan and Security Agreement. On June 18, 2014, we entered into a Loan and Security Agreement (Loan Agreement) with Ark pursuant to which we agreed to lend Ark, as amended in August 2014, up to \$1,000 for working capital purposes. Advances under the Loan Agreement bear interest at six percent (6%) per annum. Outstanding advances mature on the earlier of: (i) following the consummation of any public or private offering of securities in which Ark receives gross proceeds of at least \$5,000, (ii) an event of default under the Loan Agreement, or (iii) June 18, 2015. In connection with the Loan Agreement, we have a security interest in all of Ark's assets, including Ark's intellectual property, until the loan is repaid in full. During the period from Ark's inception in February 2014 through June 30, 2014, we paid for certain general, administrative and research and development expenses totaling \$507. The intercompany balances associated with these transactions have been eliminated in consolidation.

Bank Loan and Security Agreement. In March 2014, we entered into an amended and restated loan and security agreement, increasing the September 2013 facility to \$12,500 from \$5,000, with the same two banks. The amended and restated loan was funded in March 2014, is secured by a lien covering substantially all of our assets, excluding intellectual property, which is subject to a negative pledge, and bears interest at 7.95% per annum. We will make interest only payments on the outstanding amount of the loan on a monthly basis until October 1, 2014, after which equal monthly payments of principal and interest are due until the loan maturity date of September 30, 2017. In the event we raise \$30 million of net equity or proceeds from a collaboration, if any, the interest only period will be extended by six months. The amended and restated loan provided the Lenders additional warrants to purchase an aggregate of 34,642 shares of our 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, was recorded as debt discount and additional paid-in capital.

Agreement and Plan of Merger with IgDraSol. On March 7, 2013, we entered into various agreements with IgDraSol, a private company focused on the development of Cynviloq, as follows: (i) an exclusive option agreement, (ii) an asset purchase agreement pursuant to which we agreed to purchase all documentation, equipment, information and other know-how related to micellar nanoparticle technology encompassing Tocosol® and related technologies, and (iii) an initial services agreement, pursuant to which, IgDraSol provided certain product development and technology services related to our antibody platform. On September 9, 2013, we exercised our option to acquire IgDraSol and IgDraSol became a wholly-owned subsidiary.

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On July 29, 2013, we received official meeting minutes from an End-of-Phase II meeting held on July 23, 2013 for Cynviloq (or IG-001) with the U.S. Food and Drug Administration, or FDA. Cynviloq is initially under development for the treatment of MBC and NSCLC, in the U.S. The FDA Division of Oncology Products 1 agreed that the data available from: (i) the postmarketing surveillance studies conducted in ex-U.S. territories for MBC and NSCLC, (ii) Phase I-III studies for MBC, and (iii) Phase I-II studies in NSCLC, Ovarian, Bladder, and Pancreatic cancers are sufficient to support pursuing the 505(b)(2) Bioequivalence (BE) regulatory submission pathway approach using Abraxane® and Taxol® as the Reference Listed Drugs in a single bioequivalence study. Abraxane is an albumin-bound paclitaxel (nab-paclitaxel) product approved for MBC, NSCLC and pancreatic cancer indications. Taxol is a cremophor-based paclitaxel product approved for these indications as well as other cancer indications. We filed our BE protocol in 2013 and commenced the BE study in March 2014.

Agreement and Plan of Merger with Sherrington. On October 9, 2013, we acquired Sherrington for an aggregate of 200,000 shares of our common stock. Sherrington's sole asset was the license rights to resiniferatoxin. Upon acquisition, Sherrington became a wholly-owned subsidiary.

Underwritten Public Offering and Nasdaq Uplisting. In October 2013, we closed an underwritten public offering of 4,150,000 shares, at \$7.25 per share, and closed the full exercise of the over-allotment option granted to the representative of the underwriters to purchase an additional 622,500 shares of its common stock, with total gross proceeds of \$34.6 million, before underwriting discounts and commissions and other offering expenses payable by us. The common stock began trading on The NASDAQ Capital Market on October 25, 2013 under the symbol SRNE.

Agreement and Plan of Merger with Concortis. On December 19, 2013, we completed our previously announced merger with Concortis, which providing us with a comprehensive technology platform to create a new generation of homogenous ADCs with site-specific toxin conjugation and consistent drug-antibody ratios. We issued 1,331,978 shares of our common stock to Concortis shareholders which were valued at \$8.48 per share, the closing price per share of our common stock as of December 18, 2013.

Agreement with Esai / Morphotek. On June 25, 2014, we entered into a collaboration agreement to generate novel antibody drug conjugates (ADCs) based on a Morphotek antibody linked to chemotherapeutic agents using proprietary ADC Technology. Under the terms of the agreement, we will receive research fees, an up-front payment, milestone payments and royalties on future net sales. Additionally, we have the potential to receive up to \$50 million upon successful attainment of key milestones.

Critical Accounting Policies and Estimates

Management's discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements which are prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, related disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. We continually evaluate our estimates and judgments, the most critical of which are those related to income taxes and stock-based compensation. We base our estimates and judgments on historical experience and other factors that we believe to be reasonable under the circumstances. Materially different results can occur as circumstances change and additional information becomes known.

During the quarter ended June 30, 2014, there were no significant changes to the items that we disclosed as our critical accounting policies and estimates in Note 2 to our consolidated financial statements for the year ended December 31, 2013 contained in our 2013 Form 10-K, as filed with the SEC.

Results of Operations

The following describes certain line items set forth in our statements of operations.

Three Months Ended June 30, 2014 Compared to the Three Months Ended June 30, 2013

Revenues. Revenues were \$775 for the three months ended June 30, 2014, as compared to \$142 for the three months ended June 30, 2013. The net increase of \$633 is primarily due to sales and service revenues of \$691 generated from the sale of customized reagents and providing professional services from the ConcorTis operation that was acquired in December 2013. Activities under the two active grants received from the National Institute of Allergy and Infectious Diseases, a division of the National Institutes of Health, or NIH, for the three months ended June 30, 2014 were lower than in the corresponding period of 2013 due primarily to only one active grant in the quarter ending June 30, 2014 as compared to two active grants in quarter ending June 30, 2013.

In July 2011, we were awarded a second Advanced Technology Small Business Technology Transfer Research grant to support our program to generate and develop antibody therapeutics and vaccines to combat C. difficile infections, or the C. difficile Grant award. The project period for the C. difficile Grant award covers a two-year period which commenced in June 2011 and ended in June 2013, with a total grant award of \$600. The C. difficile Grant award revenues for the three months ended June 30, 2014 and 2013 and for the period from Inception through June 30, 2014 were \$0, \$67 and \$593, respectively.

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In June 2012, we were awarded a third Advanced Technology Small Business Technology Transfer Research grant to support our program to generate and develop novel human antibody therapeutics to combat Staph infections, including Methicillin-resistant Staph, or the Staph Grant II award. The project period for the phase I grant covers a two-year period which commenced in June 2012, with a total grant award of \$600. The Staph Grant II award revenues for the three months ended June 30, 2014 and 2013, and for the period from Inception through June 30, 2014, were \$52, \$75 and \$587, respectively.

In June 2014, the NIAID awarded us a Phase II Small Business Technology Transfer Research (STTR) grant 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), or the Staph Grant III award. The project period for this Phase II grant covers 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 three and six months ended June 30, 2014 and for the period from Inception through June 30, 2014, we recorded \$32 of revenue associated with the Staph Grant III award.

We had no other revenue during the three months ended June 30, 2014 and 2013 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 quarter to quarter 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, if any.

Cost of revenues. Cost of revenues for the three months ended June 30, 2014 were \$510 and relate to the sale of customized reagents and providing professional services. The costs generally include employee-related expenses including salary and benefits, direct materials and overhead costs including rent, depreciation, utilities, facility maintenance and insurance.

Research and Development Expenses. Research and development expenses for the three months ended June 30, 2014 and 2013 were \$5,309 and \$2,141, respectively. Research and development expenses include the costs to conduct our BE registration trial related to Cynviloq and prepare for our New Drug Application filing anticipated in 2015, costs to advance 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 \$3,168 is primarily attributable to salaries and compensation related expense, preclinical testing, depreciation, consulting and lab supply costs incurred in connection with our expanded research and development activities and our BE registration trial and activities to advance RTX into clinical trials and potentially pursue other human indications. We expect research and development expenses to increase in absolute dollars as we: (i) advance our Cynviloq BE registration trial and pursue other potential indications, including expenses incurred under agreements with CROs and investigative sites that conduct our clinical trials, the cost of acquiring, developing and manufacturing clinical trial materials, and other regulatory operating activities, (ii) incur incremental expenses associated with our efforts to further advance a number of potential drug candidates into preclinical development activities, (iii) continue to identify and advance a number of fully human therapeutic antibody and ADC preclinical drug candidates, (iv) incur higher salary, lab supply and infrastructure costs incurred in connection with supporting all of our programs.

Acquired In-process Research and Development Expenses. Acquired in-process research and development expenses for the three months ended June 30, 2014 and 2013 were \$0 and \$1,210, respectively. Acquired in-process research and development expenses for the three months ended June 30, 2013 include the costs of acquiring the Tocosol® and related technologies.

General and Administrative Expenses. General and administrative expenses for the three months ended June 30, 2014 and 2013 were \$2,361 and \$1,508, 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 \$853 is primarily attributable to higher salaries and related compensation expenses, stock-based compensation, legal costs related to general corporate and IP 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 and compliance with our public reporting obligations, and (ii) assume all of the ongoing operating costs associated with the mergers of IgDraSol, Sherrington and Concortis, and integrate their operations.

Intangible Amortization. Intangible amortization for the three months ended June 30, 2014 and 2013 was \$586 and \$0, respectively. The increase resulted primarily from the acquisition and amortization of intangible license rights from IgDraSol and from acquired technology and customer relationships from Concortis, all acquired in the latter part of 2013.

Interest Expense. Interest expense for the three months ended June 30, 2014 and 2013 was \$468 and \$22, respectively. The increase in interest expense resulted primarily from borrowings under the amended loan and security agreement.

Interest Income. Interest income for the three months ended June 30, 2014 and 2013 was \$5 and \$2, respectively. The increase in interest income resulted from higher average cash balances in 2014 as compared to the same period in 2013. We expect that continued low interest rates will significantly limit our interest income in the near term.

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Net Loss. Net loss for the three months ended June 30, 2014 and 2013 was \$8,454 and \$4,737, respectively. The increase in net loss is mainly attributable to the expanded research and development, intangible amortization and general and administrative activities.

Six Months Ended June 30, 2014 Compared to the Six Months Ended June 30, 2013

Revenues. Revenues were \$1,751 for the six months ended June 30, 2014, as compared to \$276 for the six months ended June 30, 2013. The net increase of \$1,475 is primarily due to sales and service revenues of \$1,569 generated from the sale of customized reagents and providing professional services from the Concorthis operations that was acquired in December 2013. Activities under the two active grants received from the National Institute of Allergy and Infectious Diseases, a division of the National Institutes of Health, or NIH, for the six months ended June 30, 2014 were lower than in the corresponding period of 2013 due primarily to only one active grant in the six months ending June 30, 2014 as compared to two active grants in same period of 2013.

Cost of revenues. Cost of revenues for the six months ended June 30, 2014 were \$1,073 and relate to the sale of customized reagents and providing professional services. The costs generally include employee-related expenses including salary and benefits, direct materials and overhead costs including rent, depreciation, utilities, facility maintenance and insurance

Research and Development Expenses. Research and development expenses for the six months ended June 30, 2014 and 2013 were \$11,416 and \$3,540, respectively. Research and development expenses include the costs to conduct our BE registration trial related to Cynviloq and prepare for our New Drug Application filing anticipated in 2015, costs to advance 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 \$7,876 is primarily attributable to salaries and compensation related expense, preclinical testing, depreciation, consulting and lab supply costs incurred in connection with our expanded research and development activities and our BE registration trial and activities to advance RTX into clinical trials and potentially pursue other human indications. We expect research and development expenses to increase in absolute dollars as we: (i) advance our Cynviloq BE registration trial and pursue other potential indications, including expenses incurred under agreements with CROs and investigative sites that conduct our clinical trials, the cost of acquiring, developing and manufacturing clinical trial materials, and other regulatory operating activities, (ii) incur incremental expenses associated with our efforts to further advance a number of potential drug candidates into preclinical development activities, (iii) continue to identify and advance a number of fully human therapeutic antibody and ADC preclinical drug candidates, (iv) incur higher salary, lab supply and infrastructure costs incurred in connection with supporting all of our programs.

Acquired In-process Research and Development Expenses. Acquired in-process research and development expenses for the six months ended June 30, 2014 and 2013 were \$209 and \$1,210, respectively. Acquired in-process research and development expenses for the six months ended June 30, 2014 include the costs associated with a research agreement. Acquired in-process research and development expenses for the six months ended June 30, 2013 include the costs of acquiring the Tocosol® and related technologies.

General and Administrative Expenses. General and administrative expenses for the six months ended June 30, 2014 and 2013 were \$5,746 and \$2,757, 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 \$2,989 is primarily attributable to higher salaries and related compensation expenses, stock-based compensation, legal costs related to general corporate and IP 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, compliance with our public reporting obligations, and (ii) assume all of the ongoing operating costs associated with the mergers of IgDraSol, Sherrington and Concortis, and integrate their operations.

Intangible Amortization. Intangible amortization for the six months ended June 30, 2014 and 2013 was \$1,172 and \$0, respectively. The increase resulted primarily from the acquisition and amortization of intangible license rights from IgDraSol and from acquired technology and customer relationships from Concortis, all acquired in the latter part of 2013.

Interest Expense. Interest expense for the six months ended June 30, 2014 and 2013 was \$691 and \$32, respectively. The increase in interest expense resulted primarily from borrowings under the amended loan and security agreement amended in March 2014.

Interest Income. Interest income for the six months ended June 30, 2014 and 2013 was \$9 and \$4, respectively. The increase in interest income resulted from higher average cash balances in 2014 as compared to the same period in 2013. We expect that continued low interest rates will significantly limit our interest income in the near term

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Net Loss. Net loss for the six months ended June 30, 2014 and 2013 was \$18,547 and \$7,259, respectively. The increase in net loss is mainly attributable to the expanded research and development, intangible amortization and general and administrative activities.

Liquidity and Capital Resources

As of June 30, 2014, we had \$50,155 in cash and cash equivalents primarily attributable to: (i) the closing of our underwritten public offering in October 2013 and May 2014 for aggregate net proceeds of \$58,045, (ii) the issuance of \$1,850 of convertible promissory notes, which automatically converted into 256,119 shares of our common stock upon the closing of the October 2013 underwritten public offering, and (iii) net borrowings under our \$12,500 amended and restated loan and security agreement.

Cash Flows from Operating Activities. Net cash used for operating activities was \$15,512 for 2014 and is primarily attributable to our net loss of \$18,547 and our net reduction in working capital balances of \$1,491, which were offset by \$4,526 in non-cash activities relating to stock-based compensation, acquired in-process research and development, depreciation and amortization expense and other non-cash activities. Net cash used for operating activities was \$6,297 for 2013 and primarily reflects a net loss of \$7,259, which was partially offset by \$775 in non-cash activities relating primarily to stock-based compensation and depreciation expense.

We expect to continue to incur substantial and increasing losses and have negative net cash flows from operating activities as we seek to expand and support our clinical and preclinical development and research activities.

Cash Flows from Investing Activities. Net cash used for investing activities was \$198 for 2014 as compared to \$228 for 2013. The net cash used related primarily to equipment acquired for research and development activities.

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 for 2014 and 2013 was \$34,198 and \$7,188, respectively, which were primarily derived from the closing of our underwritten public offerings, cash provided by increases in net borrowings under our amended and restated loan and security agreement.

Future Liquidity Needs. From inception through June 30, 2014, we have principally financed our operations through underwritten public offerings and private equity financings with aggregate net proceeds of \$79,851, as we have not generated any product related revenue from 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.

In March 2014, we entered into an amended and restated loan and security agreement, increasing the September 2013 facility from \$5,000 to \$12,500, with two banks. The amended and restated loan was funded in March 2014, and bears interest at 7.95% per annum. We will make interest only payments on the outstanding amount of the loan on a monthly basis until October 1, 2014, after which equal monthly payments of principal and interest are due until the loan maturity date of September 30, 2017. In the event we raise \$30 million of net equity or proceeds from a collaboration, if any, the interest only period will be extended by six months.

We anticipate that we will continue to incur net losses into the foreseeable future as we: (i) conduct our BE registration trial related to Cynviloq and prepare for our New Drug Application filing anticipated in 2015, (ii) advance RTX into clinical trials and potentially pursue other human indications, (iii) fund Ark activities in anticipation of Ark securing stand-alone financing, (iv) continue to identify and advance a number of potential mAb and ADC drug candidates into preclinical and clinical development activities, (v) continue our development of, and seek regulatory approvals for, our product candidates, and begin to commercialize any approved products, and (vi) expand our corporate infrastructure, including the costs associated with being a NASDAQ listed public company. We believe we have the ability to meet all obligations due over the course of the next twelve months.

We plan to continue to fund our losses from operations and capital funding needs through public or private equity or debt financings, strategic collaborations, licensing arrangements, asset sales, government grants or other arrangements. We filed a universal shelf registration statement on Form S-3 with the Securities and Exchange Commission (SEC), which was declared effective by the SEC in July 2013. The Shelf Registration Statement provides us with the ability to offer up to \$100 million of securities, including equity and other securities as described in the registration statement. After the May 2014 underwritten offering, we now have the ability to offer up to \$36.6 million of additional securities. Pursuant to the 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

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the time of any offering. However, we cannot be sure that such additional funds will be available on reasonable terms, or at all. If we are unable to secure adequate additional funding, we may be forced to make reductions in spending, extend payment terms with suppliers, liquidate assets where possible, and/or suspend or curtail planned programs. In addition, if we do not meet our payment obligations to third parties as they come due, we may be subject to litigation claims. Even if we are successful in defending against these claims, litigation could result in substantial costs and be a distraction to management. Any of these actions could materially harm our business, results of operations, and future prospects.

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.

Off-Balance Sheet Arrangements

Since our inception through June 30, 2014, we have not engaged in any off-balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

New Accounting Pronouncements

Refer to Note 1, Nature of Operations, Summary of Significant Accounting Policies and Business Activities, in the accompanying notes to the consolidated financial statements for a discussion of recent accounting pronouncements.

Item 4. Controls and Procedures.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under 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 principal executive officer and principal financial officer, as appropriate, to allow for timely decisions regarding required disclosure.

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. 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 principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on the foregoing, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-Q.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting during the quarter ended June 30, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

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.

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Item 1A. Risk Factors.

Our Annual Report on Form 10-K for the year ended December 31, 2013, Part I Item 1A, Risk Factors, describes important risk factors that could cause our business, financial condition, results of operations and growth prospects to differ materially from those indicated or suggested by forward-looking statements made in this Form 10-Q or presented elsewhere by management from time to time. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially and adversely affect our business.

There have been no material changes in our risk factors since the filing of our Prospectus Supplement dated May 15, 2014.

Item 6. Exhibits.

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

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SIGNATURES

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

SORRENTO THERAPEUTICS, INC.

Date: August 6, 2014

By: /s/ Henry Ji, PH.D.
Henry Ji, Ph.D.
Director, Chief Executive Officer & President
(Principal Executive Officer)

Date: August 6, 2014

By: /s/ Richard G. Vincent
Richard G. Vincent
Chief Financial Officer
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

10.15	Seventh Amendment to Office Lease, dated June 12, 2014, between Sorrento Therapeutics, Inc. and Suntree Garden, LLC.
31.1	Certification of Henry Ji, Ph.D., Principal Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended.
31.2	Certification of Richard G. Vincent, Principal Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended.
32.1	Certification of Henry Ji, Ph.D., Principal Executive Officer, and Richard G. Vincent, Principal Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended.
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