Innoviva, Inc.
Form 10-K
February 24, 2016

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Table of Contents

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended December 31, 2015**

**Or**

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

**For the transition period from to**
**Commission File No. 000-30319**

# INNOVIVA, INC.

(Exact name of registrant as specified in its charter)

| **Delaware** | **94-3265960** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **951 Gateway Boulevard, South San Francisco, California** | **94080** |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: **650-238-9600**

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

| Title of Each Class | Name of Each Exchange On Which Registered |
|---|---|
| Common Stock $0.01 Par Value | The NASDAQ Stock Market LLC |

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: **NONE**

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

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

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 ý No o

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

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

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

| Large accelerated filer ý | Accelerated filer o | Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |
|---|---|---|---|

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant based upon the closing price of the registrant's Common Stock on The NASDAQ Global Select Market on June 30, 2015 was $636,988,750. Shares of Common Stock held by each executive officer and director and stockholders known by the registrant to own 10% or more of the outstanding stock based on public filings and other information known to the registrant have been excluded since such persons may be deemed affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On February 16, 2016, there were 114,117,517 shares of the registrant's Common Stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Specified portions of the registrant's definitive Proxy Statement to be issued in conjunction with the registrant's 2016 Annual Meeting of Stockholders, which is expected to be filed not later than 120 days after the registrant's fiscal year ended December 31, 2015, are incorporated by reference into Part III of this Annual Report. Except as expressly incorporated by reference, the registrant's Proxy Statement shall not be deemed to be a part of this Annual Report on Form 10-K.

Table of Contents

**INNOVIVA, INC.**
**2015 Form 10-K Annual Report**
**Table of Contents**

Table of Contents

**Special Note Regarding Forward-Looking Statements**

*This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements involve substantial risks, uncertainties and assumptions. All statements in this Annual Report on Form 10-K, other than statements of historical facts, including, without limitation, statements regarding our strategy, future operations, future financial position, future revenues, projected costs, prospects, plans, intentions, expectations, goals and objectives may be forward-looking statements. The words "anticipates," "believes," "could," "designed," "estimates," "expects," "goal," "intends," "may," "plans," "projects," "pursuing," "will," "would" and similar expressions (including the negatives thereof) are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions, expectations or objectives disclosed in our forward-looking statements and the assumptions underlying our forward-looking statements may prove incorrect. Therefore, you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions, expectations and objectives disclosed in the forward-looking statements that we make. All written and verbal forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section.*

*Important factors that we believe could cause actual results or events to differ materially from our forward-looking statements include, but are not limited to, risks related to: lower than expected future royalty revenue from respiratory products partnered with GSK, the commercialization of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® in the jurisdictions in which these products have been approved; the strategies, plans and objectives of the company (including the company's growth strategy and corporate development initiatives beyond the existing respiratory portfolio); the timing, manner, amount and planned growth of anticipated potential capital returns to stockholders (including, without limitation, statements regarding the company's expectations of future share purchases and future cash dividends); the status and timing of clinical studies, data analysis and communication of results; the potential benefits and mechanisms of action of product candidates; expectations for product candidates through development and commercialization; the timing of regulatory approval of product candidates; projections of revenue, expenses and other financial items and risks discussed below in "Risk Factors" in Item 1A of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of Part II and elsewhere in this Annual Report on Form 10-K. Our forward-looking statements in this Annual Report on Form 10-K are based on current expectations as of the date hereof and we do not assume any obligation to update any forward-looking statements on account of new information, future events or otherwise, except as required by law.*

*We encourage you to read Management's Discussion and Analysis of our Financial Condition and Results of Operations and our consolidated financial statements contained in this Annual Report on Form 10-K. We also encourage you to read Item 1A of Part I of this Annual Report on Form 10-K, entitled "Risk Factors," which contains a more complete discussion of the risks and uncertainties associated with our business. In addition to the risks described above and in Item 1A of this report, other unknown or unpredictable factors also could affect our results. Therefore, the information in this report should be read together with other reports and documents that we file with the Securities and Exchange Commission (SEC) from time to time, including on Form 10-Q and Form 8-K, which may supplement, modify, supersede or update those risk factors. As a result of these factors, we cannot assure you that the forward-looking statements in this report will prove to be accurate. Furthermore, if our forward-looking statements prove to be inaccurate, the inaccuracy may be material. In light of the significant uncertainties in these forward-looking statements, you should not regard these statements as a representation or warranty by us or any other person that we will achieve our objectives and plans in any specified time frame, or at all.*

Table of Contents

## PART I

### ITEM 1. BUSINESS

**Overview**

Innoviva, Inc. ("Innoviva", the "Company", the "Registrant" or "we" and other similar pronouns) is focused on bringing compelling new medicines to patients in areas of unmet need by leveraging its significant expertise in the development, commercialization and financial management of bio-pharmaceuticals. Innoviva's portfolio is anchored by the respiratory assets partnered with Glaxo Group Limited ("GSK"), including RELVAR®/BREO® ELLIPTA® (fluticasone furoate/ vilanterol, "FF/VI") and ANORO® ELLIPTA® (umeclidinium bromide/ vilanterol, "UMEC/VI"). Under the Long-Acting Beta*2* Agonist ("LABA") Collaboration Agreement and the Strategic Alliance Agreement with GSK (referred to herein collectively as the "GSK Agreements"), we are entitled to receive annual royalties from GSK on sales of RELVAR®/BREO® ELLIPTA® as follows: 15% on the first $3.0 billion of annual global net sales and 5% for all annual global net sales above $3.0 billion. For other products combined with a LABA from the LABA collaboration, such as ANORO ELLIPTA , royalties are upward tiering and range from 6.5% to 10%. Innoviva is also entitled to 15% of any future payments made by GSK under its agreements originally entered into with us, and since assigned to Theravance Respiratory Company, LLC ("TRC"), relating to the combination FF/UMEC/VI and the Bifunctional Muscarinic Antagonist-Beta*2* Agonist ("MABA") program, as monotherapy and in combination with other therapeutically active components under the LABA Collaboration Agreement, which has been assigned to TRC other than RELVAR®/BREO®ELLIPTA® and ANORO® ELLIPTA®. We do not manufacture or sell any of the products commercialized under the GSK Agreements, as it is the exclusive responsibility of GSK.

Our headquarters are located at 951 Gateway Boulevard, South San Francisco, California 94080. Innoviva was incorporated in Delaware in November 1996 under the name Advanced Medicine, Inc. and began operations in May 1997. The Company changed its name to Theravance, Inc. in April 2002. In June 2014, we spun-off our research and development activities by distributing the outstanding shares of Theravance Biopharma, Inc. ("Theravance BioPharma") on a pro-rata basis to our stockholders (the "Spin-Off"), which resulted in Theravance Biopharma becoming an independent, publicly traded company. Following a rebranding exercise, we changed our name to Innoviva, Inc. in January 2016.

**Our Strategy**

Innoviva uniquely combines deep pharmaceutical industry expertise and strategic financial management with the goal of maximizing the commercial potential and royalties we receive from our partnered pharmaceutical products. By channeling our significant expertise in the key field of pharmaceutical medicines including product development, commercialization, and financial strategy Innoviva seeks to become a major partner in the delivery of compelling new medicines that impact public health. We plan to leverage our unique industry knowledge and capabilities to identify medicines that have the potential to improve the lives of patients. This patient-centric approach is central to how Innoviva operates and collaborates with a partner to advance the availability of crucial medicines and treatments. Our corporate strategy is focused on stockholder returns by:

1. Maximizing the potential value of our respiratory assets partnered with GSK;
2. Providing capital returns to our stockholders through dividends or share repurchases;
3. Reducing our overall corporate cost of capital; and
4. Building a long-term recurring revenue business.

Table of Contents

**Our Relationship with GSK**

***LABA Collaboration***

In November 2002, we entered into our LABA Collaboration Agreement with GSK to develop and commercialize once-daily LABA products for the treatment of chronic obstructive pulmonary disease ("COPD") and asthma. For the treatment of COPD, the collaboration has developed two combination products: (1) RELVAR®/BREO® ELLIPTA® (FF/VI) (BREO® ELLIPTA® is the proprietary name in the U.S. and Canada and RELVAR® ELLIPTA® is the proprietary name outside the U.S. and Canada), a once-daily combination medicine consisting of a LABA, vilanterol (VI), and an inhaled corticosteroid (ICS), fluticasone furoate (FF) and (2) ANORO® ELLIPTA® (UMEC/VI), a once-daily medicine combining a long-acting muscarinic antagonist ("LAMA"), umeclidinium bromide (UMEC), with a LABA, VI. Under the LABA Collaboration Agreement, GSK and Innoviva are exploring various paths to create triple therapy medications. GSK is now responsible for all direct research and development activities associated with the collaboration. We are also eligible to receive the associated royalty revenues from VI monotherapy, if approved and commercialized. However, GSK has recently notified us of their intent to discontinue the development of VI monotherapy following continued delays in the program, and, as such, we do not expect to receive future revenues from that product.

As a result of the launch and approval of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® in the U.S., Japan and Europe, we paid milestone fees to GSK totaling $220.0 million during the year ended December 31, 2014. Although we have no further milestone payment obligations to GSK pursuant to the LABA Collaboration Agreement, we continue to have ongoing management obligations as part of the collaboration, including certain development and commercialization activities that are expected to continue over the life of the agreements. The milestone fees paid to GSK were recognized as capitalized fees paid to a related party, which are being amortized over their estimated useful lives commencing upon the commercial launch of the product.

We are entitled to receive annual royalties from GSK on sales of RELVAR®/BREO® ELLIPTA® as follows: 15% on the first $3.0 billion of annual global net sales and 5% for all annual global net sales above $3.0 billion. For other products combined with a LABA from the LABA collaboration, such as ANORO ELLIPTA , royalties are upward tiering and range from 6.5% to 10%.

***2004 Strategic Alliance***

In March 2004, we entered into the Strategic Alliance Agreement with GSK where GSK received an option to license exclusive development and commercialization rights to product candidates from certain of our discovery programs on pre-determined terms and on an exclusive, worldwide basis. In 2005, GSK licensed our MABA program for the treatment of COPD, and in October 2011, we and GSK expanded the MABA program by adding six additional Innoviva-discovered preclinical MABA compounds (the "Additional MABAs"). The development program is funded in full by GSK and is currently in Phase II clinical studies. As a result of the transactions effected by the Spin-Off, we are only entitled to receive 15% of any contingent payments and royalties payable by GSK from sales of FF/UMEC/VI (and MABA, and MABA/FF) while Theravance Biopharma receives 85% of those same payments.

***Agreements Entered into with GSK in Connection with the Spin-Off***

On March 3, 2014, in contemplation of the Spin-Off, we, Theravance Biopharma and GSK entered into a series of agreements clarifying how the companies would implement the Spin-Off and operate following the Spin-Off. We, Theravance Biopharma and GSK entered into a three-way master agreement providing for GSK's consent to the Spin-Off provided certain conditions were met. Pursuant to a three-way master agreement entered into by and among us, Theravance Biopharma and GSK in connection with the Spin-Off, we agreed to withhold a certain number of Theravance Biopharma shares

Table of Contents

from the taxable dividend of Theravance Biopharma shares to GSK. We sold all of these shares in Theravance Biopharma during the first quarter of 2015.

The amendments to the GSK Agreements do not change the economics or royalty rates under the GSK Agreements, though the assignment of the Strategic Alliance Agreement and portions of the LABA Collaboration Agreement to TRC do change how the economics are allocated between Theravance Biopharma and us. The amendments to the GSK Agreements do provide that GSK's diligent efforts obligations regarding commercialization matters under both agreements will change upon regulatory approval in either the United States or the European Union (the "EU") of FF/UMEC/VI or a MABA in combination with FF. Upon such regulatory approval, GSK's diligent efforts obligations as to commercialization matters under the GSK Agreements will have the objective of focusing on the best interests of patients and maximizing the net value of the overall portfolio of products under the GSK Agreements. Since GSK's commercialization efforts following such regulatory approval will be guided by a portfolio approach across products in which we will retain our full interests upon the Spin-Off and also products in which we have retained only a portion of our interests following the Spin-Off, GSK's commercialization efforts may have the effect of reducing the overall value of our remaining interests in the GSK Agreements following the Spin-Off.

***Purchases of Common Stock by GSK***

Prior to 2015, affiliates of GSK purchased an aggregate of 31.6 million shares of our common stock. During 2015, GSK purchased 424,081 shares of our common stock pursuant to its periodic "top-up" rights under our Amended and Restated Governance Agreement, dated as of June 4, 2004, as amended, among us, GSK and certain GSK affiliates, for an aggregate purchase price of $6.5 million. GSK's periodic "top-up" rights terminated with the expiration of the Governance Agreement in September 2015. As of February 16, 2016, GSK beneficially owned approximately 28.1% of our outstanding capital stock.

**Recent Highlights**

In January 2016, we announced our corporate name change from Theravance, Inc. to Innoviva, Inc.

Royalty revenues earned from sales of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® in 2015 grew to $66.9 million, up 263% compared to 2014,

In the fourth quarter of 2015, net sales of RELVAR®/BREO® ELLIPTA® by GSK were $154.7 million, comprised of $72.5 million in the U.S. market (an increase 79 percent from the prior quarter in the U.S.) and $82.2 million in non-U.S. markets (an increase of 43 percent from the prior quarter).

As of December 31, 2015, RELVAR®/BREO® ELLIPTA® has been launched in 45 countries.

In the fourth quarter of 2015, sales of ANORO® ELLIPTA® by GSK were $45.4 million, an increase of 44 percent compared to the prior quarter. Sales were $31.2 million in the U.S. market (an increase of 42 percent from the prior quarter) and $14.2 million in non-U.S. markets (an increase of 48 percent from the prior quarter).

As of December 31, 2015, ANORO® ELLIPTA® has been launched in 38 countries.

Through January 29, 2016, we repurchased $37.3 million of stock under our previously announced $150 million share repurchase program through a combination of a "modified Dutch auction" tender offer (completed in December 2015) and open market purchases, with an average purchase price of $9.49 per share.

Table of Contents

**Manufacturing**

Manufacturing of RELVAR®/BREO® ELLIPTA® (FF/VI) and ANORO ELLIPTA (UMEC/VI) and for the MABA program is performed by GSK.

**Government Regulation**

The development and commercialization of products and product candidates pursuant to the GSK Agreements are subject to extensive regulation by governmental authorities in the United States and other countries. Before marketing in the United States, any medicine must undergo rigorous preclinical studies and clinical studies and an extensive regulatory approval process implemented by the FDA. Outside the United States, the ability to market a product depends upon receiving a marketing authorization from the appropriate regulatory authorities. The requirements governing the conduct of clinical studies, marketing authorization, pricing and reimbursement vary widely from country to country. In any country, the commercialization of medicines is permitted only if the appropriate regulatory authority is satisfied that our collaborative partner has presented adequate evidence of the safety, quality and efficacy of such medicines.

Once a product is approved, the FDA may withdraw the product approval if compliance with pre- and post-marketing regulatory standards is not maintained or if safety or quality issues are identified after the product reaches the marketplace. In addition, the FDA may require post-marketing studies, referred to as Phase 4 studies, to monitor the effect of approved products, and may limit further marketing of the product based on the results of these post-marketing studies. The FDA has broad post-market regulatory and enforcement powers, including the ability to suspend or delay issuance of approvals, seize products, withdraw approvals, enjoin violations, and institute criminal prosecution.

If regulatory approval for a medicine is obtained, the clearance to market the product will be limited to those diseases and conditions for which the medicine is effective, as demonstrated through clinical studies and included in the medicine's labeling. Even if this regulatory approval is obtained, a marketed medicine, its manufacturer and its manufacturing facilities are subject to continual review and periodic inspections by the FDA. The FDA ensures the quality of approved medicines by carefully monitoring manufacturers' compliance with its cGMP regulations. The cGMP regulations for drugs contain minimum requirements for the methods, facilities, and controls used in manufacturing, processing, and packaging of a medicine. The regulations are intended to make sure that a medicine is safe for use, and that it has the ingredients and strength it claims to have. Discovery of previously unknown problems with a medicine, manufacturer or facility may result in restrictions on the medicine or manufacturer, including costly recalls or withdrawal of the medicine from the market.

We and our collaborative partner are also subject to various laws and regulations regarding laboratory practices, the experimental use of animals and the use and disposal of hazardous or potentially hazardous substances in connection with the development and commercialization of products and product candidates. In each of these areas, as above, the FDA and other regulatory authorities have broad regulatory and enforcement powers, including the ability to suspend or delay issuance of approvals, seize products, withdraw approvals, enjoin violations, and institute criminal prosecution, any one or more of which could have a material adverse effect upon our business, financial condition and results of operations.

Outside the United States, our collaborative partner's ability to market partnered products will also depend on receiving marketing authorizations from the appropriate regulatory authorities. Risks similar to those associated with FDA approval described above exist with the regulatory approval processes in other countries.

Table of Contents

**Patents and Proprietary Rights**

We and our collaborative partner will be able to protect our partnered technology from unauthorized use by third parties only to the extent that such technology is covered by valid and enforceable patents or is effectively maintained as trade secrets. Our success in the future will depend in part on us and our collaborative partner obtaining patent protection for our partnered products and product candidates. Accordingly, patents and other proprietary rights are essential elements of our business.

For proprietary know-how that is not patentable, processes for which patents are difficult to enforce and any other elements of our business that involve proprietary know-how and technology that is not covered by patent applications, we rely on trade secret protection and confidentiality agreements to protect our interests. We require all of our employees, consultants and advisors to enter into confidentiality agreements. Where it is necessary to share our proprietary information or data with outside parties, our policy is to make available only that information and data required to accomplish the desired purpose and only pursuant to a duty of confidentiality on the part of those parties.

As of December 31, 2015, we owned 32 issued United States patents and 173 granted foreign patents, as well as additional pending United States patent applications and foreign patent applications. The claims in these various patents and patent applications are directed to compositions of matter, including claims covering product candidates, lead compounds and key intermediates, pharmaceutical compositions, methods of use and processes for making our compounds.

United States issued patents and foreign patents generally expire 20 years after filing. Nevertheless, issued patents can be challenged, narrowed, invalidated or circumvented, which could limit our ability to stop competitors from marketing similar products and threaten our ability to commercialize our product candidates. Our patent position, similar to other companies in our industry, is generally uncertain and involves complex legal and factual questions. To maintain our proprietary position, we will need to obtain effective claims and enforce these claims once granted. It is possible that, before any of our products can be commercialized, any related patent may expire or remain in force only for a short period following commercialization, thereby reducing any advantage of the patent. Also, we do not know whether any of our patent applications will result in any issued patents or, if issued, whether the scope of the issued claims will be sufficient to protect our proprietary position.

**Competition**

We anticipate that RELVAR®/BREO® ELLIPTA® (FF/VI) and ANORO® ELLIPTA® (UMEC/VI), will compete with a number of approved bronchodilator drugs and drug candidates under development that are designed to treat asthma and COPD. These include but are not limited to:

Advair®/Seretide (salmeterol and fluticasone proprionate as a combination) marketed by GSK,

Symbicort® (formoterol and budesonide as a combination) marketed by AstraZeneca,

Spiriva® (tiotropium) marketed by Boehringer Ingelheim,

Dulera® (formoterol and mometasone as a combination) marketed by Merck,

Tudorza ® (aclidinium) marketed by AstraZeneca and Seebri® (glycopyrronium) were also launched in the year ended December 31, 2012 (Seebri, ex-U.S.),

Incruse® (umeclidinium) and Arnuity® (fluticasone furoate), launched in January 2015 by GSK in the U.S. (we are not entitled to any royalties from either product),

UMEC/VI/FF being developed by GSK,

Foradil®/Oxis® (formoterol) marketed by a number of companies,

Table of Contents

Striverdi® Respimat® (olodaterol) marketed by Boehringer Ingelheim,

Onbrez®/Arcapta® (indacaterol) marketed by Novartis,

Ultibro®/ Ultibron®, (indacaterol combined with the LAMA glycopyrronium bromide) developed by Novartis and approved and launched in Europe and Japan in the year ended December 31, 2013 as a once-daily treatment for COPD. In the U.S., the product was approved in October 2015 at a lower strength and as a twice-daily COPD treatment,

Stiolto (U.S.)/Spiolto (E.U.) approved in mid-2015, consists of the LAMA tiotropium combined with the LABA olodaterol, marketed by Boehringer Ingelheim for the treatment of COPD,

Duaklir® Genuair® (consisting of the LAMA aclidinium bromide and LABA formoterol fumarate), developed by AstraZeneca and approved in November 2014 in the EU as a maintenance bronchodilator treatment for COPD,

Indacaterol in combination with an ICS (mometasone), being developed by Novartis for markets outside the U.S., and

Formoterol combined with the LAMA glycopyrronium pMDI is reported by AstraZeneca to be in phase III for the treatment of COPD.

In addition, several firms are developing new formulations of Advair/Seretide (salmeterol /fluticasone proprionate) and Symbicort (formoterol fumerate/budesonide) which may be marketed as generics or branded generics relative to the existing products from GSK and AstraZeneca, respectively. All of these efforts represent potential competition for any of our partnered products. Efforts have intensified following the publication of FDA draft guidance for the approval of fully substitutable versions of Advair and Symbicort in late 2013 and mid-2015 respectively. Current examples of these products include the marketed products Duoresp/Biresp from Teva (generic Symbicort), AirFluSal Forspiro by Sandoz, Rolenium by Elpen and Sirdupla by Mylan (all generic Advair) which are all available in a wide number of countries in the E.U. In the US, several competitors are attempting to gain market authorization for a generic version of Advair in the next one to two years. Chief among these are Mylan and Sandoz (Mylan confirmed filing of an ANDA with USFDA for their product in December 2015), Vectura and Roxane who own the U.S. rights to AirFluSal, and Teva who is developing both a fully substitutable and non-substitutable generic Advair that are expected to be filed in the next one to two years.

**Employees**

As of December 31, 2015, we had 13 employees. None of our employees are represented by a labor union. We consider our employee relations to be good.

**Executive Officers of the Registrant**

The following table sets forth the name, age, and position of each of our executive officers as of February 16, 2016:

| Name | Age | Positions Held |
|---|---|---|
| Michael W. Aguiar(1) | 49 | President, Chief Executive Officer and Director |
| Eric d'Esparbes | 48 | Senior Vice President and Chief Financial Officer |
| Michael Faerm | 49 | Senior Vice President and Chief Business Officer |
| George B. Abercrombie, RPh, MBA | 61 | Senior Vice President, Chief Commercial Officer |
| Theodore J. Witek, Jr., Dr.P.H. | 58 | Senior Vice President, Chief Scientific Officer |

(1) Member of the Board of Directors

Table of Contents

*Michael W. Aguiar* was appointed President and Chief Executive Officer of Innoviva, Inc. and became a member of our Board of Directors in August 2014. He joined Innoviva as Senior Vice President and Chief Financial Officer in March 2005. Prior to joining Innoviva, Mr. Aguiar served as Vice President of Finance at Gilead Sciences, Inc., a biopharmaceutical company, since 2002. Prior to Gilead Sciences, Inc., Mr. Aguiar served as Vice President of Finance at Immunex Corporation, a biopharmaceutical company, from 2001 to 2002. From 1995 to 2001, he was with Honeywell International in a variety of positions, including, most recently CFO and Vice President Finance for Honeywell Electronic Materials SBU. Mr. Aguiar earned a B.S. in biology from the University of California, Irvine and an M.B.A. in finance from the University of Michigan. Mr. Aguiar's demonstrated leadership in his field, his prior senior management experience in our industry and his experience as our Chief Executive Officer and as our former Chief Financial Officer contributed to our conclusion that he should serve as a director.

*Eric d'Esparbes* joined Innoviva, Inc. as Senior Vice President and Chief Financial Officer in October 2014. From 2010 to 2014, Mr. d'Esparbes served as the Chief Financial Officer of Joule Unlimited, a biotechnology company, where he was responsible for overseeing all of the company's financial, tax, treasury and accounting activities. Prior to Joule Unlimited, he was the Vice President, Finance of AEI Energy ("AEI"), a global emerging markets energy company, where he was responsible for optimizing the capital structure of AEI's international portfolio of energy assets, and from 2007 to 2010 served as Senior Vice President and Chief Financial Officer at AEI Asia. Mr. d'Esparbes has also served as Chief Financial Officer and other senior financial roles at Meiya Power Company Limited from 1999 to 2007 and senior financial roles at Hydro-Quebéc International from 1993 to 1999. Mr. d'Esparbes earned a Bachelor's degree in International Finance from the University of Montreal's Hautes Etudes Commerciales in Montreal, Canada.

*Michael E. Faerm* joined Innoviva, Inc. as Senior Vice President and Chief Business Officer in July 2015. Prior to joining Innoviva, Mr. Faerm spent nine years as a pharmaceuticals analyst, most recently as the Senior Pharmaceuticals Equity Research Analyst at Wells Fargo Securities, and previously as a Senior Specialty Pharmaceuticals Analyst at Credit Suisse. Mr. Faerm has also worked within the biopharmaceutical industry, holding positions in business development and strategic financial planning at Forest Laboratories and Regeneron Pharmaceuticals. Previously, he spent four years in investment banking as a member of Merrill Lynch's global healthcare team, where he focused primarily on mergers and acquisitions and financings of biotechnology and pharmaceuticals companies. He earned an MBA degree from Harvard Business School, an MS in Civil Engineering from Stanford University, and a BS in Civil Engineering from Columbia University.

*George B. Abercrombie, RPh, MBA* joined Innoviva, Inc. in June 2014. Prior to joining Innoviva, Mr. Abercrombie served as the President and Chief Executive Officer of Hoffmann-La Roche Inc. from 2001 to 2009, where he was responsible for the US and Canadian business divisions. From 1993 to 2001, Mr. Abercrombie worked at Glaxo and its successor companies, including as Senior Vice President of Commercial Operations for Glaxo Wellcome, Inc. He is the Chairman of the Board of BioCryst Pharmaceuticals, Inc., and also serves as a board member of numerous other healthcare-related organizations, including Project Hope and the North Carolina GlaxoSmithKline Foundation. Mr. Abercrombie holds an MBA from Harvard Business School and a BS from the University of North Carolina at Chapel Hill, School of Pharmacy.

*Theodore J. Witek, Jr., Dr.P.H.* joined Innoviva, Inc. in July 2014. Prior to joining Innoviva, Dr. Witek served as President and Chief Executive Officer of Boehringer Ingelheim in Canada and in Portugal. Joining Boehringer in 1992, Dr. Witek held a number of positions of increasing responsibility, including leading the global clinical development and launch of several respiratory products, most notably Spiriva®. He also led the Respiratory and Immunology clinical research groups in the US in 2001, he moved to Germany to lead the operating team for Spiriva® and also served as the Boehringer Co-chair of the Joint Operating Committee with Pfizer in their global alliance. During his tenure in

Table of Contents

Canada, Dr. Witek served on the Board of Directors at Rx&D, Canada's National Association for Research-Based Pharmaceutical Companies, chairing its Heath Technology Assessment and Public Affairs Committees. He also served over ten years on the Drug/Device Discovery and Development Committee of the American Thoracic Society, serving as Chairman from 2010 to 2012. He is currently appointed to the Ontario Heath Innovation Council. Dr. Witek holds a DrPH degree from Columbia University, an MPH from Yale University, and an MBA from Henley Management College.

**Code of Business Conduct**

The Company has adopted the Innoviva, Inc. Code of Business Conduct that applies to all directors, officers and employees. The Code of Business Conduct, as amended and restated on December 15, 2010, is available on the corporate governance section of our website at *www.inva.com*. If the Company makes any substantive amendments to the Code of Business Conduct or grants any waiver from a provision of the Code to any executive officer or director, the Company will promptly disclose the nature of the amendment or waiver on its website.

**Available Information**

Our Internet address is *www.inva.com*. Our investor relations website is located at *http://investor.inva.com*. We make available free of charge on our investor relations website under "SEC Filings" our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, our directors' and officers' Section 16 Reports and any amendments to those reports after filing or furnishing such materials to the U.S. Securities and Exchange Commission (SEC). The information found on our website is not part of this or any other report that we file with or furnish to the SEC. Innoviva and the Innoviva logo are registered trademarks of Innoviva, Inc. Trademarks, tradenames or service marks of other companies appearing in this report are the property of their respective owners.

Table of Contents

## ITEM 1A. RISK FACTORS

### Risks Related to our Business

***For the foreseeable future we will derive all of our royalty revenues from GSK and our future success depends on GSK's ability to successfully develop and commercialize the products in the respiratory programs partnered with GSK.***

Pursuant to the GSK Agreements, GSK is responsible for the development and commercialization of products in the partnered respiratory programs. Through December 31, 2015, sales of both BREO® ELLIPTA® and especially ANORO® ELLIPTA® by GSK have been significantly below our expectations which resulted in a decline in our stock price. Although we may receive milestone payments from GSK if certain development milestones are achieved in our MABA program, we believe that royalty revenues from BREO® ELLIPTA® and ANORO® ELLIPTA® will represent the majority of our future revenues from GSK. The amount and timing of revenue from such royalties and milestones is unknown and highly uncertain. Our future success depends upon the performance by GSK of its commercial obligations under the GSK Agreements. We have no control over GSK's marketing and sales efforts, and GSK might not be successful, which would harm our business and cause the price of our securities to fall.

The amount of royalties and milestone payments, if any, we receive will depend on many factors, including the following:

- the extent and effectiveness of the sales and marketing and distribution support GSK provides our partnered products;
- market acceptance and demand for our partnered products;
- the competitive landscape of generic and branded products and developing therapies that compete with our partnered products, including other products owned by GSK (such as Advair®) but which are not partnered with us and pricing pressure in the respiratory markets targeted by our partnered products;
- the size of the market for our partnered products;
- decisions as to the timing of product launches, pricing and discounts;
- GSK's ability to expand the indications for which our partnered products can be marketed;
- a satisfactory efficacy and safety profile as demonstrated in a broad patient population;
- acceptance of, and ongoing satisfaction with, our partnered products by the medical community, patients receiving therapy and third party payors;
- the ability of patients to be able to afford our partnered products or obtain health care coverage that covers our partnered products;
- safety concerns in the marketplace for respiratory therapies in general and with our partnered products in particular;
- regulatory developments relating to the manufacture or continued use of our partnered products;

the requirement to conduct additional post-approval studies or trials for our partnered products;

GSK's ability to successfully achieve development milestones with respect to our partnered MABA program;

GSK's ability to obtain regulatory approval of our partnered products in additional countries; or

the unfavorable outcome of any potential litigation relating to our partnered products.

Table of Contents

***Reduced prices and reimbursement rates from governments, payors, or competitors or other healthcare cost containment initiatives such as restrictions on use, may negatively impact royalties generated under the GSK Agreements.***

The continuing efforts of governments, pharmaceutical benefit management organizations (PBMs), insurance companies, managed care organizations and other payors of health care costs to contain or reduce costs of health care has adversely affected the price, market access, and total revenues of BREO® ELLIPTA® and ANORO® ELLIPTA® and may continue to adversely affect them in the future. In addition, our partnered products have experienced and expect to continue to experience increased competitive activity which has resulted in lower overall prices for our products.

The Patient Protection and Affordable Care Act and other potential legislative or regulatory action regarding healthcare and insurance matters, along with the trend toward managed healthcare in the U.S., could adversely influence the purchase of healthcare products and reduce demand and prices for our partnered products. This could harm GSK's ability to market our partnered products and significantly reduce future revenues. For example, when GSK launched BREO® ELLIPTA® for the treatment of COPD in the U.S. in October 2013, GSK experienced significant challenges gaining coverage at some of the largest PBMs, healthcare payors, and providers and lower overall prices than expected. Recent actions by U.S. PBMs in particular have increased discount levels for respiratory products resulting in lower net sales pricing realized for products in our collaboration. Further, if the ongoing Phase 3b studies with FF/VI do not show improved outcomes relative to the standard of care, obtaining payor coverage for RELVAR®/BREO® ELLIPTA® could become more difficult in the future. In addition, in certain foreign markets, the pricing of prescription drugs is subject to government control and reimbursement may in some cases be unavailable. We believe that pricing pressures will continue and may increase. This may make it difficult for GSK to sell our partnered products a price acceptable to us or GSK or to generate revenues in line with our analysts' expectations, which may cause the price of our securities to fall.

***If the commercialization of RELVAR®/BREO® ELLIPTA® or ANORO® ELLIPTA® in the countries in which they have received regulatory approval encounters any delays or adverse developments, or perceived delays or adverse developments, or if sales or payor coverage do not meet investor or our expectations, our business will be harmed, and the price of our securities could fall.***

Under our agreements with our collaborative partner GSK, GSK has full responsibility for commercialization of RELVAR®/ BREO® ELLIPTA® and ANORO® ELLIPTA®. GSK has launched RELVAR®/ BREO® ELLIPTA® in a number of countries including the United States (U.S.), Canada, Japan, the United Kingdom, and Germany among others. The commercial launch of both products has been below our expectations primarily due to lower overall pricing levels in the U.S. and longer timeframes to obtain payor coverage. For example, GSK recently stated that it has experienced more restrictive formulary access and lower net pricing in the U.S. respiratory market than it expected, which may indicate broader weakness in the respiratory markets targeted by RELVAR®/ BREO® ELLIPTA® and ANORO® ELLIPTA®. As a result, a number of analysts have adjusted their sales forecasts downward from previous projections. Any further delays or adverse developments or perceived additional delays or adverse developments with respect to the commercialization of RELVAR®/ BREO® ELLIPTA® and ANORO® ELLIPTA® including if sales or payor coverage do not meet investor or our expectations, will significantly harm our business and the price of our securities could fall.

Table of Contents

***We are dependent on GSK for the successful commercialization and development of products under the GSK Agreements. If GSK does not devote sufficient resources to the commercialization or development of these products, is unsuccessful in its efforts, or chooses to reprioritize its commercial programs, our business will be materially harmed.***

GSK is responsible for all clinical and other product development, regulatory, manufacturing and commercialization activities for products developed under the GSK Agreements, including RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®. Our royalty revenues under the GSK Agreements may not meet our, or investors' expectations, due to a number of important factors. GSK has a substantial respiratory product portfolio in addition to the partnered products that are covered by the GSK Agreements. GSK may make respiratory product portfolio decisions or statements about its portfolio which may be, or may be perceived to be, harmful to the respiratory products partnered with us. For instance, GSK has wide discretion in determining the efforts and resources that it will apply to the commercialization of our partnered products. The timing and amount of royalties that we may receive will depend on, among other things, the efforts, allocation of resources and successful development and commercialization of these product candidates by GSK. In addition, GSK may determine to focus its commercialization efforts on its own products. For example, in January 2015, GSK launched Incruse® (Umec) in the U.S., which is a LAMA for the treatment of COPD. GSK may determine to focus its marketing efforts on Incruse, which could have the effect of decreasing the potential market share of ANORO® ELLIPTA® and lowering the royalties we may receive for such product. Alternatively, GSK may decide to market Incruse® in combination with RELVAR®/BREO® ELLIPTA® as an open triple therapy in anticipation of future commercialization of the closed triple therapy for which we only receive limited amount of royalty revenues, and eventually compete directly against sales of RELVAR®/BREO® ELLIPTA®. In the event GSK does not devote sufficient resources to the commercialization of our partnered products or chooses to reprioritize its commercial programs, our business, operations and stock price would be negatively affected.

***If the results of the Salford Lung Study in chronic obstructive pulmonary disease (COPD) are negative or do not meet market expectations, or if the data generated from the Salford study indicate safety concerns, sales of RELVAR®/BREO® ELLIPTA® could be diminished and our ability to generate royalties from such sales could be negatively affected, and the price of our securities could fall.***

GSK is conducting the Salford Lung Study to explore the effectiveness of RELVAR®/BREO® ELLIPTA® compared to other COPD treatments when used in a broad group of people living and managing their COPD on a day-to-day basis. The Salford Lung Study is a Phase 3 multicenter, randomized open-label study of approximately 2,800 people being treated in primary care who have been diagnosed and receive regular treatment for COPD in Salford and the surrounding area. The primary endpoint is the mean annual rate of moderate and severe exacerbations while secondary endpoints will assess safety, contact with healthcare professionals and patient reported outcomes. GSK expects to report results for the Salford Lung Study in 2016.

If the data derived from the study are negative, do not meet market expectations, or identify other safety or efficacy concerns with RELVAR/BREO ELLIPTA, it could result in, among other things:

- decreased market acceptance and demand for RELVAR®/BREO® ELLIPTA®;
- decrease in the size of the market for RELVAR®/BREO® ELLIPTA®;
- safety concerns in the marketplace for RELVAR®/BREO® ELLIPTA®;
- shifts in the medical community to new treatment paradigms or standards of care;
- changes in the competitive landscape for approved and developing therapies that may compete with RELVAR®/BREO® ELLIPTA®;

Table of Contents

GSK's ability to obtain regulatory approval for RELVAR®/BREO® ELLIPTA®, in additional jurisdictions;

the unfavorable outcome or other negative effects of any potential litigation relating to RELVAR®/BREO® ELLIPTA®.

additional restrictions on the commercialization of RELVAR®/BREO® ELLIPTA® through changes to the approved RELVAR®/BREO® ELLIPTA® labels;

the imposition of additional post-approval studies or trials; or

the withdrawal of the approvals of RELVAR®/BREO® ELLIPTA®.

Our business, operations and stock price would be negatively affected if any of these or similar events occur.

***If GSK's commercialization efforts to market BREO® ELLIPTA® for asthma encounters any delays or adverse developments, or perceived delays or adverse developments, or if sales or payor coverage do not meet investor, analyst or our expectations, our business will be harmed, and the price of our securities could fall.***

On April 30, 2015, the U.S. Food and Drug Administration ("FDA") approved BREO® ELLIPTA® (FF/VI) as a once-daily inhaled treatment for asthma in patients aged 18 years and older in the U.S. If GSK's commercialization efforts to market BREO® ELLIPTA® for asthma in the U.S. encounters any delays or adverse developments, or perceived delays or adverse developments, or if sales or payor coverage do not meet investor, analyst or our expectations, our business will be harmed, and the price of our securities could fall.

***Any adverse change in FDA policy or guidance regarding the use of LABAs to treat asthma may significantly harm our business and the price of our securities could fall.***

On February 18, 2010, the FDA announced that LABAs should not be used alone in the treatment of asthma and it will require manufacturers to include this warning in the product labels of these drugs, along with taking other steps to reduce the overall use of these medicines. The FDA now requires that the product labels for LABA medicines reflect, among other things, that the use of LABAs is contraindicated without the use of an asthma controller medication such as an inhaled corticosteroid, that LABAs should only be used long-term in patients whose asthma cannot be adequately controlled on asthma controller medications, and that LABAs should be used for the shortest duration of time required to achieve control of asthma symptoms and discontinued, if possible, once asthma control is achieved. In addition, in March 2010, the FDA held an Advisory Committee to discuss the design of medical research studies (known as "clinical trial design") to evaluate serious asthma outcomes (such as hospitalizations, a procedure using a breathing tube known as intubation, or death) with the use of LABAs in the treatment of asthma in adults, adolescents, and children. Further, in April 2011, the FDA announced that to further evaluate the safety of LABAs, it is requiring the manufacturers of currently marketed LABAs to conduct additional randomized, double-blind, controlled clinical trials comparing the addition of LABAs to inhaled corticosteroids versus inhaled corticosteroids alone. Results from these post-marketing studies are expected in the year ended December 31, 2017. It is unknown at this time what, if any, effect these or future FDA actions will have on the prospects for FF/VI. The current uncertainty regarding the FDA's position on LABAs for the treatment of asthma and the lack of consensus expressed at the March 2010 Advisory Committee may result in the FDA requiring additional asthma clinical trials in the U.S. for FF/VI and increase the overall risk of FF/VI for the treatment of asthma in the U.S. We cannot predict the extent to which new FDA policy or guidance might significantly impede the discovery, development, production and marketing of FF/VI. Any adverse change in FDA policy or guidance regarding the use of LABAs to treat asthma may significantly harm our business and the price of our securities could fall.

Table of Contents

***Any adverse developments to the regulatory status of either RELVAR®/BREO® ELLIPTA® or ANORO® ELLIPTA® in the countries in which they have received regulatory approval including labeling restrictions, safety findings, or any other limitation to usage, will harm our business and may cause the price of our securities to fall.***

Although RELVAR®/BREO® ELLIPTA® or ANORO® ELLIPTA® are approved and marketed in a number of countries, it is possible that adverse changes to the regulatory status of these products could occur in the event new safety issues are identified, treatment guidelines are changed, or new studies fail to demonstrate product benefits. A number of notable pharmaceutical products have experienced adverse developments during commercialization that have resulted in the product being withdrawn, approved uses being limited, or new warnings being included. In the event that any adverse regulatory change were to occur to any of our products, our business will be harmed and the price of our securities will fall.

***Any adverse developments or results or perceived adverse developments or results with respect to the ongoing studies for FF/VI in asthma or COPD, for UMEC/VI in COPD, or any future studies will significantly harm our business and the price of our securities could fall, and if regulatory authorities in those countries in which approval has not yet been granted determine that the ongoing studies for FF/VI in asthma or COPD or the ongoing studies for UMEC/VI for COPD do not demonstrate adequate safety and efficacy, the continued development of FF/VI or UMEC/VI or both may be significantly delayed, they may not be approved by these regulatory authorities, and even if approved it may be subject to restrictive labeling, any of which will harm our business, and the price of our securities could fall.***

Although we have announced the completion of, and reported certain top- line data from, the Phase 3 registrational program for FF/VI in COPD and asthma, additional studies of FF/VI are underway. For example, in September 2015, GSK and we announced that the Study to Understand Mortality and MorbidITy" (SUMMIT) did not meet its primary endpoints, which resulted in a significant decline in the price of our stock. Any adverse developments or perceived adverse developments with respect to any prior, current or future studies in these programs will significantly harm our business and the price of our securities could fall.

Although the FDA, the European Medicines Agency, the Japanese Ministry of Health, Labour and Welfare and Health Canada have approved ANORO® ELLIPTA®, it has not yet been approved in other jurisdictions.

Any adverse developments or results or perceived adverse developments or results with respect to other pending or future regulatory submissions for the FF/VI program or the UMEC/VI program will significantly harm our business and the price of our securities could fall. Examples of such adverse developments include, but are not limited to:

- not every study, nor every dose in every study, in the Phase 3 programs for FF/VI achieved its primary endpoint and regulatory authorities may determine that additional clinical studies are required;
- safety, efficacy or other concerns arising from clinical or non-clinical studies in these programs having to do with the LABA VI, which is a component of FF/VI and UMEC/VI;
- safety, efficacy or other concerns arising from clinical or non-clinical studies in these programs;
- regulatory authorities determining that the Phase 3 programs in asthma or in COPD raise safety concerns or do not demonstrate adequate efficacy; or
- any change in FDA policy or guidance regarding the use of LABAs to treat asthma or the use of LABAs combined with a LAMA to treat COPD.

Table of Contents

***If the FDA or other applicable regulatory authorities approve generic products, including but not limited to generic forms of Advair®, that compete with RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® the royalties payable to us pursuant to the LABA Collaboration Agreement will be less than currently anticipated, which in turn would harm our business and the price of our securities could fall.***

Once an NDA or marketing authorization application outside the U.S. is approved, the product covered thereby becomes a "listed drug" that can, in turn, be cited by potential competitors in support of approval of an Abbreviated New Drug Application ("ANDA") in the United States. Agency regulations and other applicable regulations and policies provide incentives to manufacturers to create modified, non-infringing versions of a drug to facilitate the approval of an ANDA or other application for generic substitutes in the U.S. and in nearly every pharmaceutical market around the world. Numerous companies like Mylan N.V. and Teva Pharmaceuticals Industries Ltd. have publicly stated their intentions to bring generic forms of the ICS/LABA drug Advair®, when certain patents covering the Advair® delivery device expire in the year ended December 31, 2016. Mylan N.V. has recently announced the completion of the Phase 3 studies for their generic Advair program, and filed their ANDA with the FDA in December of 2015. These manufacturers might only be required to conduct a relatively inexpensive study to show that their product has the same active ingredient(s), dosage form, strength, route of administration and conditions of use, or labeling, as the branded product and that the generic product is bioequivalent to the branded product, meaning it is absorbed in the body at the same rate and to the same extent. These generic equivalents, which must meet the same quality standards as branded products, may be significantly less costly to bring to market, and companies that produce generic equivalents are generally able to offer their products at lower prices. Thus, after the introduction of a generic competitor, a significant percentage of the sales of any branded product and products that may compete with such branded product is typically lost to the generic product. Accordingly, introduction of generic products that compete against ICS/LABA products, like RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®, would materially adversely impact our future royalty revenue, profitability and cash flows. We cannot yet ascertain what impact these generic products and any future approved generic products will have on any sales of RELVAR®/BREO® ELLIPTA® or ANORO® ELLIPTA®, if approved.

***RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® face substantial competition for their intended uses in the targeted markets from products discovered, developed, launched and commercialized both by GSK and by other pharmaceutical companies, which could cause the royalties payable to us pursuant to the LABA Collaboration Agreement to be less than expected, which in turn would harm our business and the price of our securities could fall.***

GSK has responsibility for obtaining regulatory approval, launching and commercializing RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® for their intended uses in the targeted markets around the world. While these products have received regulatory approval and been launched and commercialized in the U.S. and certain other targeted markets, the products face substantial competition from existing products previously developed and commercialized both by GSK and by other competing pharmaceutical companies and can expect to face additional competition from new products that are discovered, developed and commercialized by the same pharmaceutical companies and other competitors going forward. For example, sales of Advair®, GSK's approved medicine for both COPD and asthma, continue to be significantly greater than sales of RELVAR®/BREO® ELLIPTA®, and GSK has indicated publicly that it intends to continue commercializing Advair®.

Many of the pharmaceutical companies competing in respiratory markets are international in scope with substantial financial, technical and personnel resources that permit them to discover, develop, obtain regulatory approval and commercialize new products in a highly efficient and low cost manner at competitive prices to consumers. In addition, many of these competitors have substantial commercial infrastructures that facilitate commercializing their products in a highly efficient and low cost manner at

Table of Contents

competitive prices to consumers. The market for products developed for treatment of COPD and asthma continues to experience significant innovation and reduced cost in bringing products to market over time. There can be no assurance that RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® will not be replaced by new products that are deemed more effective at lower cost to consumers. The ability of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® to succeed and achieve the anticipated level of sales depends on the commercial and development performance of GSK to achieve and maintain a competitive advantage over other products with the same intended use in the targeted markets.

If sales of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® are less than anticipated because of existing or future competition in the markets in which they are commercialized, including competition from existing and new products that are perceived as lower cost or more effective, our royalty payments will be less than anticipated, which in turn would harm our business and the price of our securities could fall.

***We and GSK are developing UMEC/VI/FF (LAMA/LABA/ICS) and MABA/FF as potential triple combination treatments for COPD and, potentially, asthma. As a result of the Spin-Off, most of our economic rights in these programs were assigned to Theravance Biopharma, Inc. If these programs are successful and GSK and the respiratory market in general views triple combination therapy as significantly more beneficial than existing therapies, including RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®, our business could be harmed, and the price of our securities could fall.***

Under our LABA Collaboration Agreement with GSK, we and GSK are exploring various paths to create triple therapy respiratory medications. The use of triple therapy is supported by the GOLD ("Global initiative for chronic Obstructive Lung Disease") guidelines in high-risk patients with severe COPD and a high risk of exacerbations. One potential triple therapy path is the combination of UMEC/VI (two separate bronchodilators) and FF (an inhaled corticosteroid), to be administered via the ELLIPTA® dry powder inhaler, referred to as UMEC/VI/FF or the "closed triple." Prior to the Spin-Off, we were entitled to receive 100% of any royalties payable under the GSK Agreements arising from sales of UMEC/VI/FF (as well as MABA and MABA/FF) if such products were successfully developed, approved and commercialized. In July 2014, we and GSK announced the initiation of a large, global Phase 3 study for the closed triple in patients with COPD. If this Phase 3 study (or any other closed triple Phase 3 studies that may be initiated in the future) is successful, GSK and the respiratory market in general may view this triple combination therapy as significantly more beneficial than existing therapies, including RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®. In such event the commercialization of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® could be adversely affected, which in turn could result in lower royalties to us. Furthermore, if the closed triple (or MABA /FF) receives regulatory approval in either the U.S. or the EU, GSK's diligent efforts obligations regarding commercialization matters will have the objective of focusing on the best interests of patients and maximizing the net value of the overall portfolio of products under the GSK Agreements. Since GSK's commercialization efforts following such regulatory approval will be guided by a portfolio approach across products in which we have retained our full interest and also products in which we now have only a small portion of our former interest, GSK's commercialization efforts may have the effect of reducing the overall value of our remaining interests in the GSK Agreements in the future. As a result of the transactions effected by the Spin-Off, however, we are now only entitled to receive 15% of any contingent payments and royalties payable by GSK from sales of FF/UMEC/VI (and MABA, and MABA/FF) while Theravance Biopharma receives 85% of those same payments.

Table of Contents

***In the event that Theravance BioPharma defaults or breaches the agreements we entered into with them in connection with the Spin-Off, our business and results of operations may be materially harmed.***

Upon the Spin-Off, our facility leases in South San Francisco, California were assigned to Theravance Biopharma. However, if Theravance Biopharma were to default on its lease obligations, we would be held liable by the landlord and thus, we have in substance guaranteed the lease payments for these facilities. We would also be responsible for lease-related payments including utilities, property taxes, and common area maintenance, which may be as much as the actual lease payments. As of December 31, 2015, the total remaining lease payments, which run through May 2020, were $27.6 million. In the event that Theravance Biopharma defaults on such obligations, our business and results of operations may be materially harmed.

Under the terms of a separation and distribution agreement entered into between us and Theravance Biopharma, Theravance Biopharma will indemnify us from (i) all debts, liabilities and obligations transferred to Theravance Biopharma in connection with the Spin-Off (including its failure to pay, perform or otherwise promptly discharge any such debts, liabilities or obligations after the Spin-Off), (ii) any misstatement or omission of a material fact in its information statement filed with the SEC, resulting in a misleading statement and (iii) any breach by it of certain agreements entered into between the parties in connection with the Spin-Off. Theravance Biopharma's ability to satisfy these indemnities, if called upon to do so, will depend upon its future financial strength and if we are not able to collect on indemnification rights from Theravance Biopharma, our financial condition may be harmed.

***We may not be able to utilize all of our net operating loss carryforwards.***

We have net operating loss carryforwards and other significant U.S. tax attributes that we believe could offset otherwise taxable income in the U.S. As a part of the overall Spin-Off transaction, the transfer of certain assets by us to Theravance Biopharma and our distribution of Theravance Biopharma ordinary shares resulted in taxable transfers pursuant to applicable provisions of the Internal Revenue Code of 1986, as amended (the "Code") and Treasury Regulations. The taxable gain recognized by us attributable to the transfer of certain assets to Theravance Biopharma will generally equal the excess of the fair market value of each asset transferred over our adjusted tax basis in such asset. Although we will not recognize any gain with respect to the cash we transferred to Theravance Biopharma, we may recognize substantial gain based on the fair market value of the other assets (other than cash) transferred to Theravance Biopharma. The determination of the fair market value of these assets is subjective and could be subject to adjustments or future challenge by the Internal Revenue Service ("IRS"), which could result in an increase in the amount of gain realized by us as a result of the transfer. Our U.S. federal income tax resulting from any gain recognized upon the transfer of our assets to Theravance Biopharma (including any increased U.S. federal income tax that may result from a subsequent determination of higher fair market values for the transferred assets), may be reduced by our net operating loss carryforward. The net operating loss carryforwards available in any year to offset our net taxable income will be reduced following a more than 50% change in ownership during any period of 36 consecutive months (an "ownership change") as determined under the Internal Revenue Code of 1986 (the "Code"). We have conducted an analysis to determine whether an ownership change had occurred since inception through December 31, 2014, and concluded that we had undergone two ownership changes in prior years. We have approximately $1.2 billion of net operating loss carryforward as of December 31, 2015. There may be certain annual limitations for utilization based on the above-described ownership change provisions. In addition, we may not be able to have sufficient future taxable income prior to their expiration because net operating losses have carryforward periods. Future changes in federal and state tax laws pertaining to net operating loss carryforwards may also cause limitations or restrictions from us claiming such net operating losses. If the net operating loss carryforwards become unavailable to us or are fully utilized, our future taxable income will not be

Table of Contents

shielded from federal and state income taxation absent certain U.S. federal and state tax credits, and the funds otherwise available for general corporate purposes would be reduced.

***If any product candidates in any respiratory program partnered with GSK are not approved by regulatory authorities or are determined to be unsafe or ineffective in humans, our business will be adversely affected and the price of our securities could fall.***

The FDA must approve any new medicine before it can be marketed and sold in the U.S. Our partner GSK must provide the FDA and similar foreign regulatory authorities with data from preclinical and clinical studies that demonstrate that the product candidates are safe and effective for a defined indication before they can be approved for commercial distribution. GSK will not obtain this approval for a partnered product candidate unless and until the FDA approves a NDA. The processes by which regulatory approvals are obtained from the FDA to market and sell a new product are complex, require a number of years and involve the expenditure of substantial resources. In order to market medicines in foreign countries, separate regulatory approvals must be obtained in each country. The approval procedure varies among countries and can involve additional testing, and the time required to obtain approval may differ from that required to obtain FDA approval. Approval by the FDA does not ensure approval by regulatory authorities in other countries, and approval by one foreign regulatory authority does not ensure approval by regulatory authorities in other foreign countries or by the FDA. Conversely, failure to obtain approval in one or more country may make approval in other countries more difficult.

Clinical studies involving product candidates partnered with GSK may reveal that those candidates are ineffective, inferior to existing approved medicines, unacceptably toxic, or that they have other unacceptable side effects. In addition, the results of preclinical studies do not necessarily predict clinical success, and larger and later-stage clinical studies may not produce the same results as earlier-stage clinical studies.

Frequently, product candidates that have shown promising results in early preclinical or clinical studies have subsequently suffered significant setbacks or failed in later clinical or non-clinical studies. In addition, clinical and non-clinical studies of potential products often reveal that it is not possible or practical to continue development efforts for these product candidates. If these studies are substantially delayed or fail to prove the safety and effectiveness of product candidates in development partnered with GSK, GSK may not receive regulatory approval for such product candidates and our business and financial condition will be materially harmed and the price of our securities may fall.

Several well-publicized Complete Response letters issued by the FDA and safety-related product withdrawals, suspensions, post-approval labeling revisions to include boxed warnings and changes in approved indications over the last several years, as well as growing public and governmental scrutiny of safety issues, have created a conservative regulatory environment. The implementation of new laws and regulations and revisions to FDA clinical trial design guidance have increased uncertainty regarding the approvability of a new drug. Further, there are additional requirements for approval of new drugs, including advisory committee meetings for new chemical entities, and formal risk evaluation and mitigation strategy at the FDA's discretion. These laws, regulations, additional requirements and changes in interpretation could cause non-approval or further delays in the FDA's review and approval of any product candidates in any respiratory program partnered with GSK.

***Even if product candidates in any respiratory program partnered with GSK receive regulatory approval, as is the case with RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®, commercialization of such products may be adversely affected by regulatory actions and oversight.***

Even if GSK receives regulatory approval for product candidates in any respiratory program partnered with GSK, this approval may include limitations on the indicated uses for which GSK can

Table of Contents

market the medicines or the patient population that may utilize the medicines, which may limit the market for the medicines or put GSK at a competitive disadvantage relative to alternative therapies. These restrictions make it more difficult to market the approved products.

For example, at the joint meeting of the Pulmonary-Allergy Drugs Advisory Committee and Drug Safety and Risk Management Advisory Committee of the FDA regarding the supplemental NDA for BREO® ELLIPTA® as a treatment for asthma, the advisory committee recommended that a large LABA safety trial with BREO® ELLIPTA® should be required in adults and in 12-17 year olds, similar to the ongoing LABA safety trials being conducted as an FDA Post-Marketing Requirement by each of the manufacturers of LABA containing asthma treatments.

In addition, the manufacturing, labeling, packaging, adverse event reporting, advertising, promotion and recordkeeping for the approved product remain subject to extensive and ongoing regulatory requirements. If we or GSK become aware of previously unknown problems with an approved product in the U.S. or overseas or at contract manufacturers' facilities, a regulatory authority may impose restrictions on the product, the contract manufacturers or on GSK, including requiring it to reformulate the product, conduct additional clinical studies, change the labeling of the product, withdraw the product from the market or require the contract manufacturer to implement changes to its facilities. GSK is also subject to regulation by regional, national, state and local agencies, including the Department of Justice, the Federal Trade Commission, the Office of Inspector General of the U.S. Department of Health and Human Services and other regulatory bodies as well as governmental authorities in those foreign countries in which any of the product candidates in any respiratory program partnered with GSK are approved for commercialization. The Federal Food, Drug, and Cosmetic Act, the Public Health Service Act and other federal and state statutes and regulations govern to varying degrees the research, development, manufacturing and commercial activities relating to prescription pharmaceutical products, including non-clinical and clinical testing, approval, production, labeling, sale, distribution, import, export, post-market surveillance, advertising, dissemination of information and promotion. Any failure to maintain regulatory approval will limit GSK's ability to commercialize the product candidates in any respiratory program partnered with GSK, which would materially and adversely affect our business and financial condition and which may cause the price of our securities to fall.

***We may not be successful in our efforts to expand our portfolio of royalty generating products.***

We may choose to acquire rights to one or more additional royalty generating products. However, we may be unable to license or acquire rights to suitable royalty generating products for a number of reasons. In particular, the licensing and acquisition of pharmaceutical product rights is a competitive area. Several more established companies are also pursuing strategies to license or acquire rights to royalty generating products. These established companies may have a competitive advantage over us. Other factors that may prevent us from licensing or otherwise acquiring rights to suitable royalty generating products include the following:

- we may be unable to license or acquire the rights on terms that would allow us to make an appropriate return from the product;
- companies that perceive us to be their competitors may be unwilling to assign or license their product rights to us; or
- we may be unable to identify suitable royalty generating products.

If we are unable to acquire or license rights to suitable royalty generating product candidates, our business may suffer.

Table of Contents

***We have a significant amount of debt including Convertible Subordinated Notes and Fixed Rate Royalty notes that are senior in capital structure and cash flow, respectively, to our common stockholders. Satisfying the obligations relating to our debt could adversely affect the amount or timing of distributions to our stockholders.***

As of December 31, 2015, we had approximately $753.2 million in total long-term liabilities outstanding, comprised primarily of $255.1 million in principal that remains outstanding under our 2.125% Convertible Subordinated Notes due 2023 (the "2023 Notes") and $493.2 million in principal that remains outstanding under our 9% Fixed Rate Royalty term notes due 2029 (the "2029 Notes" and with the 2023 Notes, the "Notes"). The 2023 Notes are unsecured debt and are not redeemable by us prior to the maturity date. Holders of the Notes may require us to purchase all or any portion of their Notes at 100% of their principal amount, plus any unpaid interest, upon a fundamental change. A fundamental change is generally defined to include a merger involving us, an acquisition of a majority of our outstanding common stock, and the change of a majority of our board without the approval of the board. In addition, to the extent we pursue and complete a monetization transaction, the structure of such transaction may qualify as a fundamental change under the Notes, which could trigger the put rights of the holders of the Notes, in which case we would be required to use a portion of the net proceeds from such transaction to repurchase any Notes put to us. Our 2029 Notes have rights to 40% of all royalty payments received from GSK related to RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® until the notes are paid in full.

Satisfying the obligations of this debt could adversely affect the amount or timing of any distributions to our stockholders. We may choose to repurchase, or refinance this debt through public or private equity or debt financings if we deem such financings available on favorable terms. If any or all of the Convertible Subordinated Notes are not converted into shares of our common stock before the maturity date, we will have to pay the holders the full aggregate principal amount of the Notes then outstanding. If the Fixed Rate Royalty are not refinanced or paid in full, then they will receive 40% of all future economics associated with RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® until the notes are paid in full. Any of the above payments could have a material adverse effect on our cash position. If we fail to satisfy these obligations, it may result in a default under the indenture, which could result in a default under certain of our other debt instruments, if any. Any such default would harm our business and the price of our securities could fall.

***If we lose key management personnel, or if we fail to retain our key employees, our ability to manage our business will be impaired.***

We have a small management team and very few employees. We are highly dependent on principal members of our management team and a small group of key employees to operate our business. Our company is located in northern California, which is headquarters to many other biotechnology and biopharmaceutical companies and many academic and research institutions. As a result, competition for certain skilled personnel in our market remains intense. None of our employees have employment commitments for any fixed period of time and they all may leave our employment at will. If we fail to retain our qualified personnel or replace them when they leave, we may be unable to continue our business operations, which may cause the price of our securities to fall.

***We rely and will continue to rely on outsourcing arrangements for many of our activities, including financial reporting and accounting and human resources.***

We currently have only 13 full-time employees and, as a result, we rely, and expect to continue to rely, on outsourcing arrangements for a significant portion of our activities, including financial reporting and accounting and human resources, as well as for certain functions as a public company. We may have limited control over these third parties and we cannot guarantee that they will perform their obligations in an effective and timely manner.

Table of Contents

***If we fail to maintain proper and effective internal control over financial reporting or if the interpretations, estimates or judgments utilized in preparing our financial statements prove to be incorrect, our operating results and our ability to operate our business could be harmed.***

The Sarbanes-Oxley Act requires, among other things, that we establish and maintain effective internal control over financial reporting and disclosure controls and procedures. Under the SEC's current rules, we are required to perform system and process evaluation and testing of our internal control over financial reporting to allow management to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our independent registered public accounting firm is also required to report on our internal control over financial reporting. Our testing and our independent registered public accounting firm's testing may reveal deficiencies in our internal control over financial reporting that are deemed to be material weaknesses and render our internal control over financial reporting ineffective. We have and expect to continue to incur substantial accounting and auditing expense and to expend significant management time in complying with the requirements of Section 404. If we are not able to maintain compliance with the requirements of Section 404 in a timely manner, or if we or our independent registered public accounting firm identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline and we could be subject to investigations or sanctions by the SEC, FINRA, NASDAQ or other regulatory authorities. In addition, we could be required to expend significant management time and financial resources to correct any material weaknesses that may be identified or to respond to any regulatory investigations or proceedings.

We are also subject to complex tax laws, regulations, accounting principles and interpretations thereof. The preparation of our financial statements requires us to interpret accounting principles and guidance and make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported revenue generated and expenses incurred during the reporting periods. Our interpretations, estimates and judgments are based on our historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for the preparation of our financial statements. GAAP presentation is subject to interpretation by the SEC, the Financial Accounting Standards Board ("FASB") and various other bodies formed to interpret and create appropriate accounting principles and guidance. In the event that one of these bodies disagrees with our accounting recognition, measurement or disclosure or any of our accounting interpretations, estimates or assumptions, it may have a significant effect on our reported results and may retroactively affect previously reported results. The need to restate our financial results could, among other potential adverse effects, result in us incurring substantial costs, affect our ability to timely file our periodic reports until such restatement is completed, divert the attention of our management and employees from managing our business, result in material changes to our historical and future financial results, result in investors losing confidence in our operating results, subject us to securities class action litigation, and cause our stock price to decline.

***As we continue to develop our business, our mix of assets and our sources of income may require that we register with the SEC as an "investment company" in accordance with the Investment Company Act of 1940.***

We have not been and have no current intention to register as an "investment company" under the Investment Company Act of 1940, or the 40 Act, because we believe the nature of our assets and the sources of our income currently exclude us from the definition of an investment company pursuant to Sections (3)(a)(1)(A), (3)(a)(1)(C) under the 40 Act and Rule 270.3a-1 of Title 17 of the Code of Federal Regulations. Accordingly, we are not currently subject to the provisions of the 40 Act, such as compliance with the 40 Act's registration and reporting requirements, capital structure requirements, affiliate transaction restrictions, conflict of interest rules, requirements for disinterested directors, and

Table of Contents

other substantive provisions. Generally, to avoid being a company that is an "investment company" under the 40 Act, it must both: (a) not be or hold itself out as being engaged primarily in the business of investing, reinvesting or trading in securities, and (b) either (i) not be engaged or propose to engage in the business of investing in securities or own or propose to acquire investment securities having a value exceeding 40% of the value of its total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis or (ii) not have more than 45% of the value of its total assets (exclusive of Government securities and cash items) consist of or more than 45% of its net income after taxes (for the last four fiscal quarters combined) be derived from securities. In addition, we would not be an "investment company" if an exception, exemption, or safe harbor under the 40 Act applies.

We monitor our assets and income for compliance with the tests under the 40 Act and seek to conduct our business activities to ensure that we do not fall within its definitions of "investment company." If we were to become an "investment company" and be subject to the strictures of the 40 Act, the restrictions imposed by the 40 Act would likely require changes in the way we do business and add significant administrative burdens to our operations. In order to ensure that we do not fall within the 40 Act, we may need to take various actions which we might otherwise not pursue. These actions may include restructuring the Company and/or modifying our mixture of assets and income.

Specifically, our mixture of debt vs. royalty assets is important to our classification as an "investment company" or not. In this regard, while we currently believe that none of the definitions of "investment company" apply to us, we may in the future rely on an exception under the 40 Act provided by Section 3(c)(5)(A). To qualify for Section 3(c)(5)(A), as interpreted by the staff of the SEC, we would be required to have at least 55% of our total assets in "notes, drafts, acceptances, open accounts receivable, and other obligations representing part or all of the sales price of merchandise, insurance, and services" (or Qualifying Assets). In a no-action letter issued to Royalty Pharma on August 13, 2010, the staff stated that royalty interests are Qualifying Assets under this exception. If the SEC or its staff in the future adopts a contrary interpretation or otherwise restricts the conclusions in the staff's no-action letter such that our royalty interests are no longer Qualifying Assets for purposes of Section 3(c)(5)(A), we could be required to register under the 40 Act.

The rules and interpretations of the SEC and the courts, relating to the definition of "investment company" are highly complex in numerous respects. While we currently intend to conduct our operations so that we will not be deemed an investment company, we can give no assurances that we will not determine it to be in the Company's and our stockholders' interest to register as an "investment company", not be deemed an "investment company" and not be required to register under the 40 Act.

**Risks Related to our Alliance with GSK**

***Because all our current and projected revenues are derived from products under the GSK Agreements, disputes with GSK could harm our business and cause the price of our securities to fall.***

All of our current and projected revenues are derived from products under the GSK Agreements. Any action or inaction by either GSK or us that results in a material dispute, allegation of breach, litigation, arbitration, or significant disagreement between the parties may be interpreted negatively by the market or by our investors, could harm our business and cause the price of our securities to fall. Examples of these kinds of issues include but are not limited to non-performance of contractual obligations and allegations of non-performance, disagreements over the relative marketing and sales efforts for our partnered products and other GSK respiratory products, disputes over public statements, and similar matters. In addition, while we obtained GSK's consent to the Spin-Off as structured, GSK could decide to challenge various aspects of our post-Spin-Off operation of Theravance Respiratory Company, LLC ("TRC"), the limited liability company jointly owned by us and Theravance Biopharma as violating or allowing it to terminate the GSK Agreements. Although we believe our operation of

Table of Contents

TRC fully complies with the GSK Agreements and applicable law, there can be no assurance that we would prevail against any such claims by GSK. Moreover, regardless of the merit of any claims by GSK, we may incur significant cost and diversion of resources in defending them. In addition, any market or investor uncertainty about the respiratory programs partnered with GSK or the enforceability of the GSK Agreements could result in significant reduction in the market price of our securities and other material harm to our business.

***Because GSK is a strategic partner as well as a significant stockholder, it may take actions that in certain cases are materially harmful to both our business or to our other stockholders.***

Although GSK beneficially owns approximately 28.1% of our outstanding capital stock as of February 16, 2016, it is also a strategic partner with rights and obligations under the GSK Agreements that cause its interests to differ from the interests of us and our other stockholders. In particular, GSK has a substantial respiratory product portfolio in addition to the partnered products that are covered by the GSK Agreements. GSK may make respiratory product portfolio decisions or statements about its portfolio which may be, or may be perceived to be, harmful to the respiratory products partnered with us. For example, GSK could promote its non-GSK/THRX respiratory products, delay or terminate the development or commercialization of the respiratory programs covered by the GSK Agreements, or take other actions, such as making public statements, that have a negative effect on our stock price. In this regard and by way of example, sales of Advair®, GSK's approved medicine for both COPD and asthma, continue to be significantly greater than sales of RELVAR®/BREO® ELLIPTA®, and GSK has indicated publicly that it intends to continue commercializing Advair®. Also, given the potential future royalty payments GSK may be obligated to pay under the GSK Agreements, GSK may seek to acquire us to reduce those payment obligations. The timing of when GSK may seek to acquire us could potentially be when it possesses information regarding the status of drug programs covered by the GSK Agreements that has not been publicly disclosed and is not otherwise known to us. As a result of these differing interests, GSK may take actions that it believes are in its best interest but which might not be in the best interests of either us or our other stockholders. In addition, upon regulatory approval of UMEC/VI/FF or a MABA/ICS in either the U.S. or the EU, GSK's diligent efforts obligations as to commercialization matters under the GSK Agreements will have the objective of focusing on the best interests of patients and maximizing the net value of the overall portfolio of products under the GSK Agreements. Since GSK's commercialization efforts following such regulatory approval will be guided by a portfolio approach across products in which we have retained our full interest and also products in which we now have only a portion of our former interest, GSK's commercialization efforts may have the effect of reducing the overall value of our remaining interests in the products covered by the GSK Agreements in the future. In addition, following the expiration of our governance agreement with GSK in September 2015, GSK is no longer subject to the restrictions thereunder regarding the voting of the shares of our capital stock owned by it.

***GSK has also indicated to us that it believes its consent may be required before we can engage in certain royalty monetization transactions with third parties, which may inhibit our ability to engage in these transactions.***

In the course of our discussions with GSK concerning the Spin-Off of Theravance Biopharma, GSK indicated to us that it believes that its consent may be required before we can engage in certain transactions designed to monetize the future value of royalties that may be payable to us from GSK under the GSK Agreements. GSK has informed us that it believes that there may be certain covenants included in these types of transactions that might violate certain provisions of the GSK Agreements. Although we believe that we can structure royalty monetization transactions in a manner that fully complies with the requirements of the GSK Agreements without GSK's consent, a third party in a proposed monetization transaction may nonetheless insist that we obtain GSK's consent for the transaction or re-structure the transaction on less favorable terms. We have obtained GSK's agreement

Table of Contents

that (i) we may grant certain pre-agreed covenants in connection with monetization of our interests in RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® and portions of our interests in TRC, and (ii) it will not unreasonably withhold its consent to our requests to grant other covenants, provided, among other conditions, that in each case, the covenants are not granted in favor of pharmaceutical or biotechnology company with a product either being developed or commercialized for the treatment of respiratory disease. If we seek GSK's consent to grant covenants other than pre-agreed covenants, we may not be able to obtain GSK's consent on reasonable terms, or at all. If we proceed with a royalty monetization transaction that is not otherwise covered by the GSK Agreement without GSK's consent, GSK could request that its consent be obtained or seek to enjoin or otherwise challenge the transaction as violating or allowing it to terminate the GSK Agreements. Regardless of the merit of any claims by GSK, we would incur significant cost and diversion of resources in defending against GSK's claims or asserting our own claims and GSK may seek concessions from us in order to provide its consent. Any uncertainty about whether or when we could engage in a royalty monetization transaction, the potential impact on the enforceability of the GSK Agreements or the loss of potential royalties from the respiratory programs partnered with GSK, could impair our ability to pursue a return of capital strategy for our stockholders ahead of our receipt of significant royalties from GSK, result in significant reduction in the market price of our securities and cause other material harm to our business.

***GSK's ownership of a significant percentage of our stock and its ability to acquire additional shares of our stock may create conflicts of interest, and may inhibit our management's ability to continue to operate our business in the manner in which it is currently being operated.***

As of February 16, 2016, GSK beneficially owned approximately 28.1% of our outstanding capital stock. As such, GSK could have substantial influence in the election of our directors, delay or prevent a transaction in which stockholders might receive a premium over the prevailing market price for their shares and have significant control over certain changes in our business. The procedures previously governing and restricting GSK offers to our stockholders to acquire outstanding voting stock and the restrictions regarding the voting of shares of our capital stock owned by it terminated upon the expiration of the governance agreement on September 1, 2015. Further, pursuant to our Certificate of Incorporation, we renounce our interest in and waive any claim that a corporate or business opportunity taken by GSK constitutes a corporate opportunity of ours unless such corporate or business opportunity is expressly offered to one of our directors who is a director, officer or employee of GSK, primarily in his or her capacity as one of our directors.

***GSK's significant ownership position and its rights under the governance agreement may deter or prevent efforts by other companies to acquire us, which could prevent our stockholders from realizing a control premium.***

As of February 16, 2016, GSK beneficially owned approximately 28.1% of our outstanding capital stock. As a result of GSK's significant ownership, other companies may be less inclined to pursue an acquisition of us and therefore we may not have the opportunity to be acquired in a transaction that stockholders might otherwise deem favorable, including transactions in which our stockholders might realize a substantial premium for their shares.

***GSK could sell or transfer a substantial number of shares of our common stock, which could depress the price of our securities or result in a change in control of our company.***

GSK is not subject to any contractual restrictions with us on its ability to sell or transfer our common stock on the open market, in privately negotiated transactions or otherwise, and these sales or transfers could create substantial declines in the price of our securities or, if these sales or transfers were made to a single buyer or group of buyers, could contribute to a transfer of control of our company to a third party. Sales by GSK of a substantial number of shares, or the expectation of such sales, could cause a significant reduction in the market price of our common stock.

Table of Contents

**Risks Related to Legal and Regulatory Uncertainty**

***If our trademarks and trade names are not adequately protected, then we may not be able to build name recognition in our markets of interest and our business may be adversely affected.***

Our registered or unregistered trademarks or trade names may be challenged, infringed, circumvented, declared generic or determined to be infringing on other marks. We may not be able to protect our rights to these trademarks and trade names, which are necessary to build name and brand recognition among potential partners or customers in our markets of interest. At times, competitors may adopt trademarks or trade names similar to ours, thereby impeding our ability to build name and brand identity and possibly leading to market confusion. In addition, there could be potential trademark or trade name infringement claims brought by owners of other registered trademarks or trademarks that incorporate variations of our registered or unregistered trademarks or trade names. There was also a risk that if there is confusion in the marketplace, the reputation, performance and/or actions of such third parties may negatively impact our stock price and our business. We therefore have, as of January 2016, adopted a new brand, Innoviva. Over the long term, if we are unable to establish name and brand recognition based on our trademarks and trade names, then we may not be able to compete effectively and our business may be adversely affected. If we fail to promote and maintain our brand successfully, or if we incur substantial expenses in an unsuccessful attempt to promote and maintain our brand, our business may be harmed.

***If the efforts of our partner, GSK, to protect the proprietary nature of the intellectual property related to products in any respiratory program partnered with GSK are not adequate, the future commercialization of any such product could be delayed, limited or prevented, which would materially harm our business and the price of our securities could fall.***

To the extent the intellectual property protection of products in any respiratory program partnered with GSK are successfully challenged or encounter problems with the U.S. Patent and Trademark Office or other comparable agencies throughout the world, the commercialization of these products could be delayed, limited or prevented. Any challenge to the intellectual property protection of a late-stage development asset or approved product arising from any respiratory program partnered with GSK could harm our business and cause the price of our securities to fall.

Our commercial success depends in part on products in any respiratory program partnered with GSK not infringing the patents and proprietary rights of third parties. Third parties may assert that these products are using their proprietary rights without authorization. In addition, third parties may obtain patents in the future and claim that use of GSK's technologies infringes upon these patents. Furthermore, parties making claims against GSK may obtain injunctive or other equitable relief, which could effectively block GSK's ability to further develop or commercialize one or more of the product candidates or products in any respiratory program partnered with GSK.

In the event of a successful claim of infringement against GSK, it may have to pay substantial damages, obtain one or more licenses from third parties or pay royalties. In addition, even in the absence of litigation, GSK may need to obtain licenses from third parties to advance its research or allow commercialization of the products. GSK may fail to obtain any of these licenses at a reasonable cost or on reasonable terms, if at all. In that event, GSK would be unable to further develop and commercialize one or more of the products, which could harm our business significantly. In addition, in the future GSK could be required to initiate litigation to enforce its proprietary rights against infringement by third parties. Prosecution of these claims to enforce its rights against others would involve substantial litigation expenses. If GSK fails to effectively enforce its proprietary rights related to our partnered respiratory programs against others, our business will be harmed, and the price of our securities could fall.

Table of Contents

**Risks Related to Ownership of our Common Stock**

***The price of our securities has been extremely volatile and may continue to be so, and purchasers of our securities could incur substantial losses.***

The price of our securities has been extremely volatile and may continue to be so. Between January 1, 2015 and December 31, 2015, the high and low sales prices of our common stock as reported on The NASDAQ Global Select Market varied between $20.20 and $6.78 per share. The stock market in general and the market for biotechnology and biopharmaceutical companies in particular have experienced extreme volatility that has often been unrelated to the companies' operating performance, in particular during the last several years. The following factors, in addition to the other risk factors described in this section, may also have a significant impact on the market price of our securities:

- any adverse developments or results or perceived adverse developments or results with respect to the commercialization of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® with GSK, including, without limitation, if payor coverage is lower than anticipated or if sales of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® are less than anticipated because of pricing pressure in the respiratory markets targeted by our partnered products or existing or future competition in the markets in which they are commercialized, including competition from existing and new products that are perceived as lower cost or more effective, and our royalty payments are less than anticipated;

- any positive developments or results or perceived positive developments or results with respect to the development of UMEC/VI/FF with GSK, including, without limitation if the new Phase 3 study (or any other closed triple Phase 3 studies that may be initiated in the future) is successful and GSK and the respiratory market in general view this triple combination therapy as significantly more beneficial than existing therapies, including RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®;

- any adverse developments or results or perceived adverse developments or results with respect to the on-going development of FF/VI with GSK, including, without limitation, any difficulties or delays encountered with regard to the regulatory path for FF/VI or any indication from clinical or non-clinical studies, including the large Phase 3b program, that FF/VI is not safe or efficacious or does not sufficiently differentiate itself from alternative therapies;

- any adverse developments or results or perceived adverse developments or results with respect to the on-going development of UMEC/VI with GSK, including, without limitation, any difficulties or delays encountered with regard to the regulatory path for UMEC/VI, any indication from clinical or non-clinical studies that UMEC/VI is not safe or efficacious;

- any adverse developments or perceived adverse developments in the field of LABAs, including any change in FDA policy or guidance (such as the pronouncement in February 2010 warning that LABAs should not be used alone in the treatment of asthma and related labeling requirements, the impact of the March 2010 FDA Advisory Committee discussing LABA clinical trial design to evaluate serious asthma outcomes or the FDA's April 2011 announcement that manufacturers of currently marketed LABAs conduct additional clinical studies comparing the addition of LABAs to inhaled corticosteroids versus inhaled corticosteroids alone);

- the occurrence of a fundamental change triggering a put right of the holders of the Notes or our inability, or perceived inability, to satisfy the obligations under the Notes when they become due;

- our incurrence of expenses in any particular quarter that are different than market expectations;

Table of Contents

the extent to which GSK advances (or does not advance) FF/VI, UMEC/VI, UMEC/VI/FF and the MABA program through development into commercialization in all indications in all major markets;

any adverse developments or perceived adverse developments with respect to our relationship with GSK, including, without limitation, disagreements that may arise between us and GSK;

announcements regarding GSK generally;

announcements of patent issuances or denials, technological innovations or new commercial products by GSK;

publicity regarding actual or potential study results or the outcome of regulatory review relating to products under development by GSK;

regulatory developments in the U.S. and foreign countries;

economic and other external factors beyond our control;

sales of stock by us or by our stockholders, including sales by certain of our employees and directors whether or not pursuant to selling plans under Rule 10b5-1 of the Securities Exchange Act of 1934;

relative illiquidity in the public market for our common stock (our three largest stockholders other than GSK collectively owned approximately 43.7% of our outstanding capital stock as of February 16, 2016 based on our review of publicly available filings); and,

potential sales or purchases of our capital stock by GSK.

***We may be unable to or elect not to continue returning capital to our stockholders***

We have a corporate goal of returning capital to stockholders and have paid quarterly dividends during the third and fourth quarters of 2014 and during the first three quarters of 2015. On October 28, 2015, we announced the acceleration of our capital return plan with a $150 million share repurchase program approved by our Board of Directors, replacing our quarterly dividend. As of December 31, 2015, we had repurchased an aggregate of $25.6 million under the repurchase program through a combination of a tender offer and open market purchases. Our announcement of our share repurchase program does not obligate us to repurchase any specific dollar amount or number of shares of common stock.

The payment of, or continuation of, capital returns to stockholders is at the discretion of our board of directors and is dependent upon our financial condition, results of operations, capital requirements, general business conditions, tax treatment of capital returns, potential future contractual restrictions contained in credit agreements and other agreements and other factors deemed relevant by our board of directors. Future capital returns may also be affected by, among other factors: our views on potential future capital requirements for investments in acquisitions and our working capital and debt maintenance requirements; legal risks; stock repurchase programs; changes in federal and state income tax laws or corporate laws; and changes to our business model. Our capital returns may change from time to time, and we cannot provide assurance that we will continue to provide any particular amounts. A reduction or suspension in our capital returns programs could have a negative effect on our stock price.

***Concentration of ownership will limit your ability to influence corporate matters.***

As of February 16, 2016, GSK beneficially owned approximately 28.1% of our outstanding capital stock and our directors, executive officers and investors affiliated with these individuals beneficially owned approximately 1.6% of our outstanding capital stock. Based on our review of publicly available

Table of Contents

filings as of February 16, 2016, our three largest stockholders other than GSK collectively owned approximately 43.7% of our outstanding capital stock. These stockholders could control the outcome of actions taken by us that require stockholder approval, including a transaction in which stockholders might receive a premium over the prevailing market price for their shares. Following the expiration of the governance agreement in September 2015, GSK is no longer subject to the restrictions thereunder regarding the voting of the shares of our capital stock owned by it.

***Anti-takeover provisions in our charter and bylaws, in our rights agreement and in Delaware law could prevent or delay a change in control of our company.***

Provisions of our Certificate of Incorporation and Bylaws may discourage, delay or prevent a merger or acquisition that stockholders may consider favorable, including transactions in which you might otherwise receive a premium for your shares. These provisions include:

- requiring supermajority stockholder voting to effect certain amendments to our Certificate of Incorporation and Bylaws;
- restricting the ability of stockholders to call special meetings of stockholders;
- prohibiting stockholder action by written consent; and
- establishing advance notice requirements for nominations for election to the Board or for proposing matters that can be acted on by stockholders at meetings.

In addition, some provisions of Delaware law may also discourage, delay or prevent someone from acquiring us or merging with us.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

Our headquarters consists of a sublease of 4,847 square feet of space in South San Francisco, California, which expires in May 2020. Management believes that this facility is currently suitable and adequate to meet the company's anticipated near-term needs. We anticipate that following the expiration of the sublease, additional or alternative space will be available at commercially reasonable terms. We do not own or lease any other properties.

## ITEM 3. LEGAL PROCEEDINGS

We are not a party to any material legal proceedings.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

*Price Range of Common Stock*

Our common stock had been traded on NASDAQ under the symbol "THRX" from October 5, 2004 until January 8, 2016. Upon changing our corporate name to Innoviva, Inc. on January 7, 2016, we changed the stock ticker symbol to "INVA" effective January 11, 2016. The following table sets forth the high and low closing prices of our common stock on a per share basis for the periods indicated and as reported on The NASDAQ Global Select Market. On June 2, 2014, we completed the Spin-Off, in which each of our stockholders received one ordinary share of Theravance Biopharma for every 3.5 shares of our common stock. The closing price of Theravance Biopharma shares on the first day of regular trading was $23.51, which represents an adjustment of $6.72. The stock prices below have not been adjusted for the impact of the Spin-Off.

| | Market Price | | Dividends |
|---|---|---|---|
| **Calendar Quarter** | **High** | **Low** | **Declared** |
| **2015** | | | |
| Fourth Quarter | $ 10.87 | $ 7.57 | |
| Third Quarter | $ 17.42 | $ 6.78 | $ 0.25 |
| Second Quarter | $ 19.89 | $ 15.18 | $ 0.25 |
| First Quarter | $ 20.20 | $ 10.68 | $ 0.25 |
| Total | | | $ 0.75 |
| **2014** | | | |
| Fourth Quarter | $ 18.64 | $ 12.90 | $ 0.25 |
| Third Quarter | $ 30.40 | $ 17.09 | $ 0.25 |
| Second Quarter | $ 31.33 | $ 23.10 | |
| First Quarter | $ 40.49 | $ 30.17 | |
| Total | | | $ 0.50 |

*Holders*

As of February 16, 2016, there were 129 stockholders of record of our common stock. As many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

*Recent Sales of Unregistered Securities*

On March 5, 2015, May 11, 2015 and August 12, 2015, we completed the sale of 92,674, 85,579 and 245,828 shares of our common stock to Glaxo Group Limited, an affiliate of GSK, at a price of $18.06, $16.00 and $14.18, respectively, per share, resulting in aggregate gross proceeds of $6.5 million before deducting transaction expenses. Neither we nor the affiliate of GSK engaged any investment advisors with respect to the sale and no underwriting discounts or commissions were paid or will be paid to any party in connection with the sale. We issued and sold the shares in reliance upon an exemption from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended.

*Dividends*

During the first three quarters of 2015, we paid aggregate cash dividends of $87.3 million to our stockholders. The payment of, or continuation of capital returns to stockholders is at the discretion of

Table of Contents

our board of directors and is dependent upon our financial condition, results of operations, capital requirements, general business conditions, tax treatment of capital returns, potential future contractual restrictions contained in credit agreements and other agreements and other factors deemed relevant by our board of directors.

*Equity Compensation Plans*

In May 2012, we adopted the 2012 Equity Incentive Plan ("2012 Plan"). The number of shares of our common stock originally reserved for issuance under the 2012 Plan is equal to 6,500,000 shares plus up to 12,667,411 additional shares that may be added to the 2012 Plan in connection with the forfeiture, repurchase, cash settlement or termination of awards outstanding under the 2004 Equity Incentive Plan ("2004 Plan"), the 2008 New Employee Equity Incentive Plan, the 1997 Stock Plan and the Long-Term Stock Option Plan (collectively, the "Prior Plans") as of December 31, 2011. In connection with the Spin-Off, outstanding stock options and other awards, along with the number of shares remaining available for future stock options and other awards, were adjusted pursuant to the anti-dilution provisions of the 2012 Plan and Prior Plans. An additional 1,373,201 shares were added to the 2012 Plan share reserve as a result of the anti-dilution adjustment of the outstanding stock options and other awards granted under the 2012 Plan and the shares remaining available for future grant under the 2012 Plan. The additional 993,130 shares added to the Prior Plans as a result of the anti-dilution provisions are included in the 12,667,411 additional shares that may be added to the 2012 Plan.

While a maximum of 12,667,411 shares could be added to the 2012 Plan from the Prior Plans, this assumes that all the awards outstanding on December 31, 2011 will be forfeited, repurchased, cash settled or terminated. Therefore, the actual number that may be added to the 2012 Plan share reserve will likely be lower. No additional awards were made after May 15, 2012 under the 2004 Plan. Stock options and stock appreciation rights ("SARs") will reduce the 2012 Plan reserve by one share for every share granted, and stock awards other than options and SARs granted will reduce the 2012 Plan share reserve by 1.45 shares for every share granted. The 2012 Plan share reserve was also reduced by the number of stock awards granted under the 2004 Plan on or after January 1, 2012, using the same ratios described.

The 2012 Plan provides for the grant of incentive stock options, nonstatutory stock options, restricted stock awards, stock unit awards and SARs to our employees, non-employee directors and consultants. Stock options may be granted with an exercise price not less than the fair market value of the common stock on the grant date. Stock options granted to employees generally have a maximum term of 10 years and vest over a four-year period from the date of grant; 25% vest at the end of one year, and 75% vest monthly over the remaining three years. We may grant options with different vesting terms from time to time. Unless an employee's termination of service is due to disability or death, upon termination of service, any unexercised vested options will be forfeited at the end of three months or the expiration of the option, whichever is earlier. Additional information regarding stock-based compensation is included in Note 1, "Description of Operations and Summary of Significant Accounting Policies," and Note 6, "Stock-Based Compensation," to the consolidated financial statements appearing in this Annual Report on Form 10-K.

*Purchases of Equity Securities by the Issuer*

On October 28, 2015, we announced the acceleration of our capital return plan with a $150 million share repurchase program effective through the end of 2016 approved by our Board of Directors, replacing our quarterly dividend. The repurchases may be made by combination of tender offers, open market purchases, private transactions, exchange offers or other means. We are not obligated to repurchase any specific dollar amount or number of shares of common stock under the share repurchase program. We will determine when, if and how to proceed with any repurchase transactions

Table of Contents

under the program, as well as the amount of any such repurchase transactions, based upon, among other things, our evaluation of our liquidity and capital needs (including for strategic and other opportunities), our business, results of operations, and financial position and prospects, general financial, economic and market conditions, prevailing market prices for shares of our common stock, corporate, regulatory and legal requirements, and other conditions and factors deemed relevant by our management and Board of Directors from time to time. The share repurchase program may be suspended or discontinued at any time.

On October 30, 2015, we commenced a "modified Dutch auction" tender offer (October 2015 Tender Offer) to purchase up to $75 million of our common stock, at a price per share of not less than $8.50 and not greater than $9.25. The October 2015 Tender Offer expired on December 1, 2015. Share repurchase activity related to the share repurchase program during the fiscal quarter ended December 31, 2015 were as follows:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| October 30, 2015 to December 31, 2015 | 2,676,236(1) | $ 9.58 | 2,676,236(1) | $ 124,364,330 |

(1) Consists of 2,576,236 shares purchased in connection with the October 2015 Tender Offer and 100,000 shares purchased in the open market through our $150 million share repurchase plan, which was publicly announced on October 28, 2015. The share repurchase plan will expire on December 31, 2016.

*Stock Performance Graph*

The graph set forth below compares the cumulative total stockholder return on our common stock for the period commencing on December 31, 2010 and ending on December 31, 2015, with the cumulative total return of (i) the NASDAQ Composite Index, (ii) the NASDAQ Pharmaceutical Index and (iii) the NASDAQ Biotechnology Index over the same period. This graph assumes the investment of $100.00 on December 31, 2010 in each of (1) our common stock, (2) the NASDAQ Composite Index, (3) the NASDAQ Pharmaceutical Index and (4) the NASDAQ Biotechnology Index, and assumes the reinvestment of dividends.

The comparisons shown in the graph below are based upon historical data. We caution that the stock price performance shown in the graph below is not necessarily indicative of, nor is it intended to forecast, the potential future performance of our common stock. Information used in the graph was obtained from sources believed to be reliable including NASDAQ, Bloomberg and Reuters, but we are not responsible for any errors or omissions in such information.

Notwithstanding anything to the contrary set forth in any of our previous or future filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, that might incorporate this Annual Report on Form 10-K or future filings made by us under those statutes, this Stock Performance Graph section shall not be deemed filed with the SEC and shall not be deemed incorporated by reference into any of those prior filings or into any future filings made by us under those statutes.

Table of Contents

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN***

Among Innoviva, Inc., the NASDAQ Composite Index, the NASDAQ Pharmaceutical Index,
and the NASDAQ Biotechnology Index

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* $100 invested on December 31, 2010 in stock or index, including reinvestment of dividends. The performance chart for Innoviva is adjusted for the June 2014 Spin Off, in which each of our stockholders received one ordinary share of Theravance Biopharma for every 3.5 shares of our common stock.

Table of Contents

## ITEM 6. SELECTED FINANCIAL DATA

The selected consolidated summary financial data below should be read in conjunction with Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Part II, Item 8, "Financial Statements and Supplementary Data", in this Annual Report on Form 10-K. The historical results are not necessarily indicative of the results to be expected in any future period.

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2012 | 2011 |
| | (In thousands, except per share data) | | | | |
| **CONSOLIDATED STATEMENT OF OPERATIONS DATA** | | | | | |
| Net revenue | $ 53,949 | $ 8,433 | $ 4,532 | $ 5,613 | $ 9,658 |
| Operating expenses: | | | | | |
| Research and development | 2,619 | 7,498 | 9,038 | 8,153 | 8,560 |
| General and administrative | 19,750 | 34,864 | 24,289 | 22,606 | 22,382 |
| Total operating expenses(1) | 22,369 | 42,362 | 33,327 | 30,759 | 30,942 |
| Income (loss) from operations | 31,580 | (33,929) | (28,795) | (25,146) | (21,284) |
| Interest and other income (expense), net | 1,463 | (2,709) | 7,510 | 460 | 415 |
| Interest expense | (51,803) | (36,892) | (9,348) | (6,003) | (6,022) |
| Loss from continuing operations | (18,760) | (73,530) | (30,633) | (30,689) | (26,891) |
| Income (loss) from discontinued operations(1) | | (94,934) | (140,068) | 12,147 | (88,453) |
| Net loss | $ (18,760) | $ (168,464) | $ (170,701) | $ (18,542) | $ (115,344) |
| Basic and diluted net loss per share: | | | | | |
| Continuing operations, net of tax | $ (0.16) | $ (0.66) | $ (0.30) | $ (0.34) | $ (0.33) |
| Discontinued operations | | (0.84) | (1.37) | 0.14 | (1.08) |
| Total | $ (0.16) | $ (1.50) | $ (1.67) | $ (0.20) | $ (1.41) |
| Shares used to compute basic and diluted net loss per share | 115,372 | 112,059 | 102,425 | 90,909 | 82,051 |
| Cash dividends declared per common share | $ 0.75 | $ 0.50 | $ | $ | $ |

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2012 | 2011 |
| | (In thousands) | | | | |
| **CONSOLIDATED BALANCE SHEET DATA** | | | | | |
| Cash, cash equivalents and marketable securities | $ 187,283 | $ 283,354 | $ 520,499 | $ 343,683 | $ 240,915 |
| Working capital | 200,834 | 238,426 | 398,794 | 231,167 | 199,267 |
| Total assets | 424,072 | 521,654 | 681,255 | 368,582 | 258,782 |
| Long-term liabilities | 753,226 | 731,247 | 297,729 | 183,588 | 300,338 |
| Accumulated deficit | (1,692,427) | (1,673,667) | (1,505,203) | (1,334,502) | (1,315,960) |
| Total stockholders' (deficit) equity | $ (342,645) | $ (223,349) | $ 299,122 | $ 155,028 | $ (87,052) |

(1)

Stock-based compensation expense included in total operating expenses is as follows:

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2012 | 2011 |
| | (In thousands) | | | | |
| Research and development | $ 1,036 | $ 2,781 | $ 573 | $ 475 | $ 725 |
| General and administrative | 5,837 | 12,980 | 7,325 | 7,310 | 8,159 |
| Stock-based compensation from continuing operations | 6,873 | 15,761 | 7,898 | 7,785 | 8,884 |
| Stock-based compensation from discontinued operations | | 11,629 | 17,789 | 15,998 | 16,032 |
| Total stock-based compensation | $ 6,873 | $ 27,390 | $ 25,687 | $ 23,783 | $ 24,916 |

Table of Contents

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis (MD&A) is intended to facilitate an understanding of our business and results of operations. This discussion and analysis should be read in conjunction with our consolidated financial statements and notes included in this Annual Report on Form 10-K. The information contained in this discussion and analysis or set forth elsewhere in this Annual Report on Form 10-K, including information with respect to our plans and strategy for our business, our operating expenses, and future payments under our collaboration agreements, includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements are based upon current expectations that involve risks and uncertainties. You should review the section entitled "Risk Factors" in Item 1A of Part I above for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis. See the section entitled "Special Note Regarding Forward Looking Statements" above for more information.

**Management Overview**

Innoviva, Inc. is focused on bringing compelling new medicines to patients in areas of unmet need by leveraging its significant expertise in the development, commercialization and financial management of bio-pharmaceuticals, to maximize the commercial potential of its respiratory assets partnered with Glaxo Group Limited ("GSK"), including RELVAR®/BREO® ELLIPTA® (fluticasone furoate/ vilanterol, "FF/VI") and ANORO® ELLIPTA® (umeclidinium bromide/ vilanterol, "UMEC/VI"). Under the Long-Acting Beta*2* Agonist ("LABA") Collaboration Agreement and the Strategic Alliance Agreement with GSK (referred to herein collectively as the "GSK Agreements"), we are entitled to receive annual royalties from GSK on sales of RELVAR®/BREO® ELLIPTA® as follows: 15% on the first $3.0 billion of annual global net sales and 5% for all annual global net sales above $3.0 billion. For other products combined with a LABA from the LABA collaboration, such as ANORO ELLIPTA , royalties are upward tiering and range from 6.5% to 10%. Innoviva is also entitled to 15% of any future payments made by GSK under its agreements originally entered into with us, and since assigned to Theravance Respiratory Company, LLC ("TRC"). In June 2014, we spun-off our research and development activities by distributing the outstanding shares of Theravance Biopharma, Inc. ("Theravance BioPharma") on a pro-rata basis to our stockholders (the "Spin-Off"), which resulted in Theravance Biopharma becoming an independent, publicly traded company.

We have designed our company structure and organization to be tailored to our focused activities of managing our respiratory assets with GSK, the commercial and developmental obligations associated with the GSK Agreements, intellectual property, licensing operations, business development activities and providing for certain essential reporting and management functions of a public company. As of December 31, 2015, we had 13 employees. Our revenues consist of royalties and potential milestone payments, if any, from our respiratory partnership agreements with GSK.

**Financial Highlights**

In the year ended December 31, 2015, our net loss from continuing operations was $18.8 million, a decrease of $54.7 million from a net loss from continuing operations $73.5 million in the year ended December 31, 2014, primarily due to an increase in net royalty revenue and a decrease in employee-related expenses, including stock-based compensation expense. Cash, cash equivalents, and marketable securities, totaled $187.3 million on December 31, 2015, a decrease of $96.1 million from December 31, 2014. The decrease was due primarily to the payments of cash dividends of $87.3 million and repurchase of common stock of $25.6 million. These outflows were partially offset by net proceeds of

Table of Contents

$10.1 million from cash provided by operating activities and proceeds of $6.0 million from issuance of common stock.

***Declaration and Payment of Cash Dividends***

During the first three quarters of 2015, our board of directors declared a quarterly dividend of $0.25 per share of common stock to stockholders resulting in aggregate cash dividends of $87.3 million paid to our stockholders in the year ended December 31, 2015. In connection with the payments of these cash dividends, the conversion rate with respect to our 2.125% Convertible Subordinated Notes due 2023 (the "2023 Notes") was adjusted.

***Share Repurchase Plan***

On October 28, 2015, we announced the acceleration of our capital return plan with a $150 million share repurchase program effective through the end of 2016 approved by our Board of Directors, replacing our quarterly dividend. The repurchases may be made by a combination of tender offers, open market purchases, private transactions, exchange offers or other means. The repurchase program will be funded using our working capital. Our announcement of the share repurchase program does not obligate us to repurchase any specific dollar amount or number of shares of common stock. We will determine when, if and how to proceed with any repurchase transactions under the program, as well as the amount of any such repurchase transactions, based upon, among other things, the results of the tender offer and our evaluation of our liquidity and capital needs (including for strategic and other opportunities), our business, results of operations, and financial position and prospects, general financial, economic and market conditions, prevailing market prices for our shares of common stock, corporate, regulatory and legal requirements, and other conditions and factors deemed relevant by our management and Board of Directors from time to time. The share repurchase program may be suspended or discontinued at any time. There can be no assurance as to the actual volume of any share repurchases in any given period or over the term of the program or as to the manner or terms of any such repurchases.

On October 30, 2015, we commenced a "modified Dutch auction" tender offer as a component of the share repurchase plan to purchase up to $75 million of our common stock, at a price per share of not less than $8.50 and not greater than $9.25. The tender offer expired on December 1, 2015 and we purchased an aggregate of 2,576,236 shares of our common stock at a purchase price of $9.25 per share for a total value of approximately $23.8 million, excluding fees and expenses relating to the tender offer.

From December 1, 2015 to December 31, 2015, we purchased 100,000 shares of our common stock at a purchase price of $9.95 per share for a total value of approximately $1.0 million in the open market.

**Recent Highlights**

In January 2016, we announced our corporate name change from Theravance, Inc. to Innoviva, Inc.

Through January 29, 2016, Innoviva repurchased $37.3 million of stock under its previously announced $150 million share repurchase program through a combination of a "modified Dutch auction" tender offer (completed in December 2015) and open market purchases, with an average purchase price of $9.49 per share.

In the fourth quarter of 2015, net sales of RELVAR®/BREO® ELLIPTA® by GSK were $154.7 million, comprised of $72.5 million in the U.S. market (an increase 79 percent from the

Table of Contents

prior quarter in the U.S.) and $82.2 million in non-U.S. markets (an increase of 43 percent from the prior quarter).

As of December 31, 2015, RELVAR®/BREO® ELLIPTA® has been launched in 45 countries.

In the fourth quarter of 2015, sales of ANORO® ELLIPTA® by GSK were $45.4 million, an increase of 44 percent compared to the prior quarter. Sales were $31.2 million in the U.S. market (an increase of 42 percent from the prior quarter) and $14.2 million in non-U.S. markets (an increase of 48 percent from the prior quarter).

As of December 31, 2015, ANORO® ELLIPTA® has been launched in 38 countries

**Collaborative Arrangements with GSK**

***LABA Collaboration***

In November 2002, we entered into our LABA Collaboration Agreement with GSK to develop and commercialize once-daily LABA products for the treatment of chronic obstructive pulmonary disease ("COPD") and asthma. For the treatment of COPD, the collaboration has developed two combination products: (1) RELVAR®/BREO® ELLIPTA® (FF/VI) (BREO® ELLIPTA® is the proprietary name in the U.S. and Canada and RELVAR® ELLIPTA® is the proprietary name outside the U.S. and Canada), a once-daily combination medicine consisting of a LABA, vilanterol (VI), and an inhaled corticosteroid (ICS), fluticasone furoate (FF) and (2) ANORO® ELLIPTA® (UMEC/VI), a once-daily medicine combining a long-acting muscarinic antagonist ("LAMA"), umeclidinium bromide (UMEC), with a LABA, VI.

As a result of the launch and approval of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® in the U.S., Japan and Europe, in accordance with the GSK Agreements, we were obligated to pay milestone fees to GSK totaling $220.0 million, all of which was paid as of December 31, 2014. Although we have no further milestone payment obligations to GSK pursuant to the LABA Collaboration Agreement, we continue to have ongoing development and commercialization activities under the GSK Agreements that are expected to continue over the life of the agreements. The milestone fees paid to GSK were recognized as capitalized fees paid to a related party, which are being amortized over their estimated useful lives commencing upon the commercial launch of the product.

We are entitled to receive annual royalties from GSK on sales of RELVAR®/BREO® ELLIPTA® as follows: 15% on the first $3.0 billion of annual global net sales and 5% for all annual global net sales above $3.0 billion. For other products combined with a LABA from the LABA collaboration, such as ANORO ELLIPTA , royalties are upward tiering and range from 6.5% to 10%.

***2004 Strategic Alliance***

In March 2004, we entered into the Strategic Alliance Agreement with GSK where GSK received an option to license exclusive development and commercialization rights to product candidates from certain of our discovery programs on pre-determined terms and on an exclusive, worldwide basis. In 2005, GSK licensed our MABA program for the treatment of COPD, and in October 2011, we and GSK expanded the MABA program by adding six additional Innoviva-discovered preclinical MABA compounds (the "Additional MABAs"). GSK is responsible for funding all future development, manufacturing and commercialization activities for product candidates in that program. As a result of the Spin-Off, we are only entitled to receive 15% of any contingent payments and royalties payable by GSK from sales of FF/UMEC/VI (and MABA, and MABA/FF) while Theravance Biopharma receives 85% of those same payments. See PART I, ITEM 1. BUSINESS Our Relationship with GSK -2004 Strategic Alliance, for more detail regarding the royalties payable by GSK under this program, if any.

Table of Contents

***Purchases of Common Stock by GSK***

Prior to 2015, affiliates of GSK purchased an aggregate of 31.6 million shares of our common stock. During 2015, GSK purchased 424,081 shares of our common stock pursuant to its periodic "top-up" rights under our Amended and Restated Governance Agreement, dated as of June 4, 2004, as amended, among us, GSK and certain GSK affiliates, for an aggregate purchase price of $6.5 million. GSK's periodic "top-up" rights terminated with the expiration of the governance agreement in September 2015. As of February 16, 2016, GSK beneficially owned approximately 28.1% of our outstanding capital stock.

**Critical Accounting Policies and Estimates**

Our management's discussion and analysis of our financial condition and results of operations is based on our financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements, as well as the reported revenue generated and expenses incurred during the reporting periods. Our estimates are based on our historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe that the accounting policies discussed below are critical to understanding our historical and future performance, as these policies relate to the more significant areas involving management's judgments and estimates.

***Revenue Recognition***

Revenue is recognized when the four basic criteria of revenue recognition are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed or determinable; and (4) collectability is reasonably assured. Where the revenue recognition criteria are not met, we defer the recognition of revenue by recording deferred revenue until such time that all criteria are met.

*Collaborative Arrangements and Multiple Element Arrangements*

We generate revenue from collaboration and license agreements for the development and commercialization of product candidates. Collaboration and license agreements may include non-refundable upfront payments, partial or complete reimbursement of research and development costs, supply arrangement, contingent payments based on the occurrence of specified events under our collaborative arrangements, license fees and royalties on sales of product candidates if they are successfully approved and commercialized. Our performance obligations under the collaborations may include the transfer of intellectual property rights in the form of licenses, obligations to provide research and development services and related materials, supply of active pharmaceutical ingredient ("API") and/or drug product, and obligations to participate on certain development and/or commercialization committees with the collaborative partners. We make judgments that affect the periods over which we recognize revenue. We periodically review our estimated periods of performance based on the progress under each arrangement and account for the impact of any changes in estimated periods of performance on a prospective basis.

On January 1, 2011, we adopted an accounting standards update that amends the guidance on accounting for new or materially modified multiple-element arrangements that we enter into subsequent to January 1, 2011. This guidance removed the requirement for objective and reliable evidence of fair value of the undelivered items in order to consider a deliverable a separate unit of

Table of Contents

accounting. It also changed the allocation method such that the relative-selling-price method must be used to allocate arrangement consideration to all the units of accounting in an arrangement. This guidance established the following hierarchy that must be used in estimating selling price under the relative-selling-price method: (1) vendor-specific objective evidence of fair value of the deliverable, if it exists, (2) third-party evidence of selling price, if vendor-specific objective evidence is not available or (3) vendor's best estimate of selling price ("BESP") if neither vendor-specific nor third-party evidence is available.

We may determine that the selling price for the deliverables within collaboration and license arrangements should be determined using BESP. The process for determining BESP involves significant judgment on our part and includes consideration of multiple factors such as estimated direct expenses and other costs, and available data. We have determined BESP for license units of accounting based on market conditions, similar arrangements entered into by third parties and entity-specific factors such as the terms of previous collaborative agreements, our pricing practices and pricing objectives, the likelihood that clinical trials will be successful, the likelihood that regulatory approval will be received and that the products will become commercialized. We have also determined BESP for services-related deliverables based on the nature of the services to be performed and estimates of the associated effort as well as estimated market rates for similar services.

For each unit of accounting identified within an arrangement, we determine the period over which the performance obligation occurs. Revenue is then recognized using either a proportional performance or straight-line method. We recognize revenue using the proportional performance method when the level of effort to complete our performance obligations under an arrangement can be reasonably estimated. Direct labor hours or full time equivalents are typically used as the measurement of performance. Any changes in the remaining estimated performance obligation periods under these collaborative arrangements will not have a significant impact on the results of operations, except for a change in estimated performance period resulting from the termination of a collaborative arrangement, which would result in immediate recognition of the related deferred revenue.

The GSK Agreements were entered into prior to January 1, 2011. The delivered items under these collaborative agreements did not meet the criteria required to be accounted for as separate accounting units for the purposes of revenue recognition. As a result, revenue from non-refundable, upfront fees and development contingent payments were recognized ratably over the expected term of our performance of research and development services under the agreements. These upfront or contingent payments received, pending recognition as revenue, were recorded as deferred revenue and recognized over the estimated performance periods.

Under the GSK Agreements, we recognized revenue of $54.0 million, $8.4 million and $4.5 million for the years ended December 31, 2015, 2014 and 2013. The remaining deferred revenue under the GSK Strategic Alliance Agreement is $4.0 million as of December 31, 2015. Any change in the estimated performance period, which is predominantly based on GSK's development timeline, will not have a significant impact on the results of operations, except for a change in estimated performance period resulting from the termination of the MABA program that would result in immediate recognition of the deferred revenue.

On January 1, 2011, we also adopted an accounting standards update that provides guidance on revenue recognition using the milestone method. Payments that are contingent upon achievement of a substantive milestone are recognized in their entirety in the period in which the milestone is achieved. Milestones are defined as events that can be achieved based on our performance and as to which, as of the inception of the arrangement, there is substantive uncertainty about whether the milestone will be achieved. Events that are contingent only on the passage of time or only on third-party performance are not considered milestones subject to this guidance. Further, the amounts received must relate solely to prior performance, be reasonable relative to all of the deliverables and payment terms in the

Table of Contents

agreement and commensurate with our performance to achieve the milestone after commencement of the agreement. Total contingent payments that may become payable to us under our collaborative agreements were up to $363.0 million as of December 31, 2015 and are considered non-substantive.

Under the GSK Agreements, royalty revenue earned is reduced by amortization expense resulting from the fees paid to GSK, which were recognized as capitalized fees paid to a related party. When amortization expense exceeds amounts recognized for royalty revenues from GSK, negative revenue would be reported in our consolidated statements of operations.

***Royalties***

We recognize royalty revenue on licensee net sales of products with respect to which we have royalty rights in the period in which the royalties are earned and reported to us and collectability is reasonably assured. Royalties are recognized net of amortization of capitalized fees paid to a related party associated with any approval and launch milestone payments made to GSK.

***Capitalized Fees paid to a Related Party***

We capitalize fees paid to licensors related to agreements for approved products or commercialized products. We capitalize these fees as capitalized fees paid to a related party ("Capitalized Fees") and amortize these Capitalized Fees on a straight-line basis over their estimated useful lives upon the commercial launch of the product, which is expected to be shortly after regulatory approval of such product. The estimated useful lives of these Capitalized Fees are based on a country-by-country and product-by-product basis, as the later of the expiration or termination of the last patent right covering the compound in such product in such country and 15 years from first commercial sale of such product in such country, unless the agreement is terminated earlier. Consistent with our policy for classification of costs under the research and development collaborative arrangements, the amortization of these Capitalized Fees is recognized as a reduction of royalty revenue.

We review our Capitalized Fees for impairment when events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The recoverability of Capitalized Fees is measured by comparing the asset's carrying amount to the expected undiscounted future cash flows that the asset is expected to generate. The determination of recoverability typically requires various estimates and assumptions, including estimating the useful life over which cash flows will occur, their amount, and the asset's residual value, if any. We derive the required cash flow estimates from near-term forecasted product sales and long-term projected sales in the corresponding market.

Our gross Capitalized Fees of $220.0 million as of December 31, 2015 consist of registrational and launch-related to milestone fees paid to GSK (see "Collaborative Arrangements with GSK" above for more information). These Capitalized Fees are amortized over their estimated useful lives using the straight-line method commencing upon commercial launch.

***Fair Value of Stock-Based Compensation Awards***

We use the Black-Scholes-Merton option pricing model to estimate the fair value of options as of the date of grant. The Black-Scholes-Merton option valuation model requires the use of assumptions, including the expected term of the award and the expected stock price volatility. We use the "simplified" method as described in Staff Accounting Bulletin No. 107, "Share Based Payment," for the expected option term because the usage of our historical option exercise data is limited due to post-IPO exercise restrictions. Beginning April 1, 2011, we have used our historical volatility to estimate expected stock price volatility. Prior to April 1, 2011, we used our peer company price volatility to estimate expected stock price volatility due to our limited historical common stock price volatility since our initial public offering in 2004. The estimated fair value of the option is expensed on a straight-line basis over the expected term of the grant.

Table of Contents

We estimated the fair value of restricted stock units ("RSUs") and restricted stock awards ("RSAs") based on the fair market values of the underlying stock on the dates of grant. The estimated fair value of time-based RSUs and RSAs is expensed on a straight-line basis over the expected term of the grant. The estimated fair value of performance-contingent RSUs and RSAs is expensed using an accelerated method over the requisite service period based on management's best estimate as to whether it is probable that the shares awarded are expected to vest. We assess the probability of the performance indicators being met on a continuous basis.

Stock-based compensation expense was calculated based on awards ultimately expected to vest and was reduced for estimated forfeitures as of the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differed from those estimates. The estimated annual forfeiture rates for stock options, RSUs and RSAs are based on our historical forfeiture experience.

We do not expect to recognize in the near future any tax benefit related to employee stock-based compensation expense as a result of the full valuation allowance on our deferred tax assets including deferred tax assets related to our net operating loss carry forwards.

For more information, refer to Note 6, "Stock-Based Compensation," to the consolidated financial statements appearing in this Annual Report on Form 10-K.

***Amortization of Debt Issuance Costs from Non-recourse Notes Payable, due 2029***

In April 2014, we entered into certain note purchase agreements relating to the private placement of $450.0 million aggregate principal amount of non-recourse 9% fixed rate term notes due 2029 (the "2029 Notes") issued by our wholly-owned subsidiary. The 2029 Notes are secured exclusively by a security interest in a segregated bank account established to receive 40% of royalties due to us under the LABA Collaboration with GSK commencing on April 1, 2014 and ending upon the earlier of full repayment of principal or May 15, 2029. The funds in the segregated bank account can only be used to make principal and interest payments on the 2029 Notes.

The 2029 Notes bear an annual interest rate of 9%, with interest and principal paid quarterly beginning November 15, 2014. The 2029 Notes may be redeemed at any time prior to maturity, in whole or in part, at specified redemption premiums. Prior to May 15, 2016, in the event that the specified portion of royalties received in a quarter is less than the interest accrued for the quarter, the principal amount of the 2029 Notes will increase by the interest shortfall amount for that period.

As part of this sale, we incurred approximately $15.3 million in transaction costs, which will be amortized to interest expense over the estimated life of the 2029 Notes based on the effective interest method. Since the principal and interest payments on the 2029 Notes are based on royalties from product sales, which will vary from quarter to quarter, the 2029 Notes may be repaid prior to the final maturity date in 2029. To the extent that the interest or principal payments are greater or less than our initial estimates or the timing of such payments is materially different than our original estimates, we will prospectively adjust the amortization of the debt issuance costs. There are a number of factors that could materially affect the amount and timing of the royalty payments due to us under the LABA Collaboration with GSK, most of which are not within our control. Such factors include, but are not limited to, the competitive landscape for approved products and developing therapies that compete with our partnered products, the ability of patients to be able to afford our partnered products, the size of the market for our partnered products, safety concerns in the marketplace for respiratory therapies in general and with our partnered products in particular, decisions as to the timing of product launches, pricing and discounts, and other events or circumstances that result in reduced royalty payments, all of which would result in an impact to the amount of debt issuance costs amortized.

Table of Contents

**Results of Operations**

***Net Revenue***

Total net revenue from continuing operations, as compared to the prior years, was as follows:

| | | | | Change | | | |
|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | 2015 | | 2014 | |
| (In thousands) | 2015 | 2014 | 2013 | $ | % | $ | % |
| Royalties from a related party | $ 66,887 | $ 18,417 | $ 1,945 | $ 48,470 | *% | $ 16,472 | *% |
| Less: amortization of capitalized fees paid to a related party | (13,823) | (11,066) | (743) | (2,757) | 25 | (10,323) | * |
| Royalty revenue | 53,064 | 7,351 | 1,202 | 45,713 | * | 6,149 | * |
| LABA collaboration | | | 1,815 | | | (1,815) | (100) |
| Strategic alliance MABA program license | 885 | 1,082 | 1,515 | (197) | (18) | (433) | (29) |
| Total net revenue from GSK | $ 53,949 | $ 8,433 | $ 4,532 | $ 45,516 | *% | $ (3,901) | 86% |

*

Not Meaningful

Total net revenue increased for the year ended December 31, 2015, compared to the year ended December 31, 2014. The increases are primarily due to higher sales of RELVAR®/BREO® ELLIPTA®, ANORO® ELLIPTA® not having been commercially launched until April 2014 and the approval in April 2015 of BREO® ELLIPTA® (FF/VI) as a once-daily inhaled treatment of asthma in patients aged 18 years and older in the U.S. Royalty revenue is reduced by amortization expense for capitalized fees paid to a related party.

Royalty revenue recognized in the year ended December 31, 2014 includes royalties from ANORO® ELLIPTA®, which was launched in the year ended December 31, 2014, and a full year of royalties from RELVAR®/ BREO® ELLIPTA®, which was launched in the fourth quarter of 2013. Royalty revenue recognized under the LABA Collaboration Agreement with GSK is reduced by amortization expense for Capitalized Fees, which commences upon commercial launch.

Revenue from collaborative arrangements includes deferred revenue under the LABA Collaboration Agreement with GSK, which was fully recognized by June 2013.

***Research & Development***

Research & Development ("R&D") expenses from continuing operations, as compared to the prior years, were as follows:

| | | | | Change | | | |
|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | 2015 | | 2014 | |
| (In thousands) | 2015 | 2014 | 2013 | $ | % | $ | % |
| Research and development expenses | $ 2,619 | $ 7,498 | $ 9,038 | $ (4,879) | (65)% | $ (1,540) | (17)% |

R&D expenses from continuing operations decreased for the year ended December 31, 2015 compared to the year ended December 31, 2014 primarily due to fewer costs incurred. Our research and development expenses are now primarily related to limited activities associated with the partnered respiratory assets with GSK. Stock-based compensation expense was higher during the year ended December 31, 2014 due to the achievement of performance conditions under a specified long-term retention and incentive equity awarded to certain employees in the year ended December 31, 2011.

43

Table of Contents

R&D expenses from continuing operations decreased in the year ended December 31, 2014 compared to the year ended December 31, 2013 primarily due to fewer allocated costs as our ongoing R&D operations were significantly smaller as a result of the Spin-Off.

***General & Administrative***

General and administrative expenses from continuing operations, as compared to the prior years, were as follows:

| | | | | Change | | | |
|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | 2015 | | 2014 | |
| (In thousands) | 2015 | 2014 | 2013 | $ | % | $ | % |
| General and administrative expenses | $ 19,750 | $ 34,864 | $ 24,289 | $ (15,114) | (43)% | $ 10,575 | 44% |

General and administrative expenses from continuing operations decreased in the year ended December 31, 2015 compared to the year ended December 31, 2014 primarily due to lower stock-based compensation expense and reduced overhead costs, mostly related to the reduced size of our operations following the Spin-Off in 2014. For the year ended December 31, 2014, stock-based compensation expense and employee-related costs were higher primarily due to the probable achievement of performance conditions under a special long-term retention and incentive equity and cash bonus awarded to certain employees in the year ended December 31, 2011.

General and administrative expenses from continuing operations increased in the year ended December 31, 2014 compared to the year ended December 31, 2013 primarily due to higher stock-based compensation expense and employee-related costs. This increase was primarily due to the probable achievement of performance conditions under a special long-term retention and incentive equity and cash bonus awarded to certain employees in the year ended December 31, 2011.

***Other Income (Expense), net and Interest Income***

Other income (expense), net and interest income, as compared to the prior years, were as follows:

| | | | | Change | | | |
|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | 2015 | | 2014 | |
| (In thousands) | 2015 | 2014 | 2013 | $ | % | $ | % |
| Other income (expense), net | $ 1,120 | $ (3,272) | $ 6,732 | $ 4,392 | (134)% | $ (10,004) | (149)% |
| Interest income | 343 | 563 | 778 | (220) | (39) | (215) | (28) |

Other income (expense), net increased in the year ended December 31, 2015 compared to the year ended December 31, 2014 primarily related to a realized gain of $1.2 million on the sale of all of the ordinary shares of Theravance Biopharma that we held as of December 31, 2014 in the first quarter of 2015.

Interest income decreased in the year ended December 31, 2015 as compared to the year ended December 31, 2014 primarily due to the full year effect of lower average cash balances resulting from the cash contribution to Theravance Biopharma in June 2014 and capital return programs in 2015.

Other income (expense), net in the year ended December 31, 2014 includes a charge of $3.8 million recognized for the unrealized loss as of December 31, 2014 on Theravance Biopharma, Inc. ordinary shares owned by us.

Interest income decreased in the year ended December 31, 2014 compared to the year ended December 2013 primarily due to lower average cash balances resulting from the cash contribution to Theravance Biopharma in June 2014 and registrational and launch-related milestone payments to GSK during the year ended December 31, 2014.

Table of Contents

Other income (expense), net in the year ended December 31, 2013 includes $1.4 million related to the change in fair value of the capped call instruments related to our convertible subordinated notes issued in the year ended December 31, 2013.

***Interest Expense***

Interest expense, as compared to the prior years, was as follows:

| | | | | Change | | | |
|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | 2015 | | 2014 | |
| (In thousands) | 2015 | 2014 | 2013 | $ | % | $ | % |
| Interest expense | $ 51,803 | $ 36,892 | $ 9,348 | $ 14,911 | 40% | $ 27,544 | 295% |

Interest expense increased in the year ended December 31, 2015 compared to the year ended December 31, 2014 primarily due to the issuance of our 2029 Notes in April 2014, and a subsequent increase of $43.2 million in the form of payment in kind ("PIK") to the outstanding principal balance, of which $22.7 million and $20.5 million was added during the years ended December 31, 2015 and 2014, respectively. See "Liquidity" section below for further information.

Interest expense increased in the year ended December 31, 2014 compared to the year ended December 31, 2013 primarily due to the issuance of our 2029 Notes in April 2014.

***Income Taxes***

As of December 31, 2015 and 2014, we had net operating loss carryforwards for federal income taxes of $1,174.7 million and $1,158.3 million, respectively. As of December 31, 2015 and 2014, we had federal research and development tax credit carryforwards of $45.2 million. We recorded a valuation allowance to offset in full the benefit related to our deferred tax assets because realization of these benefits is uncertain.

We had unrecognized tax benefits of $15.5 million as of December 31, 2015 and 2014. None of our currently unrecognized tax benefits would affect our effective income tax rate if recognized, due to the valuation allowance that currently offsets our deferred tax assets.

Utilization of net operating loss and tax credit carryforwards may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. We conducted an analysis through 2014 to determine whether an ownership change had occurred since inception. The analysis indicated that two ownership changes occurred in prior years. However, notwithstanding the applicable annual limitations, we estimate that no portion of the net operating loss or credit carryforwards will expire before becoming available to reduce federal and state income tax liabilities. Annual limitations may result in expiration of net operating loss and tax credit carryforwards before some or all of such amounts have been utilized.

***Discontinued Operations***

On June 1, 2014, we separated our research and drug development businesses from our late-stage partnered respiratory assets. The significant components of the research and drug development

Table of Contents

operations, which are presented as discontinued operations on the consolidated statements of operations, were as follows:

| | Year Ended December 31, | | | Change 2015 | | Change 2014 | |
|---|---|---|---|---|---|---|---|
| (In thousands) | 2015 | 2014 | 2013 | $ | % | $ | % |
| Net revenue | $ | $ 3,129 | $ 226 | $ (3,129) | (100)% | $ 2,903 | * |
| Income (loss) from discontinued operations | | (94,934) | (140,068) | 94,934 | (100) | 45,134 | (32)% |

*
Not Meaningful

There was no impact of the discontinued operations after the Spin-Off to our revenues and expenses for the year ended December 31, 2015.

Net revenues for the year ended December 31, 2014 includes revenue from collaborative arrangements, and products sales for which revenue recognition commenced in the first quarter of 2014, both of which were transferred to Theravance Biopharma as a part of the Spin-Off.

Loss from discontinued operations for the year ended December 31, 2014 primarily relates to R&D expenses incurred prior to June 1, 2014 in addition to external legal and accounting fees in connection with our separation strategy and the additional stock-based compensation and cash bonus expense recognized due to the achievement of performance conditions under a special long-term retention and incentive equity and cash bonus awarded to certain employees in the year ended December 31, 2011, both of which we started to incur in the year ended December 31, 2013.

Loss from discontinued operations decreased in the year ended December 31, 2014 compared to the year ended December 31, 2013 primarily due to the elimination of discontinued operations after the Spin-Off in June 2014.

**Liquidity and Capital Resources**

***Liquidity***

Since our inception, we have financed our operations primarily through private placements and public offerings of equity and debt securities and payments received under collaborative arrangements. In the year ended December 31, 2015, we have also received royalty payments from GSK from sales of RELVAR®/ BREO® ELLIPTA®, which was launched in the fourth quarter of 2013, and from ANORO® ELLIPTA®, which was launched during 2014. As of December 31, 2015, we had $187.3 million in cash, cash equivalents, and marketable securities.

As discussed above, on October 28, 2015, we announced that our Board of Directors approved a $150 million share repurchase program to be in effect through December 31, 2016. As of December 31, 2015, we had repurchased an aggregate of $25.6 of our common stock through the combination of a tender offer and open market purchases. There can be no assurance as to the actual volume of any share repurchases in any given period or over the term of the program or as to the manner or terms of any such repurchases.

Our Board of Directors declared a $0.25 per share dividend for each of the first, second and third quarters of 2015 for all stockholders of record as of the close of business on specified dates resulting in a total of $87.3 million in cash dividends to our stockholders in the year ended December 31, 2015.

Our Board of Directors declared a $0.25 per share dividend for each of the third and fourth quarter of 2014 for all stockholders of record as of the close of business on specified dates resulting in

Table of Contents

a total of $57.0 million in cash dividends paid to our stockholders in the year ended December 31, 2014.

On June 1, 2014, we contributed $393.0 million of cash, cash equivalents and marketable securities to Theravance Biopharma as initial funds for their operations, based on anticipated operating plans and financial forecasts as of the separation date. As a result of the reduction in our operations following the Spin-Off, we believe that cash from future royalty revenues, net of operating expenses, debt service and cash on hand, will be sufficient to fund our operations for at least the next twelve months.

In April 2014, we entered into certain note purchase agreements relating to the private placement of $450.0 million aggregate principal amount of non-recourse 9% fixed rate term notes due 2029 ("2029 Notes"). The 2029 Notes are secured exclusively by a security interest in a segregated bank account established to receive 40% of the royalties from global net sales and ending upon the earlier of full repayment of principal or May 15, 2029 due to us under the LABA Collaboration Agreement with GSK. Prior to May 15, 2016, in the event that the specified portion of royalties received in a quarter is less than the interest accrued for the quarter, the principal amount of the 2029 Notes will increase by the interest shortfall amount for that period, and considered as payment in kind ("PIK"). As of December 31, 2015, interest expense of $43.2 million was added to the principal balance of the 2029 Notes. We incurred approximately $15.3 million in debt issuance costs, which are being amortized to interest expense over the estimated life of the 2029 Notes.

As a result of the launch and approval of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® in the U.S., Japan and Europe, in accordance with the GSK Agreements, we were obligated to pay milestone fees to GSK totaling $220.0 million, all of which was paid as of December 31, 2014. We are not obligated to pay any additional milestones under the LABA Collaboration Agreement. These milestone fees paid to GSK were recognized as capitalized fees paid to a related party, which are being amortized over their estimated useful lives commencing upon commercial launch.

*Adequacy of cash resources to meet future needs*

We believe that our cash, cash equivalents and marketable securities will be sufficient to meet our anticipated operating needs for at least the next twelve months based upon current operating plans and financials forecasts. If our current operating plans and financial forecasts change, we may require additional funding sooner in the form of public or private equity offerings or debt financings. Furthermore, if in our view favorable financing opportunities arise, we may seek additional funding at any time. However, future financing may not be available in amounts or on terms acceptable to us, if at all. This could leave us without adequate financial resources to fund our operations as currently planned. In addition, we regularly explore debt restructuring and/or reduction alternatives, including through tender offers, redemptions, repurchases or otherwise, all consistent with the terms of our debt agreements.

*Cash Flows*

Cash flows, as compared to the prior years, were as follows:

| | Year Ended December 31, | | | Change | |
|---|---|---|---|---|---|
| **(In thousands)** | **2015** | **2014** | **2013** | **2015** | **2014** |
| Net cash provided by (used in) operating activities | $ 10,131 | $ (130,723) | $ (129,602) | $ 140,854 | $ (1,121) |
| Net cash provided by (used in) investing activities | 159,168 | (65,060) | (219,580) | 224,228 | 154,520 |
| Net cash provided by (used in) financing activities | (106,919) | 149,073 | 397,843 | (255,992) | (248,770) |

Table of Contents

*Cash Flows from Operating Activities*

Net cash provided by operating activities for the year ended December 31, 2015 of $10.1 million was primarily due to:

- $51.2 million provided by gross receipt of royalties from a related party after adjusting for a $15.7 million increase in receivables from collaborative arrangements; and
- $15.4 million used for operating expenses, after adjusting for $7.0 million of non-cash related items, consisting primarily of stock-based compensation expense; and
- $25.9 million used for interest payments on the 2023 Notes and 2029 Notes

Net cash used in operating activities for the year ended December 31, 2014 of $130.7 million was primarily due to:

- $100.5 million used for operating expenses;
- $15.9 million decrease in payable to Theravance Biopharma;
- $4.8 million increase in interest payments on convertible subordinated notes payable;
- $1.9 million used to increase inventories, all incurred prior to the Spin-Off;
- $7.7 million decrease in accounts payable primarily due to the timing of payments and our ongoing operations being significantly smaller due to the Spin-Off; and
- $3.2 million from the decrease in deferred revenue.

Net cash used in operating activities for the year ended December 31, 2013 of $129.6 million was primarily due to:

- $140.0 million used for operating expenses;
- $8.0 million used for interest payments on convertible subordinated notes payable;
- $5.2 million used to increase inventories and short term receivables;
- $8.2 million increase for cash, net of third party expenses, for the termination of our royalty participation agreement;
- $7.5 million increase in accrued liabilities, and
- $6.5 million received in upfront fees under our collaborative arrangements.

*Cash Flows from Investing Activities*

Net cash provided by investing activities for the year ended December 31, 2015 of $159.2 million was primarily due to $245.7 million of proceeds received from the sale of marketable securities and maturities of marketable securities, partially offset by $86.5 million in purchases of marketable securities.

Net cash used in investing activities in the year ended December 31, 2014 of $65.1 million was primarily due to $135.0 million used for payments to GSK for registrational and launch-related milestone fees, partially offset by $69.7 million from the sale and maturities of marketable securities, net of purchases.

Net cash used in investing activities in the year ended December 31, 2013 of $219.6 million was primarily due to $131.9 million in cash balances being invested in available-for-sale securities and $85.0 million used for milestone payments to GSK.

Table of Contents

*Cash Flows from Financing Activities*

Net cash used in financing activities for the year ended December 31, 2015 of $106.9 million was primarily due to $87.3 million of cash dividends paid to our stockholders, and $25.6 million paid for the repurchase of common stock, partially offset by $6.0 million of proceeds received from the issuance of our common stock.

Net cash provided by financing activities in the year ended December 31, 2014 of $149.1 million was primarily due to net proceeds of $434.7 million received from the private placement of our 2029 Notes and $48.9 million received from the issuance of our common stock. These increases were partially offset by $277.5 million of cash and cash equivalents contributed to Theravance Biopharma in connection with the Spin-Off and payments of cash dividends of $57.0 million to our stockholders.

Net cash provided by financing activities in the year ended December 31, 2013 of $397.8 million was primarily due to the net proceeds of $281.6 million received from the January 2013 issuance of 2.125% convertible subordinated notes due in 2023 and net proceeds from the issuances of our common stock of $153.0 million, which includes net proceeds of $126.0 million received from private placements of our common stock to an affiliate of GSK. These increases were partially offset by $36.8 million of payments on privately-negotiated capped call option transactions in connection with the issuance of the notes.

***Off-Balance Sheet Arrangements***

Upon the Spin-Off, our facility leases in South San Francisco, California were assigned to Theravance Biopharma. However, if Theravance Biopharma were to default on its lease obligations, we would be held liable by the landlord and thus, we have in substance guaranteed the lease payments for these facilities. We would also be responsible for lease-related payments including utilities, property taxes, and common area maintenance, which may be as much as the actual lease payments. As of December 31, 2015, the total remaining lease payments for the duration of the lease, which runs through May 2020, were $27.6 million. The carrying value of this lease guarantee was $1.3 million as of December 31, 2015 and is reflected in other long-term liabilities in our consolidated balance sheet.

***Commitments and Contingencies***

We indemnify our officers and directors for certain events or occurrences, subject to certain limits. We may be subject to contingencies that may arise from matters such as product liability claims, legal proceedings, shareholder suits and tax matters, as such, we are unable to estimate the potential exposure related to these indemnification agreements. We have not recognized any liabilities relating to these agreements as of December 31, 2015.

**Contractual Obligations and Commercial Commitments**

In April 2014, we entered into certain note purchase agreements relating to the private placement of $450.0 million aggregate principal amount of non-recourse 9% fixed rate term notes due 2029 issued by our wholly-owned subsidiary ("2029 Notes"). Since issuance, $43.2 million of interest expense has been added to the principal balance of the 2029 Note, of which $22.7 million and $20.5 million was added during the year ended December 31, 2015 and 2014, respectively.

Table of Contents

In the table below, we set forth our significant enforceable and legally binding obligations and future commitments as of December 31, 2015.

| | | Payment Due by Period | | | |
|---|---|---|---|---|---|
| **(In thousands)** | **Total** | **Less Than 1 Year** | **1 - 3 Years** | **3 - 5 Years** | **More Than 5 Years** |
| 2023 Notes | $ 295,767 | $ 5,421 | $ 10,842 | $ 10,842 | $ 268,662 |
| 2029 Notes | 493,162 | * | * | * | * |
| Facility leases** | 8911,904 | | | | |
| Other related costs, primarily legal fees | 773 | (623) | — | 150 | |
| Total | $ 8,150 | $ (5,213) | $ 223 | $ 3,160 | |
| Continuing operations[2] | $ 3,308 | | | $ 2,505 | |
| Discontinued operations | 4,842 | | | 655 | |
| Total | $ 8,150 | | | $ 3,160 | |

(1) Included in the restructuring charges of continuing operations for the three and nine months September 26, 2009 are net charges of $0.5 million and $0.9 million, respectively, for lease abandonment and facility closure costs related to certain facilities. Also included in the restructuring charges of continuing operations for the three and nine months ended September 26, 2009 are costs related to the divestiture and closure of discontinued businesses totaling $1.2 million and $2.5 million, respectively.

(2) Included in the restructuring charges of continuing operations for the three and nine months September 27, 2008 are charges of $0.7 million and $0.8 million for severance, and $1.7 million and $1.7 million, respectively, for lease abandonment and facility closure costs related to certain facilities. Also included in the restructuring charges of continuing operations for the three and nine months ended September 27, 2008 are costs related to the divestiture and closure of discontinued businesses totaling $0.8 million and $0.8 million, respectively.

13

**5. Long-Term Obligations**

Long-term obligations held by continuing operations consist of the following:

| *(dollars in thousands)* | **September 26, 2009** | **December 27, 2008** |
|---|---|---|
| 7% Senior Secured Notes due July 2010, net of unamortized discount of $9,184 and $20,713 at September 26, 2009 and December 27, 2008, respectively | $ 154,963 | $ 193,474 |
| 14% Senior-Subordinated Secured Second Lien Notes due December 2010, net of unamortized discount of $16,215 and $16,951 at September 26, 2009 and December 27, 2008, respectively | 119,472 | 91,505 |
| 7.5% Third Lien Subordinated Secured Convertible Notes due December 2011, net of unamortized discount of $148,605 and $185,382 at September 26, 2009 and December 27, 2008, respectively | 365,215 | 300,685 |
| Wireless spectrum leases, net of unamortized discounts of $17,206 and $18,973 at September 26, 2009 and December 27, 2008, respectively; expiring from 2011 through 2036 with one to five renewal options ranging from 10 to 15 years each | 25,250 | 24,419 |
| Collateralized non-recourse bank loan with interest at 30-day LIBOR plus 0.25%; principal and interest due upon sale of auction rate securities; secured by auction rate securities | 21,411 | 21,459 |
| Other | 1,300 | 1,322 |
| Long-term obligations held by continuing operations | 687,611 | 632,864 |
| Less current portion | (180,493) | (136,567) |
| Long-term portion | $ 507,118 | $ 496,297 |

*Senior, Second Lien and Third Lien Notes*

Under the terms of the purchase agreements for our Senior Notes and Second Lien Notes, we were required to enter into binding agreements to effect asset sales generating net proceeds of at least $350 million no later than March 31, 2009 and consummate such sales no later than six months following execution of such agreements, unless closing is delayed solely due to receipt of pending regulatory approvals (the “Asset Sale Condition”). We did not meet the Asset Sale Condition. As a result, pursuant to the terms of the note purchase agreements, the interest rate on the Senior Notes increased by 200 basis points effective March 31, 2009 and, on April 8, 2009, we issued additional warrants to purchase an aggregate of 10.0 million shares of our common stock at an exercise price of $0.01 per share to the purchasers of the Second Lien Notes. Of the warrants issued, 7.5 million were issued to Avenue AIV US, L.P., a related party. The warrants are exercisable at any time through April 6, 2012. The grant-date fair value of the warrants, which totaled $1.7 million, was recorded to additional paid-in capital and reduced the carrying value of the Second Lien Notes, and is recognized as additional interest expense over the remaining term of the Second Lien Notes.

On April 1, 2009, we obtained an amendment and waiver from the holders of our Senior Notes, Second Lien Notes, and Third Lien Notes that adjusts the Minimum Balance Condition from $15 million to $5 million, waives certain events of default relating to timely delivery of a new operating budget, permits us to issue up to $25 million of indebtedness on a pari passu basis with our Second Lien Notes, and allows us to pay certain holders of our Senior Notes payment-in-kind interest at a rate of 14%. Pursuant to the amendment and waiver, holders of 68% of the aggregate remaining outstanding principal balance of our Senior Notes at September 26, 2009 have elected to receive payment-in-kind interest in lieu of cash interest. As of September 26, 2009, we have accrued for $10.0 million in payment-in-kind interest which has been added to the outstanding principal balance of our Senior Notes in the consolidated balance sheet.

On July 2, 2009, we issued additional Second Lien Notes due 2010 in the aggregate principal amount of $15.0 million, on the same financial and other terms applicable to our existing Second Lien Notes. The Incremental Notes were issued with an original issuance discount of 5% resulting in gross proceeds of $14.3 million. After payment of transaction related expenses, we received net proceeds of $13.5 million to be used solely in connection with the ordinary course operations of our business and not for any acquisition of assets or businesses or other uses. The Incremental Purchaser was Avenue AIV US, L.P. In connection with the issuance of the Incremental Notes in July 2009, we issued warrants to purchase 7.5 million shares of our common stock at an exercise price of $0.01 per share to the purchaser of the Incremental Notes. The warrants are exercisable at any time from the date of issuance until June 2012. The grant-date fair value of the warrants, which totaled $3.5 million, was recorded to additional paid-in capital and reduced the carrying value of the Second Lien Notes, and is recognized as additional interest expense over the remaining term of the Second Lien Notes. We issued the Incremental Notes as an alternative to the working capital financing contemplated by the commitment letter we previously entered into with Navation, Inc., an entity controlled by Allen Salmasi, our Chairman.

14

**6. Related Party Transactions**

***Debt-Related Transactions***

As discussed in Note 5, we did not meet the Asset Sale Condition under the terms of the purchase agreements for our Senior Notes and Second Lien Notes. As a result, we issued additional warrants to purchase an aggregate of 10.0 million shares of our common stock at an exercise price of $0.01 per share to the purchasers of the Second Lien Notes. Of the warrants issued, 7.5 million were issued to Avenue AIV US, L.P., an affiliate of Avenue Capital Management II, L.P. ("Avenue Capital"). Robert Symington, a Senior Portfolio Manager with Avenue Capital, is a member of our Board of Directors. The warrants are exercisable at any time through April 6, 2012. The grant-date fair value of the warrants, which totaled $1.7 million, was recorded to additional paid-in capital and reduced the carrying value of the Second Lien Notes, and is recognized as additional interest expense over the remaining term of the Second Lien Notes.

On July 2, 2009, we issued additional Second Lien Notes due 2010 in the aggregate principal amount of $15.0 million, on the same financial and other terms applicable to our existing Second Lien Notes. The Incremental Purchaser was Avenue AIV US, L.P. In connection with the issuance of the Incremental Notes in July 2009, we issued warrants to purchase 7.5 million shares of our common stock at an exercise price of $0.01 per share to the purchaser of the Incremental Notes. The warrants are exercisable at any time from the date of issuance until June 2012. The grant-date fair value of the warrants, which totaled $3.5 million, was recorded to additional paid-in capital and reduced the carrying value of the Second Lien Notes, and is recognized as additional interest expense over the remaining term of the Second Lien Notes.

***Sale of Noncontrolling Interest in PacketVideo***

On July 2, 2009, we sold a 35% noncontrolling interest in our PacketVideo subsidiary to NTT DOCOMO, Inc. ("DOCOMO"), a customer of PacketVideo, for $45.5 million. PacketVideo sells a version of its multimedia player to DOCOMO for installation into DOCOMO handset models. The net proceeds from this transaction were used in July 2009 to redeem a portion of the Senior Notes at a redemption price of 105% of the principal amount thereof plus accrued interest.

Under the terms of the Stock Purchase Agreement, DOCOMO was granted certain rights in the event of future transfers of PacketVideo stock or assets, preemptive rights in the event of certain issuances of PacketVideo stock, and a call option exercisable under certain conditions to purchase the remaining shares of PacketVideo at the then current fair value. In addition, DOCOMO will have certain governance and consent rights applicable to the operations of PacketVideo. In order to facilitate the DOCOMO investment, NextWave's noteholders provided certain waivers, including a release of PacketVideo's guaranty of NextWave indebtedness.

During the three and nine months ended September 26, 2009, PacketVideo recognized $3.8 million in related party revenues from DOCOMO in the consolidated statements of operations.

**7. Comprehensive Loss**

Comprehensive loss attributable to the noncontrolling interest in subsidiary and NextWave are as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 26, | September 27, | September 26, | September 27, |
| *(in thousands)* | **2009** | **2008** | **2009** | **2008** |
| Net loss | $ (101,669) | $ (233,300) | $ (239,335) | $ (412,774) |
| Net unrealized gains on marketable securities | — | — | — | 10 |
| Foreign currency translation adjustment | 3,778 | (6,110) | 4,657 | (510) |
| Total comprehensive loss | (97,891) | (239,410) | (234,678) | (413,274) |
| Comprehensive loss attributable to noncontrolling interest in subsidiary | (632) | — | (632) | — |
| Comprehensive loss attributable to NextWave | $ (97,259) | $ (239,410) | $ (234,046) | $ (413,274) |

**8. Net Loss Per Common Share Information**

Basic and diluted net loss per common share for the three and nine months ended September 26, 2009 and September 27, 2008 is computed by dividing net loss attributable to NextWave common shares during the period by the weighted average number of common shares outstanding

during the respective periods, without consideration of common stock equivalents. In accordance with earnings per share accounting guidance, our weighted average number of common shares outstanding includes the weighted average of 57.5 million warrants exercisable for shares of our common stock that were outstanding as of September 26, 2009 as they are issuable for an exercise price of $0.01 each.

The following securities that could potentially dilute earnings per share in the future are not included in the determination of diluted loss per share as they are antidilutive. The share amounts are determined using a weighted average of the

shares outstanding during the respective periods and assume that the last day of the respective quarterly periods were the end dates of the contingency period for any contingently issuable shares in accordance with earnings per share accounting guidance.

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 26, | September 27, | September 26, | September 27, |
| *(in thousands)* | **2009** | **2008** | **2009** | **2008** |
| Third Lien Notes / Series A Preferred Stock | 45,662 | 35,319 | 44,830 | 34,666 |
| Outstanding stock options | 19,210 | 22,139 | 16,689 | 21,882 |
| Common stock warrants | 500 | 2,436 | 500 | 2,436 |
| Restricted stock | 11 | 151 | 480 | 94 |
| Contingently issuable shares under advisory contract | — | 833 | — | 833 |

In addition to the securities listed above, we issued 3.7 million and 2.5 million shares of our common stock in October 2009 in payment of additional purchase consideration in connection with our 2007 acquisitions of IPWireless and GO Networks, respectively.

**9. Stockholders' Deficit**

Changes in shares of common stock, stockholders' deficit attributable to NextWave and the noncontrolling interest in subsidiary and total stockholders' deficit for the nine months ended September 26, 2009 are as follows:

| *(in thousands)* | Shares of Common Stock | Stockholders' Deficit Attributable to NextWave | Noncontrolling Interest in Subsidiary | Total Stockholders' Deficit |
|---|---|---|---|---|
| Balance at December 27, 2008 | 103,092 | $ (56,116) | $ — | $ (56,116) |
| Sale of noncontrolling interest in our PacketVideo subsidiary | | 30,954 | 15,072 | 46,026 |
| Shares issued for stock options and warrants exercised, net of repurchases | 3,077 | 409 | — | 409 |
| Share-based compensation expense | — | 3,993 | 359 | 4,352 |
| Fair value of warrants issued in connection with the Second Lien Notes | — | 5,179 | — | 5,179 |
| Foreign currency translation adjustment | — | 4,260 | 397 | 4,657 |
| Net loss | — | (238,306) | (1,029) | (239,335) |
| Balance at September 26, 2009 | 106,169 | $ (249,627) | $ 14,799 | $ (238,828) |

The effect of the change in ownership interest between NextWave and the noncontrolling interest in subsidiary is as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 26, | September 27, | September 26, | September 27, |
| *(in thousands)* | **2009** | **2008** | **2009** | **2008** |
| Net loss attributable to NextWave | $ (100,640) | $ (233,300) | $ (238,306) | $ (412,774) |
| Transfers from the noncontrolling interest: | | | | |
| Increase in NextWave's additional paid-in capital for sale of 35% ownership interest in PacketVideo | 30,954 | — | 30,954 | — |
| Change from net loss attributable to NextWave and transfers from the noncontrolling interest | $ (69,686) | $ (233,300) | $ (207,352) | $ (412,774) |

**10. Share-Based Payments**

***NextWave Stock Option Plans***

At September 26, 2009, we may issue up to an aggregate of 31.1 million shares of NextWave common stock under our equity compensation plans, of which 19.4 million shares are reserved for issuance upon exercise of granted and outstanding options and 11.7 million shares are available for future grant.

The following table summarizes stock option activity under our equity compensation plans during the nine months ended September 26, 2009:

| | Number of Shares (in thousands) | Weighted Average Exercise Price per Share |
|---|---|---|
| Outstanding at December 27, 2008 | 16,259 | $ 6.71 |
| Granted | 12,920 | $ 0.36 |
| Exercised | (1,187) | $ 0.34 |
| Canceled | (8,567) | $ 6.77 |
| Outstanding at September 26, 2009 | 19,425 | $ 2.85 |
| Exercisable at September 26, 2009 | 12,635 | $ 3.32 |

We utilized the Black-Scholes option-pricing model for estimating the grant-date fair value of employee stock awards with the following assumptions:

| | Nine Months Ended | |
|---|---|---|
| | September 26, 2009 | September 27, 2008 |
| Risk-free interest rate | 2.13%-3.00% | 1.98%-3.47% |
| Expected life (in years) | 5.3-6.0 | 3.5-10.0 |
| Weighted average stock price volatility | 117% | 53% |
| Expected dividend yield | 0% | 0% |
| Weighted average grant-date fair value per share | $ 0.30 | $ 2.80 |

The risk-free interest rates are based on the implied yield available on U.S. Treasury constant maturities in effect at the time of the grant with remaining terms equivalent to the respective expected lives of the awards. Because we have a limited history of stock option exercises and due to the recent significant structural changes to our business resulting from the implementation of our global restructuring initiative, we determine the expected award life of each grant based primarily on the “simplified method” described in accounting guidance for share-based payments, and the expected award lives applied by certain of our peer companies. We determine expected volatility based primarily on our historical stock price volatility. We have never paid cash dividends and have no present intention to pay cash dividends on our common stock and therefore we have assumed a dividend yield of zero.

***PacketVideo Corporation 2009 Equity Incentive Plan***

In August 2009, the board of directors of our PacketVideo subsidiary approved the PacketVideo Corporation 2009 Equity Incentive Plan which provides for the issuance of up to 8.2 million shares of PacketVideo common stock for awards that may be issued under the plan. The Plan provides for the issuance of stock options, restricted stock awards and stock appreciation rights to employees, directors and consultants of PacketVideo. The options generally vest over four years and have a maximum contractual term of seven years. At September 26, 2009, PacketVideo may issue up to 8.2 million shares of common stock of PacketVideo, of which 6.4 million are granted and outstanding options and 1.8 million are available for future grants.

The following table summarizes stock option activity under the PacketVideo equity compensation plan during the nine months ended September 26, 2009:

| | Number of Shares (in thousands) | Weighted Average Exercise Price per Share |
|---|---|---|
| Outstanding at December 27, 2008 | — | $ — |
| Granted | 6,442 | $ 2.78 |
| Exercised | — | $ — |
| Canceled | — | $ — |
| Outstanding at September 26, 2009 | 6,442 | $ 2.78 |
| Exercisable at September 26, 2009 | — | $ — |

During the nine months ended September 26, 2009, we utilized the Black-Scholes option-pricing model for estimating the grant-date fair value of the PacketVideo employee stock awards using a risk-free interest rate of 2.45%, an expected life of 4.6 years, a stock price volatility of 64% and an expected dividend yield of 0%, resulting in a weighted average grant-date fair value of $1.49 per share.

The risk-free interest rates are based on the implied yield available on U.S. Treasury constant maturities in effect at the time of the grant with remaining terms equivalent to the respective expected lives of the awards. Because PacketVideo has a

limited history of stock option exercises, we determine the expected award life of each grant based primarily on the "simplified method" described in accounting guidance for share-based payments, and the expected award lives applied by certain of PacketVideo's peer companies. We determined expected volatility based primarily on an average of PacketVideo's peer companies' expected stock price volatilities due to lack of trading history of PacketVideo common stock. PacketVideo has never paid cash dividends and has no present intention to pay cash dividends on PacketVideo common stock and therefore we have assumed a dividend yield of zero.

The following table summarizes the share-based compensation expense for all plans included in each operating expense line item in our consolidated statements of operations:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 26, | September 27, | September 26, | September 27, |
| *(in thousands)* | **2009** | **2008** | **2009** | **2008** |
| Cost of revenues | $ 282 | $ 106 | $ 645 | $ 290 |
| Engineering, research and development | 350 | 413 | 846 | 1,060 |
| Sales and marketing | 43 | 27 | 190 | 202 |
| General and administrative | 618 | 651 | 2,338 | 2,757 |
| Total continuing operations | 1,293 | 1,197 | 4,019 | 4,309 |
| Discontinued operations | 59 | 2,449 | 333 | 4,384 |
| Total share-based compensation | $ 1,352 | $ 3,646 | $ 4,352 | $ 8,693 |

At September 26, 2009, the total unrecognized share-based compensation expense for all plans relating to unvested share-based awards granted to employees, net of forfeitures, was $15.4 million, which we anticipate recognizing as a charge against income over a weighted average period of 3 years.

**11. Fair Value Measurements**

***Assets and Liabilities Measured at Fair Value on a Recurring Basis***

The following table summarizes our assets and liabilities that require fair value measurements on a recurring basis and their respective input levels based on the fair value hierarchy contained in fair value measurements and disclosures accounting guidance:

| | | Fair Value Measurements September 26, 2009 Using: | | |
|---|---|---|---|---|
| | Fair Value at September 26, | Quoted Market Prices for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs |
| *(in thousands)* | **2009** | **(Level 1)** | **(Level 2)** | **(Level 3)** |
| Cash and cash equivalents | $ 23,000 | $ 23,000 | $ — | $ — |
| Auction rate securities[(1)] | 24,039 | — | — | 24,039 |
| Auction rate securities rights[(2)] | 1,211 | — | — | 1,211 |
| Embedded derivatives [(3)] | 18,992 | — | — | 18,992 |

(1) Included in restricted cash and marketable securities in the accompanying consolidated balance sheet.
(2) Included in other noncurrent assets in the accompanying consolidated balance sheet.
(3) Included in other long-term liabilities in the accompanying consolidated balance sheet.

Auction Rate Securities. At September 26, 2009, we estimated the fair value of our auction rate securities, which we have classified as trading securities under debt and equity securities accounting guidance, using a discounted cash flow model (Level 3 inputs), which measures fair value based on the present value of projected cash flows over a specific period. The values are then discounted to reflect the degree of risk inherent in the security and achieving the projected cash flows. The discounted cash flow model used to determine the fair value of the auction rate securities utilized a discount rate of 2.5%, which represents an estimated market rate of return, and an estimated period until sale and/or successful auction of the security of 1.0 year. The determination of the fair value of our auction rate securities also considered, among other things, the collateralization underlying the individual securities and the creditworthiness of the counterparty.

Auction Rate Securities Rights. Our auction rate securities rights allow us to sell our auction rate securities at par value to UBS at any time during the period of June 30, 2010 through July 2, 2012. We have elected to measure the fair value of the auction rate securities rights under financial instruments accounting guidance, which we believe will mitigate volatility in our reported earnings due to the inverse relationship between the fair value of the auction rate securities rights and the underlying auction rate securities. At September 26, 2009, we estimated the fair value of our auction rate securities rights using a discounted cash flow model, similar to the auction rate securities (Level 3 inputs). The discounted cash flow model utilized a discount rate of 1.0% and an estimated period until recovery of 1.0 years, which represents the period until the earliest date that we can exercise our auction rate securities rights.

Embedded Derivatives. Our obligation to redeem the Second Lien Notes and Third Lien Notes upon an asset sale and a change in control constitute embedded derivatives under derivatives and hedging accounting guidance. Accordingly, we have bifurcated the estimated fair value of each embedded derivative from the fair value of the Second Lien Notes and Third Lien Notes upon issuance, and recognized subsequent changes in the fair value of the embedded derivatives against income. We measured the estimated fair value of the Second Lien Notes and Third Lien Notes embedded derivatives using a probability-weighted discounted cash flow model (Level 3 inputs). The discounted cash flow model utilizes management assumptions of the probability of occurrence of redemption of the Second Lien Notes and Third Lien Notes upon an asset sale and a change in control.

The following table summarizes the activity in assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3 Inputs – see chart below):

| | | | Embedded Derivatives | | |
|---|---|---|---|---|---|
| *(in thousands)* | **Auction Rate Securities** | **Auction Rate Securities Rights** | **Second Lien Notes** | **Third Lien Notes** | **Total** |
| Balance at December 27, 2008 | $ 20,798 | $ 4,210 | $ (968) | $ (10,792) | $ 13,248 |
| Purchases, issuances, sales, exchanges and settlements | — | — | (182) | (203) | (385) |
| Unrealized gains (losses) included in other expense, net | 3,241 | (2,999) | (298) | (6,549) | (6,605) |
| Balance at September 26, 2009 | $ 24,039 | $ 1,211 | $ (1,448) | $ (17,544) | $ 6,258 |

***Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis***

The following table summarizes our assets and liabilities that were measured at fair value on a nonrecurring basis during the period and their respective input levels based on the fair value hierarchy contained in fair value measurements and disclosures accounting guidance:

| | | Fair Value Measurements Using: | | |
|---|---|---|---|---|
| *(in thousands)* | **Fair Value At September 26, 2009** | **Quoted Market Prices for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Wireless spectrum licenses held for sale | $ 60,609 | $ — | $ 60,609 | $ — |
| Property and equipment, net[(1)] | 13,699 | — | — | 13,699 |

(1) Includes property and equipment of continuing operations of $4.5 million, property and equipment of discontinued operations of $4.2 million and property and equipment held for sale by discontinued operations of $5.0 million.

Wireless Spectrum Licenses. Through our continued efforts to sell our remaining domestic spectrum licenses and our wireless spectrum licenses in Germany, we determined that the carrying value of these spectrum licenses exceeded their fair value based primarily on bids received and negotiations with third parties regarding the sale of these licenses. We estimated the fair value of these wireless spectrum licenses based on advanced negotiations and submitted bids from third parties for the purchase of the licenses (Level 2 Inputs – see chart above). Accordingly, during the three and nine months ended September 26, 2009, we wrote-down the carrying value of our domestic spectrum licenses and our wireless spectrum licenses in Germany to their estimated fair value and recognized asset impairment charges of $36.0 million and $52.2 million, respectively. For the three and nine months ended September 26, 2009, $13.8 million and $29.8 million is reported in continuing operations and $22.2 million and $22.4 million is reported in discontinued operations, respectively.

Property and Equipment, Net. In connection with the implementation of our global restructuring initiative, we continue to review our long-lived assets for impairment and, during the nine months ended September 26, 2009, determined that indicators of impairment were present for the long-lived assets in our semiconductor segment as well as certain other long-lived assets. Accordingly, based on the accounting guidance for impairment or disposal of long-lived assets, we performed an assessment to determine if the carrying value of these long-lived assets was recoverable through estimated undiscounted future cash flows resulting from the use of the assets and their eventual disposition (Level 3 inputs). Based on the impairment assessment performed, we determined that the carrying value of our property and equipment exceeded its estimated fair value and accordingly we recognized asset impairment charges of $5.2 million and $9.5 million during the three and nine months ended September 26, 2009, respectively.

The following table summarizes the activity in assets and liabilities measured at fair value on a non-recurring basis using significant unobservable inputs (Level 3 Inputs – see chart below):

| *(in thousands)* | Property and Equipment, Net |
|---|---|
| Balance at December 27, 2008 | $ 24,132 |
| Purchases and disposals, net | 1,209 |
| Depreciation expense | (2,388) |
| Asset impairment charges | (9,582) |
| Foreign currency and other | 328 |
| Balance at September 26, 2009 | $ 13,699 |

***Fair Value of Other Financial Instruments***

The carrying amounts of certain of our financial instruments of continuing operations, including cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and note payable to bank, approximate fair value due to their short-term nature. The carrying amounts and fair values of our long-term obligations of continuing operations are as follows:

| | September 26, 2009 | | December 27, 2008 | |
|---|---|---|---|---|
| *(in thousands)* | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Senior Notes | $ 154,963 | $ 150,530 | $ 193,474 | $ 171,822 |
| Second Lien Notes | 119,472 | 119,472 | 91,505 | 91,505 |
| Third Lien Notes | 365,215 | 365,215 | 300,685 | 300,685 |
| Wireless spectrum leases | 25,250 | 12,498 | 24,419 | 16,445 |

We determined the fair value of our Senior Notes and wireless spectrum licenses using a discounted cash flow model with a discount rate of 32.5% at September 26, 2009, which represents our estimated incremental borrowing rate. The Second and Third Lien Notes were measured at fair value upon issuance in October 2008 and July 2009.

**12. Legal Proceedings**

On September 16, 2008, a putative class action lawsuit, captioned Sandra Lifschitz, On Behalf of Herself and All Others Similarly Situated, Plaintiff, v. NextWave Wireless Inc., Allen Salmasi, George C. Alex and Frank Cassou, Defendants", was filed in the U.S. District Court for the Southern District of California against us and certain of our officers. The suit alleges that the defendants made false and misleading statements and/or omissions in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The suit seeks unspecified damages, interest, costs, attorneys' fees, and injunctive, equitable or other relief on behalf of a purported class of purchasers of our common stock during the period from March 30, 2007 to August 7, 2008. A second putative class action lawsuit captioned "Benjamin et al. v. NextWave Wireless Inc. et al." was filed on October 21, 2008 alleging the same claims on behalf of purchasers of our common stock during an extended class period, between November 27, 2006 through August 7, 2008. On February 24, 2009, the Court issued an Order consolidating the two cases and appointing a lead plaintiff pursuant to the Private Securities Litigation Reform Act. On May 15, 2009, the lead plaintiff filed an Amended Complaint, and on June 29, 2009, we filed a Motion to Dismiss that Amended Complaint. The Motion currently is pending with the Court. At this time, the case remains in the initial pleading stages and management is not able to offer any assessment as to the likelihood of prevailing on the merits.

We were notified on July 11, 2008 that the former stockholders of GO Networks filed a demand for arbitration in connection with the February 2008 milestone. In the demand, the stockholder representative claimed that we owed compensation to the former stockholders of GO Networks on the basis of GO Networks purportedly having partially achieved the February 2008 milestone under the acquisition agreement. The stockholder representative sought damages of $10.4 million. Further, on December 5, 2008, the stockholder representative amended his demand and added claims pertaining to the August 2008 milestone. In the claims, the stockholder representative asserted, among other claims, that we acted in bad faith in a manner that prevented the achievement of the milestone, and he sought damages of $12.8 million in connection with these additional claims. We disputed that the February 2008 milestone has been met and denied any wrongdoing with respect to the August 2008 milestone. In September 2009, the parties executed a settlement agreement and requested that the arbitration panel dismiss the matter with prejudice.

We are also currently involved in other legal proceedings in the ordinary course of our business operations. We estimate the range of liability related to pending litigation where the amount and range of loss can be estimated. We record our best estimate of a loss when the loss is considered probable. Where a liability is probable and there is a range of estimated loss with no best estimate in the range, we record the minimum estimated liability related to the claim. As additional information becomes available, we assess the potential liability related to our pending litigation and revise our estimates. As of September 26, 2009, other than the matters described above, we have not recorded any significant accruals for contingent liabilities associated with our legal proceedings based on our belief that a liability, while possible, is not probable. Further, any possible range of loss cannot be estimated at this time. Revisions to our estimate of the potential liability could materially

impact future results of operations.

**13. Indemnifications**

We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products. We have also entered into indemnification agreements with our officers and directors. Although the maximum potential amount of future payments we could be required to make under these indemnifications is unlimited, to date we have not incurred material costs to defend lawsuits or settle claims related to these indemnification provisions. Additionally, we have insurance policies that, in most cases, would limit our exposure and enable us to recover a portion of any amounts paid. Therefore, we believe the estimated fair value of these agreements is minimal and likelihood of incurring an obligation is remote. Accordingly, we have not accrued any liabilities in connection with these indemnification obligations as of September 26, 2009.

**14. Segment Information**

Our business is currently organized in two reportable segments on the basis of products, services and strategic initiatives as follows:

- Multimedia – device-embedded multimedia software, media content management platforms, and content delivery services delivered through our PacketVideo subsidiary.
- Strategic Initiatives – manages our portfolio of worldwide licensed wireless spectrum assets.

We evaluate the performance of our segments based on revenues and loss from operations excluding depreciation and amortization. Corporate overhead expenses and other income and charges are not allocated to segments in our internal management reports because they are not considered in evaluating the segments' operating performance. Unallocated income and charges include investment income on corporate investments and interest expense related to the Senior Notes, Second Lien Notes and Third Lien Notes and the change in the fair value of the embedded derivatives on the Second Lien Notes and Third Lien Notes, all of which were deemed not to be directly related to the businesses of the segments. We have no intersegment revenues.

Financial information for our continuing reportable segments for the three and nine months ended September 26, 2009 and September 27, 2008 is as follows:

| *(in thousands)* | **Multimedia** | **Strategic Initiatives** | **Other or Unallocated** | **Discontinued Operations** | **Consolidated** |
|---|---|---|---|---|---|
| **For the Three Months Ended:** | | | | | |
| **September 26, 2009** | | | | | |
| Revenues from external customers | $8,004 | $109 | $— | $— | $ 8,113 |
| Revenues – related party | 3,842 | — | — | — | 3,842 |
| Loss from operations | (2,514) | (14,701) | (7,224) | — | (24,439) |
| Significant non-cash and non-recurring items included in loss from operations above: | | | | | |
| Depreciation and amortization expense | 1,343 | 2,072 | 10 | — | 3,425 |
| Asset impairment charges | — | 13,764 | — | — | 13,764 |
| Restructuring charges | 30 | — | 1,682 | — | 1,712 |
| **September 27, 2008** | | | | | |
| Revenues from external customers | $16,876 | $— | $— | $— | $ 16,876 |
| Income (loss) from operations | (8) | 15,805 | (17,878) | — | (2,081) |
| Significant non-cash items included in loss from operations above: | | | | | |
| Depreciation and amortization expense | 1,536 | 2,520 | 1,074 | — | 5,130 |
| Asset impairment charges | — | — | 2,244 | — | 2,244 |
| Restructuring charges | 83 | — | 3,102 | — | 3,185 |
| **For the Nine Months Ended:** | | | | | |
| **September 26, 2009** | | | | | |
| Revenues from external customers | $36,949 | $114 | $— | $— | $ 37,063 |
| Revenues – related party | 3,842 | — | — | — | 3,842 |
| Loss from operations | (7,038) | (35,201) | (26,676) | — | (68,915) |
| Significant non-cash and non-recurring items included in loss from operations above: | | | | | |
| Depreciation and amortization expense | 4,285 | 6,589 | 140 | — | 11,014 |
| Asset impairment charges | — | 29,836 | 214 | — | 30,050 |
| Restructuring charges | 33 | 6 | 3,721 | — | 3,760 |
| **September 27, 2008** | | | | | |
| Revenues from external customers | $47,989 | $— | $— | $— | $ 47,989 |
| Income (loss) from operations | (4,456) | 8,939 | (45,141) | — | (40,658) |
| Significant non-cash items included in loss from operations above: | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Depreciation and amortization expense | 4,681 | 7,295 | 3,156 | — | 15,132 |
| Asset impairment charges | — | — | 2,244 | — | 2,244 |
| Restructuring charges | 83 | — | 3,225 | — | 3,308 |
| **At September 26, 2009** | | | | | |
| Total assets | $72,337 | $463,159 | $55,620 | $ 26,167 | $ 617,283 |
| Wireless spectrum licenses, intangible assets and goodwill | 55,001 | 462,297 | 72 | 14,280 | 531,650 |
| **At December 27, 2008** | | | | | |
| Total assets | $73,383 | $ 520,377 | $102,930 | $ 60,820 | $ 757,510 |
| Wireless spectrum licenses, intangible assets and goodwill | 57,505 | 519,071 | 81 | 36,094 | 612,751 |

**15. Subsequent Events**

In October 2009, we issued 3.7 million shares of our common stock to the former shareholders of IPWireless, as a result of the achievement of certain revenue milestones in 2007 as specified in the acquisition agreement, and 2.5 million shares to the former shareholders of GO Networks, as a result of an arbitration settlement.

On October 30, 2009, the Board of Directors of WiMAX Telecom GmbH, the holding company for NextWave's discontinued WiMAX Telecom business in Austria and Croatia, filed an insolvency proceeding in Austria in accordance with local law to permit the orderly wind-down of such entity. The court in Austria has entered an order appointing an administrator to manage the insolvency of WiMAX Telecom GmbH. As a result of the appointment of the administrator, NextWave no longer controls WiMAX Telecom GmbH and its subsidiaries and will not receive any proceeds from the assets of the WiMAX entities. NextWave has obtained a waiver of events of default resulting from the insolvency filing under its Senior Notes, Second Lien Notes and Third Lien Notes, including a rescission of the acceleration of maturity triggered as a result of such filing.

**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operation**

*In addition to historical information, the following discussion contains forward-looking statements that are subject to risks and uncertainties. Actual results may differ substantially from those referred to herein due to a number of factors, including but not limited to risks described in the section entitled Risk Factors and elsewhere in this Quarterly Report. Additionally, the following discussion and analysis should be read in conjunction with the consolidated financial statements and the notes thereto included in Item 1 of Part I of this Quarterly Report and the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 27, 2008 contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 2, 2009.*

**OVERVIEW**

**Third Quarter Highlights**

- Our revenues from continuing operations from our mobile multimedia segment for the third quarter of 2009 totaled $12.0 million compared to $16.9 million for the third quarter of 2008.
- Our revenues from continuing operations from our mobile multimedia segment for the first nine months of 2009 totaled $40.9 million compared to $48.0 million for the first nine months of 2008.
- During the third quarter and first nine months of 2009, we completed sales of certain of our owned AWS spectrum licenses in the United States to third parties for net proceeds (after deducting direct and incremental selling costs) of $21.2 million and $26.7 million, and recognized net gains on the sales of $1.6 million and $2.3 million, respectively. The net proceeds from the sales received after July 15, 2009 were used to redeem a portion of the Senior Notes at a redemption price of 102% of the principal amount thereof plus accrued interest and net proceeds received prior to July 16, 2009 were used to redeem a portion of the Senior Notes at a redemption price of 105% of the principal amount thereof plus accrued interest.
- During the third quarter of 2009 we issued additional Second Lien Notes due 2010 in the aggregate principal amount of $15.0 million, on the same financial and other terms applicable to our existing Second Lien Notes. The Incremental Notes were issued with an original issuance discount of 5% resulting in gross proceeds of $14.3 million. After payment of transaction related expenses, we received net proceeds of $13.5 million to be used solely in connection with the ordinary course operations of our business and not for any acquisition of assets or businesses or other uses.
- During the third quarter of 2009 we sold a 35% noncontrolling interest in our PacketVideo subsidiary to NTT DOCOMO, Inc. ("DOCOMO"), a customer of PacketVideo, for $45.5 million. The net proceeds from this transaction were used in July 2009 to redeem a portion of the Senior Notes at a redemption price of 105% of the principal amount thereof plus accrued interest.
- During the third quarter of 2009 we sold certain of our owned Semiconductor business patents and patent applications to Wi-Lan Inc, a Canadian intellectual property company, for a cash payment of $2.5 million and recognized $2.5 million as a gain from business divestitures during the three and nine months ended September 26, 2009.

**Our Business and Operating Segments**

NextWave Wireless Inc. is a holding company for mobile multimedia businesses and a significant wireless spectrum portfolio. As a result of our global restructuring initiative, our continuing operations are focused on two key segments: Multimedia, consisting of the operations of our wholly owned subsidiary PacketVideo, and Strategic Initiatives, focused on the management of our wireless spectrum interests.

In the second half of 2008, we commenced the implementation of our global restructuring initiative in an effort to reduce our working capital requirements, narrow our business focus and reorganize our operating units. Key results of this initiative include an approximately 53% reduction in our global workforce to date, the divestiture of our IPWireless network infrastructure business, the discontinuation of operations at our GO Networks, Cygnus, Global Services and NextWave Networks Products Support infrastructure businesses and our semiconductor business, and the closure of several facilities throughout the world. We anticipate that further implementation of our global restructuring initiative may result in additional headcount reductions and operating unit divestitures or discontinuations, including the divestiture or wind-down of our discontinued WiMax Telecom business. In July 2009, we sold our owned Semiconductor business patents and patent applications to Wi-Lan Inc, a Canadian intellectual property company for $2.5 million.

To further enhance our operational flexibility, on April 1, 2009, we obtained an amendment and waiver from the holders of our Senior Notes, Second Lien Notes, and Third Lien Notes that adjusts our minimum cash balance requirement from $15 million to $5 million, waives certain events of default relating to timely delivery of a new operating budget, permits us to issue up to $25 million of indebtedness on a pari passu basis with our Second Lien Notes, and allows us to pay certain holders of our Senior Notes payment-in-kind interest at a rate of 14%. Additionally, on July 2, 2009, we issued additional Second Lien Notes due 2010 (the "Incremental Notes") in the aggregate principal amount of $15.0 million, on the same financial and other terms applicable to our existing Second Lien Notes. The Incremental Notes were issued with an original issuance discount of 5%

resulting in gross proceeds of $14.3 million. After payment of transaction related expenses, we received net proceeds of $13.5 million to be used solely in connection with the ordinary course operations of our business and not for any acquisition of assets or businesses or other uses.

*Multimedia Segment*

PacketVideo was founded in 1998 and supplies multimedia software and services to many of the world's largest network operators and wireless handset manufacturers. These companies in turn use PacketVideo's platform to offer music and video services on mobile handsets, generally under their own brands. To date, over 250 million PacketVideo-powered handsets have been shipped worldwide. PacketVideo has been contracted by some of the world's largest carriers, such as Orange, DOCOMO, Rogers Wireless, TeliaSonera, TELUS Mobility, and Verizon Wireless to design and implement the embedded multimedia software capabilities contained in their handsets. PacketVideo's software is compatible with virtually all network technologies including CDMA, GSM, WiMAX, LTE and WCDMA.

In addition, since 2006 PacketVideo has offered software products for use on PCs, consumer electronics and other devices in the home. We believe that media consumption in the home and media consumption on mobile handsets is converging. PacketVideo's TwonkyMedia product line is designed to capitalize on this trend. PacketVideo has invested in the development and acquisition of a wide range of technologies and capabilities to provide its customers with software solutions to enable home/office digital media convergence using communication protocols standardized by the Digital Living Network Alliance. The TwonkyMedia suite of products that provide for content search, discovery, organization and content delivery/sharing amongst consumer electronics products connected to an Internet Protocol-based network. This powerful platform is designed to provide an enhanced user experience by intelligently responding to user preferences based on content type, day-part, and content storage location. In addition, PacketVideo's patented Digital Rights Management ("DRM") solutions, already in use by many wireless carriers globally, represent a key enabler of digital media convergence by preventing the unauthorized access or duplication of multimedia content used or shared by PacketVideo-enabled devices. Additionally, PacketVideo is one of the largest suppliers of Microsoft DRM technologies for the wireless market today.

Although we believe that PacketVideo's products are advantageous and well positioned for success, PacketVideo's business largely depends upon volume based sales of devices into the market. The economic downturn in the global markets has affected consumer spending habits. PacketVideo's customers and distribution partners, telecommunications companies and consumer electronics device manufacturers, are not immune to such uncertain and adverse market conditions. PacketVideo relies on these partners as distribution avenues for its developed products. Additionally, competitive pressures may cause further price wars in an effort to win or sustain business which will have an effect on overall margins and projections. If economic conditions continue to deteriorate, this may result in lower than expected sales volumes, resulting in lower revenue, gross margins, and operating income. In July 2009, a subsidiary of DOCOMO purchased a 35% noncontrolling interest in our PacketVideo subsidiary.

*Strategic Initiatives Segment*

Our strategic initiatives business segment is engaged in the management of our global wireless spectrum holdings. Our total spectrum holdings consist of approximately ten billion MHz points-of-presence ("POPs"), covering approximately 216.2 million total POPs, with 107.3 million POPs covered by 20 MHz or more of spectrum, and an additional 90.6 million POPs covered by at least 10 MHz of spectrum. In addition, a number of markets, including much of the New York metropolitan region, are covered by 30 MHz or more of spectrum. Our domestic spectrum resides in the 2.3 GHz Wireless Communication Services ("WCS"), 2.5 GHz Broadband Radio Service ("BRS")/Educational Broadband Service ("EBS"), and 1.7/2.1 GHz AWS bands and offers propagation and other characteristics suitable to support high-capacity, mobile broadband services.

Our international spectrum holdings include nationwide 3.5 GHz licenses in Austria, Croatia, Germany, Slovakia and Switzerland; a nationwide 2.0 GHz license in Norway; 2.3 GHz licenses in Canada; and 2.5 GHz licenses in Argentina and Chile, covering 145 million POPs.

We continue to pursue the sale of our wireless spectrum holdings and any sale or transfer of the ownership of our wireless spectrum holdings is subject to regulatory approval. We expect that we will be required to successfully monetize most of our wireless spectrum assets in order to retire our debt.

During the first nine months of 2009, we completed the sale of certain of our owned AWS spectrum licenses in the United States to a third party for net proceeds, after deducting direct and incremental selling costs, of $26.7 million, and recognized net gains on the sales of $2.3 million. The net proceeds from the sales received after July 15, 2009 were used to redeem a portion of the Senior Notes at a redemption price of 102% of the principal amount thereof plus accrued interest and net proceeds received prior to July 16, 2009 were used to redeem a portion of the Senior Notes at a redemption price of 105% of the principal amount thereof plus accrued interest.

To date, we have realized a positive return on the sale of the majority of our domestic AWS spectrum licenses. However, there can be no assurance that we will realize a similar return upon the sale of our remaining wireless spectrum holdings. The sale price of our wireless spectrum assets will be impacted by, among other things:

24

- the FCC's final resolution of ongoing proceedings regarding interference from satellite digital audio radio services to our WCS spectrum licenses;
- the timing and associated costs of build out or substantial service requirements attached to our domestic and international spectrum licenses, where a failure to comply with these requirements could result in license forfeiture;
- timing of closure of potential sales, in particular if it is necessary to accelerate the planned sale of certain of our spectrum licenses in order to meet debt payment obligations;
- worldwide economic conditions which we believe have adversely affected manufacturers of telecommunications equipment and technology and led to a delay in global network deployments; and
- availability of capital for prospective spectrum buyers, which has been negatively impacted by the downturn in the credit and financial markets.

As we have previously disclosed, our efforts to sell our wireless spectrum holdings on favorable terms has been delayed by current market conditions, as well as regulatory and other market activities involving potential buyers. We are continuing to have discussions with numerous parties who have expressed interest in our various spectrum assets. However, we believe that adverse economic conditions continue to affect potential purchasers of our wireless spectrum, and there can be no assurance as to the timing of further spectrum sales or the sales prices that will be attained.

**RESULTS OF OPERATIONS**

The results of operations of our Networks segment, which includes our GO Networks, IPWireless and Cygnus subsidiaries, and our Global Services and NextWave Network Product Support strategic business units, our Semiconductor segment and our WiMax Telecom business, have been reported as discontinued operations in the consolidated financial statements for all periods presented.

***Comparison of Our Third Quarter of 2009 to Our Third Quarter of 2008 – Continuing Operations***

**Revenues**

| | **Three Months Ended** | | |
|---|---|---|---|
| *(in millions)* | **September 26, 2009** | **September 27, 2008** | **Increase (Decrease)** |
| Revenues | $ 8.2 | $ 16.9 | $ (8.7) |
| License fee revenues – related party | 3.8 | — | 3.8 |
| Total revenues | $ 12.0 | $ 16.9 | $ (4.9) |

Total revenues from continuing operations for the third quarter of 2009 were $12.0 million, as compared to $16.9 million for the third quarter of 2008, a decrease of $4.9 million. Total revenues for both periods primarily consist of revenues generated by our Multimedia segment. The decrease in revenues was attributable to an acceleration of Sony Ericsson revenues of $1.5 million in the third quarter of 2008 due to the cancellation of a non-recurring development project, a decrease in revenues of $1.0 million attributable to other Sony Ericsson non-recurring business, a decrease in revenues of $1.5 million relating to other customer cancellations, in addition to lower royalty revenues in the third quarter of 2009 resulting from a decline in unit sales to mobile subscribers by wireless operators and device manufacturers. Unit sales were adversely impacted by worldwide economic conditions which caused a softening in consumer demand for new devices and services.

Related party revenues represent sales of a version of PacketVideo's multimedia player, to DOCOMO for installation into DOCOMO handset models. In July 2009, DOCOMO became a related party when its subsidiary purchased a 35% noncontrolling interest in our PacketVideo subsidiary.

Sales to two Multimedia customers, Verizon Wireless and DOCOMO, accounted for 42% and 32%, respectively, of our total revenues from continuing operations during the third quarter of 2009. Sales to three Multimedia customers, Verizon Wireless, DOCOMO and Sony Ericsson accounted for 33%, 21% and 15%, respectively, of our total revenues from continuing operations during the third quarter of 2008.

In general, the financial consideration received from wireless carriers and mobile phone and wireless device manufacturers is primarily derived from a combination of technology development contracts, royalties, software support and maintenance and wireless broadband products.

We expect that revenues from our Multimedia segment for fiscal year 2009 will be affected by the current adverse worldwide economic conditions, and among other things, new product and service introductions, competitive conditions, customer marketing budgets for introduction

of new subscriber products, the rate of expansion of our customer base, the build-out rate of wireless networks, price increases, subscriber device life cycles and demand for wireless data services.

**Operating Expenses**

| *(in millions)* | Three Months Ended September 26, 2009 | September 27, 2008 | Increase (Decrease) |
|---|---|---|---|
| Cost of revenues | $ 4.4 | $ 4.9 | $ (0.5) |
| Cost of revenues – related party | 0.1 | — | 0.1 |
| Engineering, research and development | 5.1 | 7.5 | (2.4) |
| Sales and marketing | 1.8 | 3.1 | (1.3) |
| General and administrative | 11.1 | 17.4 | (6.3) |
| Asset impairment charges | 13.8 | 2.2 | 11.6 |
| Restructuring charges | 1.7 | 3.2 | (1.5) |
| Total operating expenses | $ 38.0 | $ 38.3 | $ (0.3) |

***Cost of Revenues***

Total cost of revenues from continuing operations as a percentage of the associated revenues for the third quarter of 2009 was 38%, as compared to 29% for the third quarter of 2008. The decline in gross margins in the third quarter of 2009 reflects $1.7 million in lower royalty revenues, which have minimal associated cost of revenue and the recognition of relatively high margin revenue for Sony Ericsson in the third quarter of 2008 which did not recur in the third quarter of 2009.

Total cost of revenues from continuing operations, which consists entirely of cost of revenues generated by our Multimedia segment, primarily includes direct engineering labor expenses, allocated overhead costs, costs associated with offshore contract labor costs, other direct costs related to the execution of technology development contracts and amortization of purchased intangible assets.

Included in total cost of revenues during the third quarters of 2009 and 2008 is $0.7 million and $0.9 million, respectively, of amortization of purchased intangible assets. Also included in cost of revenues during the third quarters of 2009 and 2008 is $0.3 million and $0.1 million, respectively, of share-based compensation expense.

We believe that total cost of revenues as a percentage of revenue for future periods will be affected by, among other things, sales volumes, competitive conditions, product mix, changes in average selling prices, and our ability to make productivity improvements through continual cost reduction programs.

***Engineering, Research and Development***

The $2.4 million decrease in engineering, research and development expenses during the third quarter of 2009, as compared to the third quarter of 2008, is attributable primarily to an $2.1 million decrease in third party contract expenses and other operating expenses of our Multimedia segment resulting from cost reduction efforts during 2009, and reductions in our corporate engineering, research and development expenses resulting from the global restructuring initiative we implemented in the second half of 2008, which included reductions in workforce and certain overhead and discretionary costs. The compensation related costs incurred in relation to the employees terminated in connection with the restructuring are included in restructuring charges.

Included in engineering, research and development expenses during each of the third quarters of 2009 and 2008 is $0.4 million of share-based compensation expense.

We expect engineering, research and development expense to remain relatively flat throughout the remainder of 2009.

***Sales and Marketing***

The $1.3 million decrease in sales and marketing expenses from continuing operations during the third quarter of 2009, as compared to the third quarter of 2008, is primarily attributable to a $0.6 million decrease in the sales and marketing expenses of our Multimedia segment as a result of cost reduction actions implemented in the first quarter of 2009 and a $0.7 million decrease in our corporate marketing expenses resulting from the global restructuring initiative we implemented in the second half of 2008, which included reductions in workforce and certain overhead and

discretionary costs. The compensation related costs incurred in relation to the employees terminated in connection with the restructuring are included in restructuring charges.

Included in sales and marketing expenses during each of the third quarters of 2009 and 2008 is $0.3 million of amortization of purchased intangible assets. Also included in sales and marketing expenses during the third quarters of 2009 and 2008 is $43,000 and $27,000 of share-based compensation expense.

We expect sales and marketing expenses to remain relatively flat throughout the remainder of 2009.

***General and Administrative***

Of the $6.3 million decrease in general and administrative expenses from continuing operations during the third quarter of 2009, as compared to the third quarter of 2008, $7.4 million is attributable primarily to the corporate cost reductions resulting from the global restructuring initiative we implemented in the second half of 2008, which included reductions in workforce and certain overhead and discretionary costs, and the closure of certain facilities and $0.4 million is attributable to lower amortization expense resulting our classification of our wireless spectrum licenses in Europe as assets held for sale, which, in accordance with accounting guidance for assets while held for sale, we are no longer amortizing. The costs incurred in connection with our global restructuring initiative, including compensation related costs incurred related to terminated employees, costs incurred related to vacated leased facilities and other restructuring related costs, are included in restructuring charges. This decrease was partially offset by an additional accrual during the third quarter of 2009 for $1.1 million related to the arbitration settlement that was paid in October 2009 through the issuance of 2.5 million shares of our common stock to the former shareholders of GO Networks as a result of the settlement of an arbitration proceeding and the issuance of 3.7 million shares of our common stock to the former shareholders of IPWireless as a result of the achievement of certain revenue milestones in 2007, as specified in the acquisition agreement.

Included in general and administrative expenses during the third quarters of 2009 and 2008 are $2.1 million and $2.5 million, respectively, of amortization of finite-lived wireless spectrum licenses and $63,000 and $10,000, respectively, of amortization of purchased intangible assets. Also included in general and administrative expenses during each of the third quarters of 2009 and 2008 is $0.6 million of share-based compensation expense.

We expect general and administrative expenses to remain relatively flat throughout the remainder of 2009.

***Asset Impairment Charges***

Through our continued efforts to sell our remaining wireless spectrum licenses in Germany, during the third quarter of 2009, we determined that the carrying value of these spectrum licenses exceeded their fair value based primarily on bids received and negotiations with third parties regarding the sale of these licenses, which led to our decision not to pursue build out obligations during this time period. Accordingly, during the third quarter of 2009, we wrote-down the carrying value of our wireless spectrum license in Germany to their estimated fair value and recognized an asset impairment charge related to continuing operations of $13.8 million.

In connection with the implementation of our global restructuring initiative in 2008, we reviewed our long-lived assets for impairment and determined that indicators of impairment were present for certain long-lived assets, primarily leasehold improvements at vacated leased facilities. In accordance with accounting guidance for property, plant and equipment, we performed a recoverability assessment of these assets and concluded that the carrying value of certain of the long-lived assets was not recoverable. Accordingly, during the third quarter of 2008, we recognized an impairment loss of $2.2 million.

We may incur additional asset impairment charges in the future as we continue to implement asset divestiture actions.

***Restructuring Charges***

In connection with the implementation of our global restructuring initiative, during the third quarter of 2009, our corporate support function incurred $29,000 in employee termination costs, $0.5 million in lease abandonment costs and $1.2 million of costs related to the divestiture and closure of discontinued businesses.

During the third quarter of 2008, we terminated 252 employees worldwide and vacated three leased facilities in the United States and, accordingly, incurred employee termination costs of $0.7 million, lease abandonment charges of $1.7 million and other restructuring costs of $0.8 million related to continuing operations.

**Gain on Sale of Wireless Spectrum Licenses**

During the third quarters of 2009 and 2008, we completed sales of certain of our owned AWS spectrum licenses in the United States to third parties for net proceeds, after deducting direct and incremental selling costs, of $21.2 million and $35.8, and recognized net gains on the sales of $1.6 million and $19.3 million, respectively.

**Interest Income**

Interest income from continuing operations during the third quarter of 2009 was $0.1 million, as compared to $0.2 million during the third quarter of 2008, a decrease of $0.1 million resulting from the decline in our unrestricted and restricted cash, cash equivalents and marketable securities balances held by continuing operations during 2009.

Interest income in the future will be affected by changes in short-term interest rates and changes in our cash, cash equivalents and marketable securities balances, which may be materially impacted by divestitures and other financial activities

**Interest Expense**

Interest expense from continuing operations during the third quarter of 2009 was $44.7 million, as compared to $12.0 million during the third quarter of 2008, an increase of $32.7 million. The increase is primarily attributable to $1.8 million and $8.9 million of interest expense and interest accretion of the debt discount and issuance costs related to our Senior Notes and Second Lien Notes, respectively, and $22.0 million in interest expense and interest accretion of the debt discount related to our Third Lien Notes.

Interest expense from continuing operations will be impacted over the next twelve months by the timing and amount of redemptions of our Senior Notes using the proceeds from asset sales and other financial activities.

**Other Income and Expense, Net**

Other expense, net, from continuing operations during the third quarter of 2009 was $6.5 million, as compared to $1.6 million during the third quarter of 2008, an increase of $4.9 million, which is attributable primarily to $5.4 million in changes in the estimated fair value of our embedded derivatives and $0.5 million in higher foreign currency exchange losses. This increase was partially offset by $1.0 million in higher net unrealized gains recognized to increase the carrying value of our auction rate securities and related rights to their estimated fair value.

**Income Tax Benefit (Provision)**

During the third quarters of 2009 and 2008 substantially all of our U.S. subsidiaries had net losses for tax purposes and, therefore, no material income tax provision or benefit was recognized for these subsidiaries. Certain of our controlled foreign corporations had net income for tax purposes based on cost sharing and transfer pricing arrangements with our United States subsidiaries in relation to research and development expenses incurred.

Our effective income tax rate from continuing operations during the third quarter of 2009 was (1.3)%, resulting in a $1.0 million income tax benefit of on our pre-tax loss of $75.5 million. The income tax benefit consists of a $1.1 million benefit from the effect of the change in the effective income tax rate on the deferred tax liabilities associated with indefinite life intangible assets, partially offset by a provision of $0.1 million related to foreign withholding tax on royalty payments received from our PacketVideo customers.

Our effective income tax rate from continuing operations during the third quarter of 2008 was 0.9%, resulting in a $0.1 million income tax provision on our pre-tax loss of $15.4 million. The income tax provision consists primarily of $0.1 million related to foreign withholding tax on royalty payments received from our PacketVideo customers.

**Noncontrolling Interest**

On July 2, 2009, we sold a 35% noncontrolling interest in our PacketVideo subsidiary to DOCOMO, a customer of PacketVideo. During the third quarter of 2009, the net loss from continuing operations attributable to noncontrolling interest in subsidiary totaled $1.0 million and represents DOCOMO's share of PacketVideo's net loss from July 2, 2009.

***Comparison of Our First Nine Months of 2009 to Our First Nine Months of 2008 – Continuing Operations***

**Revenues**

| | **Nine Months Ended September 26,** | **September 27,** | |
|---|---|---|---|
| *(in millions)* | **2009** | **2008** | **Increase (Decrease)** |
| Revenues | $ 37.1 | $ 48.0 | $ (10.9) |
| Revenues – related party | 3.8 | — | 3.8 |
| Total revenues | $ 40.9 | $ 48.0 | $ (7.1) |

Total revenues from continuing operations for the first nine months of 2009 were $40.9 million, as compared to $48.0 million for the first nine months of 2008, a decrease of $7.1 million. Total revenues for both periods primarily consist of revenues generated by our Multimedia segment. The decrease in revenues was attributable to an acceleration of $7.1 million in revenues from Sony Ericsson during the first nine months of 2008

resulting from a change in contract terms and cancellation of a non-recurring development project, a decrease in revenues of $1.0 million attributable to other Sony Ericsson non-recurring business, a decrease in revenues of $4.0 million relating to other customer cancellations, in addition to $0.8 million decrease in royalty revenues during the first nine months of 2009 resulting from a decline in unit sales of mobile subscribers, wireless operators and device manufacturers. Unit sales were adversely impacted by worldwide economic conditions which caused a softening in consumer demand for new devices and services. The decrease in revenues was partially offset by increased non-recurring technology development revenues of $5.8 million primarily resulting from the receipt of final acceptance from Google on technology development services performed in support of the Open Handset Alliance (“OHA”) in the first quarter of 2009.

Sales to three Multimedia customers, Verizon Wireless, DOCOMO and Google, accounted for 37%, 20%, and 14%, respectively, of our total revenues from continuing operations during the first nine months of 2009. Sales to Google primarily represent the completion of technology development deliverables in support of the OHA. We do not anticipate recognizing significant revenues associated with transactions with Google in future quarters. Sales to three Multimedia customers, Verizon Wireless, Sony Ericsson and DOCOMO, accounted for 37%, 17% and 17%, respectively, of our total revenues from continuing operations during the first nine months of 2008.

**Operating Expenses**

| | Nine Months Ended | | |
|---|---|---|---|
| | **September 26,** | **September 27,** | |
| *(in millions)* | **2009** | **2008** | **Increase (Decrease)** |
| Cost of revenues | $ 16.2 | $ 14.6 | $ 1.6 |
| Cost of revenues – related party | 0.1 | — | 0.1 |
| Engineering, research and development | 16.7 | 20.6 | (3.9) |
| Sales and marketing | 6.9 | 10.9 | (4.0) |
| General and administrative | 38.4 | 56.3 | (17.9) |
| Asset impairment charges | 30.0 | 2.3 | 27.7 |
| Restructuring charges | 3.8 | 3.3 | 0.5 |
| Total operating expenses | $ 112.1 | $ 108.0 | $ 4.1 |

***Cost of Revenues***

Total cost of revenues from continuing operations as a percentage of the associated revenues for the first nine months of 2009 was 40%, as compared to 30% for the first nine months of 2008. The decline in gross margins during the first nine months of 2009 reflects a $2.3 million decrease in royalty revenues, which have minimal associated cost of revenue and the recognition of relatively high margin revenue for Sony Ericsson during the first nine months of 2008, which did not recur in 2009. Additionally, certain costs related to contract adjustments were recognized during the first nine months of 2009 which lowered overall gross margins.

Included in total cost of revenues during the first nine months of 2009 and 2008 is $2.2 million and $2.4 million of amortization of purchased intangible assets. Also included in total cost of revenues during the first nine months of 2009 and 2008 is $0.6 million and $0.3 million, respectively, of share-based compensation expense.

***Engineering, Research and Development***

The $3.9 million decrease in engineering, research and development expenses during the first nine months of 2009, as compared to the first nine months of 2008, is attributable primarily to a $2.0 million decrease in third party contract expenses and other operating expenses of our Multimedia segment resulting from cost reduction efforts during 2009, and reductions in our engineering, research and development expenses resulting from the global restructuring initiative we implemented in the second half of 2008, which included reductions in workforce and certain overhead and discretionary costs. The compensation related costs incurred in relation to the employees terminated in connection with the restructuring are included in restructuring charges.

Included in engineering, research and development expenses during the first nine months of 2009 and 2008 is $0.8 million and $1.1 million, respectively, of share-based compensation expense.

***Sales and Marketing***

The $4.0 million decrease in sales and marketing expenses from continuing operations during the first nine months of 2009, as compared to the first nine months of 2008, is primarily attributable to a $2.2 million decrease in the sales and marketing expenses of our Multimedia segment as a result of cost reduction actions implemented in the first quarter of 2009 and a $1.8 million decrease in our marketing expenses resulting from the global restructuring initiative we implemented in the second half of 2008, which included reductions in workforce and certain overhead and discretionary costs. The compensation related costs incurred in relation to the employees terminated in connection with the restructuring are included in restructuring charges.

Included in sales and marketing expenses during each of the first nine months of 2009 and 2008 is $0.8 million of amortization of purchased intangible assets. Also included in sales and marketing expenses during each of the first nine months of 2009 and 2008 is $0.2 million of share-based compensation expense.

***General and Administrative***

Of the $17.9 million decrease in general and administrative expenses from continuing operations during the first nine months of 2009, as compared to the first nine months of 2008, $19.0 million is attributable primarily to the cost reductions resulting from the global restructuring initiative we implemented in the second half of 2008, which included reductions in workforce and certain overhead and discretionary costs, and the closure of certain facilities and $1.1 million is attributable to

lower amortization expense resulting our classification of our wireless spectrum licenses in Europe as assets held for sale, which, in accordance with accounting guidance for assets while held for sale, we are no longer amortizing. The costs incurred in connection with our global restructuring initiative, including compensation related costs incurred related to terminated employees, costs incurred related to vacated leased facilities and other restructuring related costs, are included in restructuring charges. This decrease was partially offset by a $2.2 million arbitration settlement expensed during the first nine of months of 2009 that was paid in October 2009 through the issuance of 2.5 million shares of our common stock to the former shareholders of GO Networks.

Included in general and administrative expenses during the first nine months of 2009 and 2008 is $6.6 million and $7.3 million, respectively, of amortization of finite-lived wireless spectrum licenses and $0.3 million and $0.4 million, respectively, of amortization of purchased intangible assets. Also included in general and administrative expenses during the first nine months of 2009 and 2008 is $2.3 million and $2.8 million, respectively, of share-based compensation expense.

***Asset Impairment Charges***

Through our continued efforts to sell our remaining domestic spectrum licenses and our wireless spectrum licenses in Germany, during the third quarter of 2009, we determined that the carrying value of these spectrum licenses exceeded their fair value based primarily on bids received and negotiations with third parties regarding the sale of these licenses, which led to our decision not to pursue build out obligations during this time period. Accordingly, during the first nine months of 2009, we wrote-down the carrying value of our domestic AWS spectrum licenses and our wireless spectrum license in Germany to their estimated fair value and recognized an asset impairment charge related to continuing operations of $29.8 million.

Additionally, during the first nine months of 2009, we recognized an asset impairment charge of $0.2 million related to certain long-lived and prepaid assets utilized by our corporate administration functions.

During the first nine months of 2008, we recognized an asset impairment charge of $2.3 million primarily related to leasehold improvements at vacated leased facilities.

***Restructuring Charges***

In connection with the implementation of our global restructuring initiative, during the first nine months of 2009, our corporate support function incurred $0.3 million in employee termination costs, $1.0 million in lease abandonment and related facility closure costs and $2.5 million of costs related to the divestiture and closure of discontinued businesses.

During the first nine months of 2008, we terminated 252 employees worldwide and vacated three leased facilities in the United States and, accordingly, incurred employee termination costs of $0.8 million, lease abandonment charges of $1.7 million and other restructuring costs of $0.8 million related to continuing operations.

**Gain on Sale of Wireless Spectrum Licenses**

During the first nine months of 2009 and 2008, we completed sales of certain of our owned AWS spectrum licenses in the United States to third parties for net proceeds, after deducting direct and incremental selling costs, of $26.7 million and $35.8 million, and recognized net gains on the sales of $2.3 million and $19.3 million, respectively.

**Interest Income**

Interest income from continuing operations during the first nine months of 2009 was $0.4 million, as compared to $2.7 million during the first nine months of 2008, a decrease of $2.3 million resulting from the decline in our unrestricted and restricted cash, cash equivalents and marketable securities balances held by continuing operations during 2009.

**Interest Expense**

Interest expense from continuing operations during the first nine months of 2009 was $120.5 million, as compared to $45.9 million during the first nine months of 2008, an increase of $74.6 million. The increase is primarily attributable to $23.0 million of interest expense and interest accretion of the debt discount and issuance costs related to our Second Lien Notes, which were issued in October 2008, and $64.7 million in interest expense and interest accretion of the debt discount related to our Third Lien Notes, which were issued in October 2008, partially offset by $2.3 million in lower interest expense related to our Senior Notes resulting from redemptions of the Senior Notes since the fourth quarter of 2008 using the proceeds from sales of wireless spectrum licenses and $10.5 million which is attributable to consent fees paid during the first nine months of 2008 to withdraw $75.0 million from the cash reserve account related to our Senior Notes.

**Other Income and Expense, Net**

Other expense, net, from continuing operations during the first nine months of 2009 was $8.1 million, as compared to $3.4 million during the first nine months of 2008, an increase of $4.7 million. Changes in the estimated fair value of our embedded derivatives of $6.2 million and higher net foreign currency exchange losses of $1.0 million were partially offset by higher net unrealized gains of $3.0 million that were recognized to increase the carrying value of our auction rate securities and related rights to their estimated fair value.

**Income Tax Benefit (Provision)**

During the first nine months of 2009 and 2008 substantially all of our U.S. subsidiaries had net losses for tax purposes and, therefore, no material income tax provision or benefit was recognized for these subsidiaries. Certain of our controlled foreign corporations had net income for tax purposes based on cost sharing and transfer pricing arrangements with our United States subsidiaries in relation to research and development expenses incurred.

Our effective income tax rate during the first nine months of 2009 was (0.4)% resulting in a $0.7 million income tax benefit, on our pre-tax loss of $197.2 million, The net income tax benefit consists of a $1.1 million benefit from the effect of the change in the effective income tax rate on the deferred tax liabilities associated with indefinite life intangible assets, partially offset by a provision of $0.1 million that was primarily related to income taxes of certain controlled foreign corporations and a provision of $0.3 million that was related to foreign withholding tax on royalty payments received from our PacketVideo customers.

Our effective income tax rate during the first nine months of 2008 was 0.7%, resulting in a $0.6 million income tax provision on our pre-tax loss of $87.3 million. The income tax provision consists of $0.3 million of income taxes related to our controlled foreign corporations and $0.3 million for foreign withholding tax on royalty payments received from certain PacketVideo customers.

**Noncontrolling Interest**

During the first nine months of 2009, the net loss from continuing operations attributable to noncontrolling interest in subsidiary totaled $1.0 million and represents DOCOMO's share of PacketVideo's net loss from July 2, 2009.

**Segment Results**

Results for our continuing operating segments for the first three and nine months of 2009 and 2008 are as follows.

| *(in millions)* | Multimedia | Strategic Initiatives | Other or Unallocated | Consolidated |
|---|---|---|---|---|
| **For the Three Months Ended:** | | | | |
| **September 26, 2009** | | | | |
| Revenues from external customers | $ 8.0 | $ 0.1 | $ — | $ 8.1 |
| Revenues – related party | 3.8 | — | — | 3.8 |
| Loss from operations | (2.5) | (14.7) | (7.2) | (24.4) |
| Significant non-cash items included in loss from operations above: | | | | |
| Depreciation and amortization expense | 1.3 | 2.1 | — | 3.4 |
| Asset impairment charges | — | 13.8 | — | 13.8 |
| Restructuring charges | — | — | 1.7 | 1.7 |
| **September 27, 2008** | | | | |
| Revenues from external customers | $ 16.9 | $ — | $ — | $ 16.9 |
| Income (loss) from operations | — | 15.8 | (17.9) | (2.1) |
| Significant non-cash items included in loss from operations above: | | | | |
| Depreciation and amortization expense | 1.5 | 2.5 | 1.1 | 5.1 |
| Asset impairment charges | — | — | 2.2 | 2.2 |
| Restructuring credits | 0.1 | — | 3.1 | 3.2 |
| **For the Nine Months Ended:** | | | | |
| **September 26, 2009** | | | | |
| Revenues from external customers | $ 37.0 | $ 0.1 | $ — | $ 37.1 |
| Revenues – related party | 3.8 | — | — | 3.8 |
| Loss from operations | (7.0) | (35.2) | (26.7) | (68.9) |
| Significant non-cash items included in loss from operations above: | | | | |
| Depreciation and amortization expense | 4.3 | 6.6 | 0.1 | 11.0 |
| Asset impairment charges | — | 29.8 | 0.2 | 30.0 |
| Restructuring charges | 0.1 | — | 3.7 | 3.8 |
| **September 27, 2008** | | | | |
| Revenues from external customers | $ 48.0 | $ — | $ — | $ 48.0 |
| Income (loss) from operations | (4.5) | 8.9 | (45.1) | (40.7) |

| | | | | |
|---|---|---|---|---|
| Significant non-cash items included in loss from operations above: | | | | |
| Depreciation and amortization expense | 4.7 | 7.3 | 3.1 | 15.1 |
| Asset impairment charges | — | — | 2.2 | 2.2 |
| Restructuring charges | 0.1 | — | 3.2 | 3.3 |

***Multimedia***

Total revenues for the Multimedia segment decreased $5.1 million and $7.2 million during the third quarter and first nine months of 2009, respectively, when compared to the same periods in 2008.

The $5.1 million decrease in revenues during the third quarter was attributable primarily to an acceleration of Sony Ericsson revenues of $1.5 million in the third quarter of 2008 due to the cancellation of a non-recurring development project, a decrease in revenues of $1.0 million attributable to other Sony Ericsson non-recurring business, a decrease in revenues of $1.5 million relating to other customer cancellations, in addition to lower royalty revenues in the third quarter of 2009 resulting from a decline in unit sales to mobile subscribers by wireless operators and device manufacturers. Unit sales were adversely impacted by worldwide economic conditions which caused a softening in consumer demand for new devices and services.

The $7.1 million decrease in revenues during the first nine months of 2009 was attributable to an acceleration of $7.1 million in revenues from Sony Ericsson during the first nine months of 2008 resulting from a change in contract terms and cancellation of a non-recurring development project, a decrease in revenues of $1.0 million attributable to other Sony Ericsson non-recurring business, a decrease in revenues of $4.0 million relating to other customer cancellations, in addition to a $0.8 million decrease in royalty revenues during the first nine months of 2009 resulting from a decline in unit sales of mobile subscribers, wireless operators and device manufacturers. The decrease in revenues was partially offset by increased non-recurring technology development revenues of $5.8 million primarily resulting from the receipt of final acceptance from Google on technology development services performed in support of the OHA in the first quarter of 2009.

Loss from operations for the Multimedia segment increased $2.5 million during each of the third quarter and first nine months of 2009 and was attributable to the decrease in revenues of $5.1 million and $7.2 million, respectively, described above, partially offset by decreases in the operating expenses of our Multimedia segment as a result of cost reduction actions implemented during of 2009.

***Strategic Initiatives***

Loss from operations for the Strategic Initiatives segment increased $30.5 million and $44.1 million during the third quarter and first nine months of 2009, respectively, when compared to the same periods in 2008. The increase during the third quarter and first nine months of 2009 is primarily attributable to $13.8 million and $29.8 million in asset impairment charges related to certain of our domestic AWS spectrum licenses and our Germany wireless spectrum license and lower net gains on our sales of wireless spectrum licenses of $17.7 million and $17.0 million, respectively, partially offset by lower operating expenses resulting from cost reduction actions implemented in the first six months of 2009.

***Other or Unallocated***

The loss from operations classified as Other or Unallocated decreased $10.7 million and $18.4 million during the third quarter and first nine months of 2009, respectively, and is primarily attributable to the corporate cost reductions resulting from the global restructuring initiative we implemented in the second half of 2008, which included reductions in workforce and certain overhead and discretionary costs, and the closure of certain facilities. These decreases were partially offset by a $2.2 million arbitration settlement paid in October 2009 through the issuance of 2.5 million shares of our common stock to the former shareholders of GO Networks.

***Comparison of Our Third Quarter and First Nine Months of 2009 to Our Third Quarter and First Nine Months of 2008 – Discontinued Operations***

The results of operations of our discontinued Networks and Semiconductor segments and WiMax Telecom business are as follows:

| | **Three Months Ended** | | | **Nine Months Ended** | | |
|---|---|---|---|---|---|---|
| | **September 26,** | **September 27,** | | **September 26,** | **September 27,** | |
| *(in millions)* | **2009** | **2008** | **Increase (Decrease)** | **2009** | **2008** | **Increase (Decrease)** |
| Revenues | $ 1.3 | $ 21.3 | $ (20.0) | $ 4.4 | $ 48.0 | $ (43.6) |
| Operating expenses: | | | | | | |
| Cost of revenues | 1.5 | 24.1 | (22.6) | 4.8 | 54.8 | (50.0) |
| Engineering, research and development | (0.3) | 30.4 | (30.7) | 2.4 | 103.0 | (100.6) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Sales and marketing | 0.2 | 5.2 | (5.0) | 1.1 | 20.9 | (19.8) |
| General and administrative | 0.9 | 6.9 | (6.0) | 3.4 | 19.0 | (15.6) |
| Asset impairment charges | 29.1 | 167.7 | (138.6) | 33.7 | 169.9 | (136.2) |
| Restructuring charges | 0.1 | 4.7 | (4.6) | 5.1 | 4.8 | 0.3 |
| Total operating expenses | 31.5 | 239.0 | (207.5) | 50.5 | 372.4 | (321.9) |
| Net gain on business divestitures | 3.1 | — | 3.1 | 3.2 | — | 3.2 |
| Loss from operations | (27.1) | (217.7) | 190.6 | (42.9) | (324.4) | 281.5 |
| Other income and (expense), net | (0.2) | 0.8 | (1.0) | (0.2) | 0.5 | (0.7) |
| Loss before income taxes | (27.3) | (216.9) | 189.6 | (43.1) | (323.9) | 280.8 |
| Income tax benefit (provision) | 0.2 | (0.8) | 1.0 | 0.2 | (1.0) | 1.2 |
| Loss from discontinued operations | $ (27.1) | $ (217.7) | $ 190.6 | $ (42.9) | $ (324.9 ) | $ 282.0 |

***Revenues***

The $20.0 million and $43.6 million decrease in revenues from discontinued operations during the third quarter and first nine months of 2009, respectively, was primarily attributable to our divestiture of our IPWireless subsidiary in December 2008.

***Cost of Revenues***

The $22.6 million and $50.0 million decrease in cost of revenues from discontinued operations during the third quarter and first nine months of 2009, respectively, was primarily attributable to our divestiture of our IPWireless subsidiary and the discontinuation of operations at our GO Networks subsidiary in the fourth quarter of 2008.

***Engineering, Research and Development***

The $30.7 million and $100.6 million decrease in engineering, research and development expenses from discontinued operations during the third quarter and first nine months of 2009, respectively, is primarily attributable to our divestiture of our IPWireless subsidiary and the discontinuation of operations at our GO Networks subsidiary in the fourth quarter of 2008, and the shut down of the operations of our semiconductor business in the first quarter of 2009. The compensation related costs incurred in relation to the employees terminated in connection with the shutdown of our semiconductor business are included in restructuring charges. Settlements of certain of our third party engineering contract service agreements which reduced our payment obligations accounted for the $0.3 million credit to engineering, research and development during the third quarter of 2009.

***Sales and Marketing***

The $5.0 million and $19.8 million decrease in sales and marketing expenses from discontinued operations during the third quarter and first nine months of 2009, respectively, is primarily attributable our divestiture of our IPWireless subsidiary and the discontinuation of operations at our GO Networks subsidiary in the fourth quarter of 2008, and the shut down of the operations of our semiconductor business in the first quarter of 2009. The compensation related costs incurred in relation to the employees terminated in connection with the shut down of our semiconductor business are included in restructuring charges.

***General and Administrative***

The $6.0 million and $15.6 million decrease in general and administrative expenses from discontinued operations during the third quarter and first nine months of 2009, respectively, is primarily attributable to our divestiture of our IPWireless subsidiary and the discontinuation of operations at our GO Networks subsidiary in the fourth quarter of 2008, and lower operating expenses at our WiMax Telecom subsidiary resulting from cost reduction actions implemented in the first quarter of 2009.

***Asset Impairment Charges***

Through our continued efforts to sell our wireless spectrum licenses in Europe and Chile, during the third quarter of 2009, we determined that the carrying value of these spectrum licenses exceeded their fair value based primarily on bids received and negotiations with third parties regarding the sale of these licenses, which led to our decision not to pursue build out obligations in Europe during this time period. Accordingly, during the third quarter and first nine months of 2009, we wrote-down the carrying value of our wireless spectrum licenses in Europe and Chile to their estimated fair value and recognized asset impairment charges of $22.3 million and $22.4 million, respectively.

In connection with the implementation of our global restructuring initiative, we continue to review our long-lived assets for impairment and, during the first nine months of 2009, determined that indicators of impairment were present for the long-lived assets in our discontinued WiMax Telecom and semiconductor businesses. We performed an impairment assessment of these assets and concluded that their carrying value exceeded their fair value. Accordingly, during the third quarter and first nine months of 2009, we recognized asset impairment charges of $5.2 million and $9.7 million, respectively.

During the third quarter and first nine months of 2009 we wrote-off the remaining net book value of the purchased customer base intangible asset of WiMax Telecom as indicators of impairment existed, and, as a result of this write-off, we recognized a non-cash asset impairment charge of $1.6 million during the third quarter and first nine months of 2009.

In connection with the implementation of our global restructuring initiative in the third quarter of 2008, we recognized an impairment loss of $167.7 million during the third quarter of 2008 for goodwill, intangible asset and certain other long-lived assets related to our Networks segment

The impairment loss of $169.9 million that we recognized during the first nine months of 2008 also reflects the $2.2 million impairment loss we recognized in the second quarter of 2008 related to an office building we own in Nevada.

***Restructuring Charges***

In connection with the implementation of our global restructuring initiative, during the third quarter and first nine months of 2009, we incurred $0 and $4.6 million of employee termination costs, and $0.1 million and $0.6 million in contract termination costs, respectively, related to our discontinued operations. The employee termination costs incurred in the first nine months of 2009 primarily resulted from the termination of 230 employees upon the shut down of our semiconductor business.

In connection with the implementation of our global restructuring initiative in the third quarter of 2008, we terminated 151 employees in our Networks segment and incurred employee termination costs of $4.3 million and lease abandonment charges of $0.4 million. During the first nine months of 2008, we incurred employee termination costs of $4.4 million and lease abandonment charges of $0.4 million related to our Networks segment.

***Other Expense, Net***

Other expense, net, during the third quarter of 2009 increased from other income, net, of $0.8 million in 2008 to other expense, net, of $0.2 million, an increase in expense of $1.0 million which was primarily attributable to net foreign currency exchange rate losses recognized during the third quarter of 2009. Other expense, net, during first nine months of 2009 increased from other income, net, of $0.5 million in 2008 to other expense, net, of $0.2 million, an increase in expense of $0.7 million and was primarily attributable to $0.5 million in lower net foreign currency exchange rate gains and $0.1 million in lower interest income recognized during the first nine months of 2009.

**LIQUIDITY AND CAPITAL RESOURCES**

We have funded our operations, business combinations, strategic investments and wireless spectrum license acquisitions primarily with the $550.0 million in cash received in our initial capitalization in April 2005, the net proceeds of $295.0 million from the issuance of the Senior Notes in July 2006, the net proceeds of $351.1 million from our issuance of Series A Preferred Stock in March 2007 and the net proceeds of $101.0 million from our issuance of the Second Lien Notes in October 2008 and July 2009. Our total unrestricted cash, cash equivalents and marketable securities held by continuing operations totaled $22.2 million at September 26, 2009. We had a net working capital deficit of $105.3 million at September 26, 2009, reflecting a negative impact of $155.0 million attributable to the maturity of our 7% Senior Secured Notes (“the Senior Notes”) in July 2010.

Our Senior Notes require payments of approximately $164.1 million in principal plus accrued interest in July 2010 and our Senior-Subordinated Secured Second Lien Notes due 2010 (the “Second Lien Notes”) require payment of approximately $135.7 million in principal plus accrued interest in December 2010. Our cash reserves and cash generated from operations are not sufficient to meet these payment obligations. We must consummate sales of our wireless spectrum assets yielding proceeds that are sufficient to retire this indebtedness or renegotiate the maturity of our secured notes and/or seek to refinance such indebtedness. Currently, we are in discussion with certain holders of our secured notes regarding the extension of the maturity of such notes. There can be no assurance that we will be able to extend the maturity of our secured notes or that asset sales or any additional financing will be achievable on acceptable terms. If we are unable to renegotiate or pay our debt at maturity, the holders of our notes could proceed against the assets pledged to secure these obligations, which include our spectrum assets and the capital stock of our material subsidiaries, which would impair our ability to continue as a going concern. Our financial statements do not include any adjustments related to the recovery of assets and classification of liabilities that might be necessary should we be unable to continue as a going concern.

In an effort to reduce our future working capital requirements and in order to comply with the terms of our Senior Notes, Second Lien Notes and Third Lien Notes, in the second half of 2008, our Board of Directors approved the implementation of a global restructuring initiative, pursuant to which we have divested, either through sale, dissolution or closure, our network infrastructure businesses and our semiconductor business. We have also taken other cost reduction actions. The actions completed as a result of our global restructuring initiative are described in more detail in Note 1 to our Condensed Consolidated Financial Statements in this Form 10-Q under the heading “Restructuring Initiative and Discontinued Operations”.

On July 2, 2009, we issued additional Second Lien Notes due 2010 (the "Incremental Notes") in the aggregate principal amount of $15.0 million, on the same financial and other terms applicable to our existing Second Lien Notes. The Incremental Notes were issued with an original issuance discount of 5% resulting in gross proceeds of $14.3 million. After payment of transaction related expenses, we received net proceeds of $13.5 million to be used solely in connection with the ordinary course operations of our business and not for any acquisition of assets or businesses or other uses. The purchaser of the Incremental Notes was Avenue AIV US, L.P., an affiliate of Avenue Capital Management II, L.P. ("Avenue Capital"). Robert Symington, a Senior Portfolio Manager with Avenue Capital, is a member of our Board of Directors. In July 2009, we issued warrants to purchase 7.5 million shares of our common stock at an exercise price of $0.01 per share to the purchaser of the Incremental Notes. The warrants are exercisable at any time from the date of issuance until June 2012.

Our Senior Notes, Second Lien Notes and Third Lien Notes require that the net proceeds from any sales or dispositions of assets be applied towards the repayment of the notes, rather than being used to fund our ongoing operations. Additionally, the Senior Notes and Second Lien Notes require that we maintain a minimum cash balance of $5.0 million (the “Minimum Balance Condition”). Failure to comply with the Minimum Balance Condition results in an immediate event of default.

In 2010, we have capital expenditure needs associated with certain build-out or substantial service requirements. These requirements apply to our licensed wireless spectrum, which generally must be satisfied as a condition of license renewal. The renewal deadline and the substantial

service build-out deadline for our domestic WCS spectrum is July 21, 2010. We also have certain build-out requirements internationally in 2009, 2012 and 2013, and failure to make those service demonstrations could

also result in license forfeiture. We plan to seek and enter into third party arrangements pursuant to which in exchange for access to certain of our spectrum, such parties would commit the financial resources necessary to meet our build-out requirements. We have obtained third party arrangements which we believe will allow us to satisfy our substantial service requirements with respect to our domestic WCS spectrum.

We believe that the completion of the asset divestiture and cost reduction actions, our current cash and cash equivalents, projected revenues from our Multimedia segment, our ability to pay payment-in-kind interest as allowed under the current agreement, in lieu of cash interest, to the holders of 68% of the aggregate remaining outstanding principal balance of our Senior Notes and our third party arrangements with respect to our domestic WCS spectrum build-out requirements will allow us to meet our estimated operational cash requirements, other than the pending maturity of our Senior Notes as discussed above, at least through September 2010. Should we be unable to achieve the revenues and/or cash flows through September 2010 as contemplated in our operating plan, or if we were to incur significant unanticipated expenditures, we will implement certain additional actions to reduce our working capital requirements including staffing reductions, the deferral of capital expenditures associated with the build-out requirements of our international wireless spectrum licenses and further reductions in foreign operations.

Our long term operating success will depend on our ability to execute our cost reduction and divestiture programs in a timely manner, to obtain favorable cash flow from the growth and market penetration of our PacketVideo subsidiary, and optimally executing our wireless spectrum sale program so as to meet debt payment requirements.

The following table presents our working capital (deficit), and our cash and cash equivalents balances:

| *(in millions)* | **September 26, 2009** | **June 27, 2009** | **Increase (Decrease) for the Three Months Ended September 26, 2009** | **December 27, 2008** | **Decrease for the Nine Months Ended September 26, 2009** |
|---|---|---|---|---|---|
| Working capital (deficit) | $ (105.3) | $ (18.5) | $ (86.8) | $ 21.2 | $ (126.5) |
| Cash and cash equivalents | $ 22.2 | $ 17.2 | $ 5.0 | $ 60.8 | $ (38.6) |
| Cash and cash equivalents – discontinued operations | 0.8 | 0.6 | 0.2 | 0.7 | 0.1 |
| Total cash and cash equivalents | $ 23.0 | $ 17.8 | $ 5.2 | $ 61.5 | $ (38.5) |

**Uses of Cash, Cash Equivalents and Marketable Securities**

The following table presents our utilization of cash, cash equivalents and marketable securities:

| | **Three Months Ended** | | **Nine Months Ended** | |
|---|---|---|---|---|
| *(in millions)* | **September 26, 2009** | **September 27, 2008** | **September 26, 2009** | **September 27, 2008** |
| Beginning cash, cash equivalents and marketable securities | $ 17.8 | $ 66.7 | $ 61.5 | $ 166.7 |
| Net operating cash used by continuing operations | (18.8) | (25.1) | (49.1) | (73.2) |
| Proceeds from the sale of noncontrolling interest in PacketVideo | 45.5 | — | 45.5 | — |
| Proceeds from the sale of wireless spectrum licenses | 21.2 | 35.8 | 26.7 | 35.8 |
| Proceeds from issuance of long-term obligations, net of costs to issue | 13.5 | 21.5 | 13.5 | 21.5 |
| Payments on long-term obligations, excluding wireless spectrum lease obligations | (55.4) | (0.7) | (61.4) | (2.7) |
| Cash paid for acquisition of wireless spectrum licenses and subsequent lease obligations | (0.2) | (0.2) | (0.9) | (4.7) |

| | | | | |
|---|---|---|---|---|
| Purchases of property and equipment | (1.6) | (0.5) | (1.8) | (2.7) |
| Decrease (increase) in restricted cash | — | (57.2) | — | 17.8 |
| Net cash acquired from (paid for) business combinations, net of cash returned under claims | — | 4.8 | — | (0.3) |
| Other, net | (0.5) | 2.2 | — | (2.2) |
| Net operating, investing and financing cash provided (used) by discontinued operations | 1.5 | (35.8) | (11.0) | (144.5) |
| Ending cash, cash equivalents and marketable securities | 23.0 | 11.5 | 23.0 | 11.5 |
| Less: ending cash, cash equivalents and marketable securities-discontinued operations | (0.8) | (6.1) | (0.8) | (6.1) |
| Ending cash, cash equivalents and marketable securities-continuing operations | $ 22.2 | $ 5.4 | $ 22.2 | $ 5.4 |

**Significant Investing and Financing Activities During the First Nine Months of 2009**

During the first nine months of 2009, we completed sales of certain of our owned AWS spectrum licenses in the United States to third parties for net proceeds, after deducting direct and incremental selling costs, of $26.7 million, and recognized gains on the sales totaling $2.3 million. The net proceeds from the sales received after July 15, 2009 were used to redeem a portion of the Senior Notes at a redemption price of 102% of the principal amount thereof plus accrued interest and net proceeds received prior to July 16, 2009 were used to redeem a portion of the Senior Notes at a redemption price of 105% of the principal amount thereof plus accrued interest.

During the third quarter of 2009 we issued additional Second Lien Notes due 2010 in the aggregate principal amount of $15.0 million, on the same financial and other terms applicable to our existing Second Lien Notes. The Incremental Notes were issued with an original issuance discount of 5% resulting in gross proceeds of $14.3 million. After payment of transaction related expenses, we received net proceeds of $13.5 million to be used solely in connection with the ordinary course operations of our business and not for any acquisition of assets or businesses or other uses.

During the third quarter of 2009 we sold a 35% noncontrolling interest in our PacketVideo subsidiary to DOCOMO for $45.5 million. The net proceeds from this transaction were used in July 2009 to redeem a portion of the Senior Notes at a redemption price of 105% of the principal amount thereof plus accrued interest.

During the third quarter of 2009 we sold certain of our owned Semiconductor business patents and patent applications to Wi-Lan Inc, a Canadian intellectual property company, for a cash payment of $2.5 million and recognized $2.5 million as a gain from business divestitures during the three and nine months ended September 26, 2009.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our discussion and analysis of our results of operations and liquidity and capital resources are based on our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition, valuation of intangible assets and investments, and litigation. We base our estimates on historical and anticipated results and trends and on various other assumptions that we believe are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results that differ from our estimates could have a significant adverse effect on our operating results and financial position. Our accounting policies are described in more detail in Note 1 to our consolidated financial statements for the year ended December 27, 2008, contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 2, 2009.

There have been no significant changes in our critical accounting policies and estimates from December 27, 2008.

**Contractual Obligations**

The following table summarizes our cash contractual obligations for continuing and discontinued operations at September 26, 2009 and the effect such obligations are expected to have on our liquidity and cash flows in future fiscal year periods.

| | Payments Due by Fiscal Year Period | | | | |
|---|---|---|---|---|---|
| *(in thousands)* | **Total** | **Remainder of 2009** | **Years 2010-2011** | **Years 2012-2013** | **Years 2014 and Thereafter** |
| Continuing Operations: | | | | | |
| Long-term obligations[1] | $ 878,818 | $ 21,601 | $ 309,447 | $ 522,195 | $ 25,575 |
| Services and other purchase agreements | 4,414 | 2,190 | 1,783 | 441 | — |
| Operating leases | 5,278 | 985 | 2,905 | 1,388 | — |
| Other[2] | 650 | 400 | 250 | — | — |
| | 889,160 | 25,176 | 314,385 | 524,024 | 25,575 |

| | | | | | |
|---|---|---|---|---|---|
| Discontinued Operations: | | | | | |
| Long-term obligations | 4,190 | 31 | 22 | 1,220 | 2,917 |
| Services and other purchase agreements | 8,153 | — | — | — | 8,153 |
| Operating leases | 307 | 78 | 86 | 86 | 57 |
| | 12,650 | 109 | 108 | 1,306 | 11,127 |
| Total | $ 901,810 | $ 25,285 | $ 314,493 | $ 525,330 | $ 36,702 |

(1) Amounts presented do not include cash interest payments on the Senior Notes or the future issuance of additional Second Lien Notes and Third Lien Notes in payment of interest. We have assumed that the remaining principal balance of the Senior Notes as well as the Second Lien Notes and Third Lien Notes will not be repaid until their respective maturity dates.

(2) As of September 26, 2009 we have accrued for $0.2 million and $0.5 million in cash payable to the former shareholders of IPWireless, as a result of the achievement of certain revenue milestones in 2007 as specified in the acquisition agreement, and to GO Networks, as a result of an arbitration settlement, respectively, of which $0.4 million each was paid subsequent to the end of our third quarter in 2009. The remaining cash payable of $0.3 million to the former shareholders of GO Networks is expected to be paid in March 2010. In addition to the amounts payable in cash, we have accrued for $3.8 million at September 26, 2009, in additional purchase consideration payable through the issuance of 6.2 million shares of our common stock to the former shareholders of IPWireless, as a result of the achievement of certain revenue milestones in 2007 as specified in the acquisition agreement, and GO Networks, as a result of an arbitration settlement. These shares were issued in October 2009.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

***Interest Rate Risk***

At September 26, 2009, our investment portfolios held by continuing and discontinued operations included unrestricted and restricted cash and investment securities that are subject to interest rate risk and will decline in value if interest rates increase. Interest income earned on our investments is affected by changes in the general level of U.S. interest rates. These income streams are generally not hedged.

Due to the relatively short duration of our investment portfolio, an immediate ten percent change in interest rates (e.g., 3.00% to 3.30%) would have no material impact on our financial condition or results of operations.

***Foreign Currency Risk***

In addition to our U.S. operations, we conduct business through international subsidiaries, primarily located in Europe and Asia. As a result, our financial position, results of operations and cash flows can be affected by fluctuations in foreign currency exchange rates, particularly fluctuations in the Euro, Swiss Franc and Japanese Yen exchange rates. Additionally, a portion of our sales to customers located in foreign countries, specifically certain sales by our PacketVideo subsidiary, are denominated in Euros, which subjects us to foreign currency risks related to those transactions.

We analyze our exposure to currency fluctuations and may engage in financial hedging techniques in the future to reduce the effect of these potential fluctuations. We do not currently have hedging contracts in effect.

***Other Market Risk***

At September 26, 2009, we held auction rate securities with an aggregate carrying value of $24.0 million. With the liquidity issues experienced in the global credit and capital markets, auction rate securities have experienced multiple failed auctions as the amount of securities submitted for sale has exceeded the amount of purchase orders, and as a result, we have been unable to liquidate our remaining auction rate securities and these securities are subject to declines in fair value as a result of their current illiquidity. To date, we have recognized net losses of $1.2 million representing our estimate of the decline in the fair value of our auction rate securities through September 26, 2009. The risk associated with the illiquidity of our auction rate securities is mitigated by our participation in UBS's auction securities rights offering, which allow us to sell our auction rate securities at par value to UBS at any time during the period of June 30, 2010 through July 2, 2012.

**Item 4. Controls and Procedures**

**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), that are designed to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC 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 timely decisions regarding required financial disclosures. Because of inherent limitations, our disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of such disclosure controls and procedures are met.

As more fully described in Item 9A of our Annual Report on Form 10-K for the year ended December 27, 2008, we reported that our management identified a control deficiency that represents a material weakness in our internal control over financial reporting. The material weaknesses identified by management resulted from a lack of effective controls over the accounting for our global restructuring initiative, including the accounting and income tax implications of asset sales, impairments and divestitures, and debt issuances and redemptions. As a result of the identification of this material weakness, our principal executive officer and principal financial officer concluded that as of December 27, 2008, our disclosure controls and procedures were not effective pursuant to Exchange Act Rules 13a-15(f) and 15d-15(f).

We have implemented remediation actions required to successfully remediate the identified material weakness in our internal control over financial reporting, which included supplementing our existing accounting personnel with additional resources with expertise in technical accounting matters.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based on this evaluation, our principal executive officer and our principal financial officer concluded that the identified material weakness in our internal control over financial reporting has been remediated and, therefore, our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report.

**Changes in Internal Control over Financial Reporting**

Except in connection with the remediation actions described above, there have been no changes in our internal control over financial reporting during the third quarter of fiscal 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

On September 16, 2008, a putative class action lawsuit, captioned Sandra Lifschitz, On Behalf of Herself and All Others Similarly Situated, Plaintiff, v. NextWave Wireless Inc., Allen Salmasi, George C. Alex and Frank Cassou, Defendants", was filed in the U.S. District Court for the Southern District of California against us and certain of our officers. The suit alleges that the defendants made false and misleading statements and/or omissions in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The suit seeks unspecified damages, interest, costs, attorneys' fees, and injunctive, equitable or other relief on behalf of a purported class of purchasers of our common stock during the period from March 30, 2007 to August 7, 2008. A second putative class action lawsuit captioned "Benjamin et al. v. NextWave Wireless Inc. et al." was filed on October 21, 2008 alleging the same claims on behalf of purchasers of our common stock during an extended class period, between November 27, 2006 through August 7, 2008. On February 24, 2009, the Court issued an Order consolidating the two cases and appointing a lead plaintiff pursuant to the Private Securities Litigation Reform Act. On May 15, 2009, the lead plaintiff filed an Amended Complaint, and on June 29, 2009, we filed a Motion to Dismiss that Amended Complaint. The Motion currently is pending with the Court. At this time, the case remains in the initial pleading stages and management is not able to offer any assessment as to the likelihood of prevailing on the merits.

We were notified on July 11, 2008 that the former stockholders of GO Networks filed a demand for arbitration in connection with the February 2008 milestone. In the demand, the stockholder representative claimed that we owed compensation to the former stockholders of GO Networks on the basis of GO Networks purportedly having partially achieved the February 2008 milestone under the acquisition agreement. The stockholder representative sought damages of $10.4 million. Further, on December 5, 2008, the stockholder representative amended his demand and added claims pertaining to the August 2008 milestone. In the claims, the stockholder representative asserted, among other claims, that we acted in bad faith in a manner that prevented the achievement of the milestone, and he sought damages of $12.8 million in connection with these additional claims. We disputed that the February 2008 milestone has been met and denied any wrongdoing with respect to the August 2008 milestone. In September 2009, the parties executed a settlement agreement and requested that the arbitration panel dismiss the matter with prejudice.

We are also currently involved in other legal proceedings in the ordinary course of our business operations. We estimate the range of liability related to pending litigation where the amount and range of loss can be estimated. We record our best estimate of a loss when the loss is considered probable. Where a liability is probable and there is a range of estimated loss with no best estimate in the range, we record the minimum estimated liability related to the claim. As additional information becomes available, we assess the potential liability related to our pending litigation and revise our estimates. As of September 26, 2009, other than the matters described above, we have not recorded any significant accruals for contingent liabilities associated with our legal proceedings based on our belief that a liability, while possible, is not probable. Further, any possible range of loss cannot be estimated at this time. Revisions to our estimate of the potential liability could materially impact future results of operations.

**ITEM 1A. Risk Factors**

**Risks Relating to Our Business**

***We have substantial debt maturities in 2010 and 2011 and our cash reserves and cash generated from operations are not sufficient to meet these payment obligations. There can be no assurance that we will be able to extend our debt maturities or that asset sales or any additional financing will be achievable on acceptable terms and any failure to pay our debt at maturity will impair our ability to continue as a going concern.***

Our secured notes require payments of approximately $299.8 million plus accrued interest in 2010. Our Senior Notes, having an aggregate principal amount of $164.1 million at September 26, 2009, will mature in July 2010 and our Second Lien Notes, having an aggregate principal amount of approximately $135.7 million at September 26, 2009, will mature in December 2010. In addition, our Third Lien Notes, having an aggregate principal amount of $513.8 million at September 26, 2009, will mature in December 2011. Sixty-eight-percent of the aggregate remaining outstanding principal balance of our Senior Notes, and all of our Second Lien Notes and Third Lien Notes, bear payment-in-kind interest at rates of 14.0%, 14.0% and 7.5%, respectively, which will increase the principal amount of this debt upon retirement. Our cash

reserves and cash generated from operations are not sufficient to meet these payment obligations. We must consummate sales of our wireless spectrum assets yielding proceeds that are sufficient to retire this indebtedness, renegotiate the maturity of our secured notes and/or seek to refinance such indebtedness. Currently, we are in discussion with certain holders of our secured notes regarding the extension of the maturity of such notes. There can be no assurance that we will be able to extend the maturity of our secured notes or that asset sales or any additional financing will be achievable on acceptable terms. If we are unable to renegotiate or pay our debt at

maturity, the holders of our notes could proceed against the assets pledged to secure these obligations, which include our spectrum assets and the capital stock of our material subsidiaries, which would impair our ability to continue as a going concern. Our financial statements do not include any adjustments related to the recovery of assets and classification of liabilities that might be necessary should we be unable to continue as a going concern.

***Our capital structure requires that we successfully monetize a substantial portion of our wireless spectrum assets in order to retire our debt. The value of our equity securities is dependent on our ability to successfully retire our debt.***

We are required to use the net proceeds of asset sales to retire our debt and expect that we will be required to successfully monetize a substantial portion of our wireless spectrum assets in order to retire our debt. There is no guarantee that we will be able to find third parties interested in purchasing our wireless spectrum assets at prices sufficient to retire this debt prior to maturity. The sale price of our wireless spectrum assets will be impacted by, among other things:

- the FCC's final resolution of ongoing proceedings regarding interference from satellite digital audio radio services to our WCS spectrum licenses;
- build-out or substantial service requirements attached to our domestic and international spectrum licenses, where a failure to comply with these requirements could result in license forfeiture;
- timing of closure of potential sales, particularly if it is necessary to accelerate the planned sale of certain of our spectrum licenses in order to meet debt payment obligations;
- worldwide economic conditions which we believe have adversely affected manufacturers of telecommunications equipment and technology and led to a delay in global network deployments; and
- availability of capital for prospective spectrum bidders has been negatively impacted by the downturn in the credit and financial markets.

If we are unable to consummate sales of our wireless spectrum assets that are sufficient to retire our indebtedness, the holders of our notes could proceed against the assets pledged to secure these obligations, which include our spectrum assets and the capital stock of our material subsidiaries, which would impair our ability to continue as a going concern and the value of our equity securities will be impaired.

***We are highly leveraged and our operating flexibility will be significantly reduced by our debt covenants.***

As of September 26, 2009, the aggregate principal amount of our secured indebtedness was $813.7 million. This amount includes our Senior Notes with an aggregate principal amount of $164.1 million, our Second Lien Notes with an aggregate principal amount of $135.7 million and our Third Lien with an aggregate principal amount of $513.8 million. Covenants in the purchase agreements for our Senior Notes and Second Lien Notes impose operating and financial restrictions on us. These restrictions prohibit or limit our ability, and the ability of our subsidiaries, to, among other things:

- pay dividends to our stockholders;
- incur, or cause to incur, additional indebtedness or incur liens;
- sell assets for consideration other than cash;
- consolidate or merge with or into other companies;
- issue shares of our common stock or securities of our subsidiaries;
- make capital expenditures or other strategic investments in our business not contemplated by the Operating Budget; or
- acquire assets or make investments.

In addition, any proceeds from the sale of our assets may not be retained to finance our operations but must be used to redeem our Senior Notes, Second Lien Notes and Third Lien Notes.

We anticipate that our overall level of indebtedness and covenant restrictions will:

- limit our ability to pursue business opportunities;
- limit our flexibility in planning for, or reacting to, changes in the markets in which we compete;
- place us at a competitive disadvantage relative to our competitors with less indebtedness;
- render us more vulnerable to general adverse economic, regulatory and industry conditions; and
- require us to dedicate a substantial portion of our cash flow, as well as all proceeds from asset sales, to service our debt.

40

Our ability to meet our cash requirements, including our debt service obligations, is dependent upon our ability to substantially improve our operating performance, which will be subject to general economic and competitive conditions and to financial, business and other factors, many of which are or may be beyond our control. If our operating results, cash flow or asset sale proceeds prove inadequate, we could face substantial liquidity problems and might be required to accelerate asset sales, forego expenditures permitted by the Operating Budget or shut down businesses on an accelerated basis to meet our debt and other obligations. Further, any of these actions may not be sufficient to allow us to comply with our debt covenants or may have an adverse impact on our business. Our existing debt agreements limit our ability to take certain of these actions. Our failure to generate sufficient operating cash flow to pay our debts, to refinance our indebtedness or to successfully undertake any of these other actions could have a material adverse effect on us.

A breach of any covenants contained in the note purchase agreements governing our secured notes could result in a default under our indebtedness. If we are unable to repay or refinance those amounts, the holders of our notes could proceed against the assets pledged to secure these obligations, which include our spectrum assets and substantially all of our other assets.

***The terms of our Senior Notes and Second Lien Notes require us to certify our compliance with a restrictive operating budget and to maintain a minimum cash balance. A failure to comply with these terms may result in an event of default which could result in the acceleration of maturity of our indebtedness and an impairment in our ability to continue as a going concern.***

The terms of our Senior Notes and Second Lien Notes require us to deliver a six-month Operating Budget to the noteholders on a quarterly basis, which budget is reasonably acceptable to Avenue Capital. Avenue Capital holds 78% of the aggregate principal amount of our Second Lien Notes and 51% of the aggregate principal amount of our Senior Notes. Our Operating Budget requires us to cut costs and limits the funding that we may provide to specified businesses (the “Named Businesses”, which have already been sold or discontinued as part of our global restructuring initiative).

We must deliver monthly certifications relating to our cash balances to the holders of our Senior Notes and Second Lien Notes. If we are unable to certify that our cash balances have not deviated in a negative manner by more than 10% from budgeted balances, default interest will accrue and, if such condition persists, (i) for two monthly reporting periods, if we have not satisfied our obligations to cease funding to the Named Business within the required timeframes or (ii) three monthly reporting periods, if we have satisfied such obligations, an event of default would occur under our Senior Notes, Second Lien Notes, and, if the maturity of the foregoing indebtedness were to be accelerated, our Third Lien Notes. In addition, we must certify that we have maintained a Minimum Cash Balance of $5 million, and any failure to maintain such Minimum Cash Balance will result in an immediate event of default under our Senior Notes, Second lien Notes, and, if the maturity of the foregoing indebtedness were to be accelerated, our Third Lien Notes. Upon an acceleration of our debt following an event of default, the holders of our notes could proceed against the assets pledged to secure these obligations, which include our spectrum assets and the capital stock of our material subsidiaries, which would impair our ability to continue as a going concern.

***Our restructuring and cost reduction activities expose us to contingent liabilities, accounting charges, and other risks.***

We have realized significant operating losses during each reporting period since our inception in 2005 and expect to realize further operating losses in the future. In an effort to reduce our working capital requirements, in the third quarter of 2008, we commenced the implementation of a global restructuring initiative, pursuant to which we have divested, either through sale, dissolution or closure, our network infrastructure businesses and our semiconductor business. We have also taken other cost reduction actions described in more detail in Note 1 to our Condensed Consolidated Financial Statements contained in this Form 10-Q. During the nine months ended September 26, 2009, we incurred employee termination costs of $4.9 million, lease abandonment and related facility closure costs of $0.8 million and other restructuring costs of $3.1 million, including costs related to the divestiture and closure of discontinued businesses and contract termination charges.

The completion of our restructuring activities has required and will continue to require significant management time and focus and the incurrence of professional fees and other expenses. The accounting for certain of our restructuring activities is complex, and we identified a material weakness in our internal control over financial reporting as of December 27, 2008 due to our failure to properly account for such transactions and have implemented remediation of these control deficiencies in 2009.

Our restructuring activities and cost reduction efforts are subject to risks including the effect of accounting charges which may be incurred, expenses of employee severance or contract terminations or defaults, or legal claims by employees or creditors. In addition, we may face difficulty in retaining critical employees, customers or suppliers who may believe that a continued relationship with us is of greater risk due to our restructuring activities. If we cannot successfully complete our restructuring efforts, our expenses will continue to exceed our revenue and available funding resources and we will not be able to continue as a going concern and could potentially be forced to seek relief through a filing under the U.S. Bankruptcy Code.

***Our internal controls over financial reporting were determined to have a material weakness as of December 27, 2008.***

The Sarbanes-Oxley Act of 2002 and SEC rules require that management report annually on the effectiveness of our internal control over financial reporting. Among other things, management must conduct an assessment of our internal control over financial reporting to allow

management to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act.



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As more fully described in Item 9A of our Annual Report on Form 10-K for the year ended December 27, 2008, our management concluded that our disclosure controls and procedures were not effective as of the end of the period covered by our Annual Report, in particular due to a control deficiency that represents a material weakness in our internal control over financial reporting. A material weakness is defined as a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The material weakness identified by management resulted from a lack of effective controls over the accounting for our global restructuring initiative, including the accounting and tax implications of asset sales, impairments and divestitures, and debt issuances and redemptions. Our failure to properly account for our global restructuring initiative resulted from a lack of a sufficient number of employees with appropriate levels of knowledge, expertise and training in the application of generally accepted accounting principles relevant to these types of transactions. This material weakness is more fully explained in “Part II Item 9A” in our Annual Report on Form 10-K. We have implemented remediation actions required to successfully remediate the identified material weakness in our internal control over financial reporting, which included supplementing our existing accounting personnel with additional resources with expertise in technical accounting matters.

Any failure to implement effective internal controls could cause us to fail to meet our reporting obligations. Inadequate internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our common stock, and may require us to incur additional costs to improve our internal control system.

***The failure of our Multimedia segment to sustain and grow its business in the current challenging economic climate may adversely impact our ability to comply with our Operating Budget and will have an adverse effect on our business.***

Revenues of our Multimedia segment business have been impacted by global economic conditions and a decline in handset sales. If the operating performance of our Multimedia segment were to continue to deteriorate, our ability to meet the targeted cash balance levels set forth in the Operating Budget, and required to be certified to the holders of our Second Lien Notes and Senior Notes, may be impacted. Given the divestiture and/or discontinuation of operations of our network infrastructure subsidiaries, all of our operating revenues are generated by our Multimedia segment. Current economic conditions make it extremely difficult for our customers, our vendors and us to accurately forecast and plan future business activities, and they could cause U.S. and foreign businesses to slow spending on the products and services offered by our Multimedia segment, which would delay and lengthen sales cycles. Furthermore, during challenging economic times our customers may face issues gaining timely access to sufficient credit, which could result in an impairment of their ability to make timely payments to us. We cannot predict the timing, strength or duration of any economic slowdown or subsequent economic recovery, worldwide, or in the wireless communications markets. If the economy or markets in which we operate continue to deteriorate, the business, financial condition and results of operations of our Multimedia segment will likely be materially and adversely affected. If our Multimedia segment experiences a significant decline in its revenues or operating margins, this will have a significant adverse effect on our business and our ability to comply with our debt covenants.

***Our common stock could be delisted from the NASDAQ Global Market if our stock price continues to trade below $1.00 per share.***

On October 7, 2008, we received a Staff Deficiency Letter from The NASDAQ Stock Market LLC, or NASDAQ, notifying us that we were not in compliance with NASDAQ’s Marketplace Rule 4450(a)(5), (“the Rule”), because the closing bid price for our Common Stock had, for the preceding 30 consecutive business days, closed below the minimum $1.00 per share requirement for continued listing. In accordance with NASDAQ Marketplace Rule 4450(e)(2), we were provided a period of 180 calendar days to regain compliance. On October 16, 2008, NASDAQ announced that they had suspended the enforcement of the Rule until January 19, 2009, and as a result, the period during which we had to regain compliance had been extended to July 10, 2009. On July 15, 2009, NASDAQ announced that they had determined to continue the temporary suspension of the Rule until July 31, 2009, and as a result, the period during which we have to regain compliance has been extended to January 21, 2010. If at any time before January 21, 2010, the bid price of our Common Stock closes at or above $1.00 per share for a minimum of 10 consecutive business days, NASDAQ will provide written notification that we have achieved compliance with the Rule. If compliance with the Rule cannot be demonstrated by January 21, 2010, our Common Stock will be subject to delisting from The NASDAQ Global Market.

In the event that we receive notice that our common stock is being delisted from The NASDAQ Global Market, NASDAQ rules permit us to appeal any delisting determination by the NASDAQ staff to a NASDAQ Listing Qualifications Panel. Alternatively, NASDAQ may permit us to transfer the listing of our common stock to The NASDAQ Capital Market if we satisfy the requirements for initial inclusion set forth in Marketplace Rule 4310(c), except for the bid price requirement. If our application for transfer is approved, we would have an additional 180 calendar days to comply with the Minimum Bid Price Rule in order to remain on The NASDAQ Capital Market. While we may consider measures such as a reverse stock split in order to maintain compliance with the Minimum Bid Price Rule, at this time, we cannot determine whether we can meet the other quantitative listing requirements of the NASDAQ Global Market or the NASDAQ Capital Market.

Delisting from The NASDAQ Global Market could have an adverse effect on our business and on the trading of our common stock. If a delisting of our common stock from the NASDAQ Stock Market were to occur, our common stock would trade on the OTC Bulletin Board or on the pink sheets” maintained by the National Quotation Bureau, Inc. Our stock price, as well as the liquidity of our common stock, may be adversely impacted as a result.

42

***We have become and may continue to be the target of securities class action suits and derivative suits which could result in substantial costs and divert management attention and resources.***

Securities class action suits and derivative suits are often brought against companies following periods of volatility in the market price of their securities. Defending against these suits can result in substantial costs to us and divert the attention of our management.

On September 16, 2008, a putative class action lawsuit, captioned Sandra Lifschitz, On Behalf of Herself and All Others Similarly Situated, Plaintiff, v. NextWave Wireless Inc., Allen Salmasi, George C. Alex and Frank Cassou, Defendants", was filed in the U.S. District Court for the Southern District of California against us and certain of our officers. The suit alleges that the defendants made false and misleading statements and/or omissions in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The suit seeks unspecified damages, interest, costs, attorneys' fees, and injunctive, equitable or other relief on behalf of a purported class of purchasers of our common stock during the period from March 30, 2007 to August 7, 2008. A second putative class action lawsuit captioned "Benjamin et al. v. NextWave Wireless Inc. et al." was filed on October 21, 2008 alleging the same claims on behalf of purchasers of our common stock during an extended class period, between November 27, 2006 through August 7, 2008. On February 24, 2009, the Court issued an Order consolidating the two cases and appointing a lead plaintiff pursuant to the Private Securities Litigation Reform Act. On May 15, 2009, the lead plaintiff filed an Amended Complaint, and on June 29, 2009, we filed a Motion to Dismiss that Amended Complaint. The Motion currently is pending with the Court. At this time, the case remains in the initial pleading stages and management is not able to offer any assessment as to the likelihood of prevailing on the merits.

***We operate in an extremely competitive environment which could materially adversely affect our ability to win market acceptance of our products and achieve profitability.***

We continue to experience intense competition for our products and services. Our competitors range in size from Fortune 500 companies to small, specialized single-product businesses. At present, the primary competitors for our multimedia software products are the internal multimedia design teams at large OEM handset manufacturers such as Nokia, Samsung, LG, Sony Ericsson, Motorola, Apple, RIM, HTC, Palm and others. Many of these companies now offer their own internally developed multimedia services (e.g., Nokia Ovi, SonyEricsson PlayNow) that come bundled with various handset products. While these groups compete against us in the overall market for wireless multimedia, these companies also represent the primary distribution channel for delivering PacketVideo products. This is because PacketVideo's mobile operator customers ask these manufacturers to install or preload a version of PacketVideo's software customized for such mobile operator in handsets that they purchase. In addition to the handset manufacturers, a number of companies compete with PacketVideo at various product levels, including Adobe, Microsoft, MobiTV, NXP Software, Real Networks, Sasken, Streamezzo, SurfKitchen, and UIEvolution, offering software products and services that directly or indirectly compete with PacketVideo.

For the connected home set of product solutions, our primary competitors again include internal software design teams at large consumer electronics companies like Sony, Microsoft, Cisco Linksys, Samsung and Panasonic. In addition, we face competition from a number of other companies such as Apple, Macrovision, Microsoft, Monsoon Networks, the Orb, and Real Networks. Our ability to generate adequate revenues to meet our Operating Budget will depend, in part, upon our ability to effectively compete with these competitors.

***Our Multimedia business is dependent on a limited number of customers.***

Our Multimedia segment generates all of our revenues from continuing operations and is dependent on a limited number of customers. For the nine months ended September 26, 2009, sales to three Multimedia customers, Verizon Wireless, NTT DOCOMO and Google accounted for 37%, 20% and 14%, respectively, of our consolidated revenues from continuing operations. If any of these customers terminate their relationships with us, our revenues and results of operations could be materially adversely affected.

***Our customer agreements do not contain minimum purchase requirements and can be cancelled on terms that are not beneficial to us.***

Our customer agreements with wireless service providers and mobile phone and device manufacturers are not exclusive and many contain no minimum purchase requirements or flexible pricing terms. Accordingly, our customers may effectively terminate these agreements by no longer purchasing our products or reducing the economic benefits of those arrangements. In many circumstances, we have indemnified these customers from certain claims that our products and technologies infringe third-party intellectual property rights. Our customer agreements have a limited term of one to five years, in some cases with evergreen, or automatic renewal, provisions upon expiration of the initial term. These agreements set out the terms of our distribution relationships with the customers but generally do not obligate the customers to market or distribute any of our products or applications. In addition, in some cases customers can terminate these agreements early or at any time, without cause.

***Defects or errors in our products and services or in products made by our suppliers could harm our relations with our customers and expose us to liability. Similar problems related to the products of our customers or licensees could harm our business.***

43

Our products and technologies are inherently complex and may contain defects and errors that are detected only when the products are in use. Further, because our products and technologies serve as critical functions in our customers' products, such defects or errors could have a serious impact on our customers, which could damage our reputation, harm our customer relationships and expose us to liability. Defects in our products and technologies or those used by our customers or licensees, equipment failures or other difficulties could adversely affect our ability and that of our customers and licensees to ship products on a timely basis as well as customer or licensee demand for our products. Any such shipment delays or declines in demand could reduce our revenues and harm our ability to achieve or sustain desired levels of profitability. We and our customers or licensees may also experience component or software failures or defects which could require significant product recalls, reworks and/or repairs which are not covered by warranty reserves and which could consume a substantial portion of the capacity of our third-party manufacturers or those of our customers or licensees. Resolving any defect or failure related issues could consume financial and/or engineering resources that could affect future product release schedules. Additionally, a defect or failure in our products and technologies or the products of our customers or licensees could harm our reputation and/or adversely affect the growth of our business.

PacketVideo prides itself on quality embedded software and has spent a decade improving upon its processes and performance. While we are not immune to product issues, developing for existing platforms that are constantly being upgraded and new platforms that have not fully been tested in the commercial market require much experience. Some of our technology may launch with a platform that does not do well in the market and some of our technology may launch on popular platforms that may have been modified due to aggressive timelines upon which PacketVideo has very little influence over. It is the nature of our business to continuously improve upon our deliverables.

With regards to the connected home products, the market is new, the products are not standardized and PacketVideo has no control over the design of the products with which it must connect. Moreover, PacketVideo must work with each individual consumer electronics manufacturer to ensure seamless connectivity and given the size of the consumer electronics device market, a large number of resources is constantly required.

***We may be unable to protect our own intellectual property and could become subject to claims of infringement, which could adversely affect the value of our products and technologies and harm our reputation.***

As a technology company, we expect to incur expenditures to create and protect our intellectual property and, possibly, to assert infringement by others of our intellectual property. Other companies or entities also may commence actions or respond to an infringement action that we initiate by seeking to establish the invalidity or unenforceability of one or more of our patents or to dispute the patentability of one or more of our pending patent applications. In the event that one or more of our patents or applications are challenged, a court may invalidate the patent, determine that the patent is not enforceable or deny issuance of the application, which could harm our competitive position. If any of our patent claims are invalidated or deemed unenforceable, or if the scope of the claims in any of these patents is limited by court decision, we could be prevented from licensing such patent claims. Even if such a patent challenge is not successful, it could be expensive and time consuming to address, divert management attention from our business and harm our reputation. Effective intellectual property protection may be unavailable or limited in certain foreign jurisdictions.

We also expect to incur expenditures to defend against claims by other persons asserting that the technology that is used and sold by us infringes upon the right of such other persons. From time to time, we have received, and expect to continue to receive, notices from our competitors and others claiming that their proprietary technology is essential to our products and seeking the payment of a license fee. Any claims, with or without merit, could be time consuming to address, result in costly litigation and/or the payment of license fees, divert the efforts of our technical and management personnel or cause product release or shipment delays, any of which could have a material adverse effect upon our ability to commercially launch our products and technologies and on our ability to achieve profitability. If any of our products were found to infringe on another company's intellectual property rights or if we were found to have misappropriated technology, we could be required to redesign our products or license such rights and/or pay damages or other compensation to such other company. If we were unable to redesign our products or license such intellectual property rights used in our products, we could be prohibited from making and selling such products. In any potential dispute involving other companies' patents or other intellectual property, our customers and partners could also become the targets of litigation. Any such litigation could severely disrupt the business of our customers and partners, which in turn could hurt our relations with them and cause our revenues to decrease.

***We are subject to risks associated with our international operations.***

We operate or hold spectrum licenses through various subsidiaries and joint ventures in Argentina, Austria, Canada, Chile, Croatia, Germany, Norway, Slovakia and Switzerland and have additional operations located in Finland, France, Germany, India, Japan, South Korea and Switzerland.

Our activities outside the United States operate in different competitive and regulatory environments than we face in the United States, with many of our competitors having a dominant incumbent market position and/or greater operating experience in the specific geographic market. In addition, in some international markets, foreign governmental authorities may own or control the incumbent telecommunications companies operating under their jurisdiction. Established relationships between government-owned or government-controlled telecommunications companies and their traditional local telecommunications providers often limit access of third parties to these markets.

44

In addition, owning and operating wireless spectrum licenses in overseas jurisdictions may be subject to a changing regulatory environment. In particular, our ownership of wireless broadband spectrum in Argentina remains subject to obtaining governmental approval. Additionally, we have initiated insolvency proceedings for our WiMAX Telecom GmbH business in Austria and the retention by WiMAX Telecom GmbH of its wireless broadband spectrum licenses in Austria may be compromised due to such proceedings. We cannot assure you that changes in foreign regulatory guidelines for the issuance or use of wireless licenses, foreign ownership of spectrum licenses, the adoption of wireless standards or the enforcement and licensing of intellectual property rights will not adversely impact our operating results. Due to these competitive and regulatory challenges, our activities outside the United States may require a disproportionate amount of our management and financial resources, which could disrupt our operations and adversely affect our business.

***We are dependent on a small number of individuals, and if we lose key personnel upon whom we are dependent, our business will be adversely affected.***

Our future success depends largely upon the continued service of our board members, executive officers and other key management and technical personnel, particularly James Brailean, our Chief Executive Officer, Chief Operating Officer and President.

Our key employees represent a significant asset, and the competition for these employees is intense in the wireless communications industry. Due to our history of operating losses and our business restructuring efforts which has resulted, and will continue to result, in the divestiture or discontinuation of operations of some of our subsidiaries, we may have particular difficulty attracting and retaining key personnel given the significant use of incentive compensation by well-established competitors. We do not maintain key person life insurance on any of our personnel. We also have no covenants against competition or nonsolicitation agreements with certain of our key employees. The loss of one or more of our key employees or our inability to attract, retain and motivate qualified personnel could negatively impact our ability to design, develop and commercialize our products and technology.

**Risks Relating to Government Regulation**

***If we do not comply with build-out requirements relating to our domestic and international spectrum licenses, such licenses could be subject to forfeiture.***

Certain “build-out” or “substantial service” requirements apply to our licensed wireless spectrum, which generally must be satisfied as a condition of license renewal. In particular, the renewal deadline and the substantial service build-out deadline for our domestic WCS spectrum is July 21, 2010; for our domestic BRS and EBS spectrum, the substantial service build-out deadline is May 1, 2011; and for our domestic AWS spectrum, the substantial service build-out deadline is December 18, 2021. Failure to make the substantial service demonstration domestically, without seeking and obtaining an extension from the FCC, would result in license forfeiture. Extensions of time to meet substantial service demonstrations are not routinely granted by the FCC. We plan to seek and enter into third party arrangements pursuant to which in exchange for access to certain of our spectrum, such parties would commit the financial resources necessary to meet our build-out requirements. We have obtained third party arrangements, which we believe will allow us to satisfy our substantial service requirements with respect to our domestic WCS spectrum. Our reliance on a third party to meet our substantial service requirements may subject us to risks of non-renewal in the event that such party does not perform its obligations. There can be no assurance at this time that we will identify satisfactory third party arrangements with respect to our domestic BRS and EBS spectrum.

We also have certain build-out requirements internationally, and failure to make those service demonstrations could also result in license forfeiture. For example, in Canada, our 2.3 GHz licenses are subject to mid-term in-use demonstration requirements in November of 2012 and in April of 2013. In Germany, our 3.5 GHz licenses are subject to an obligation to achieve coverage of 15% of all municipalities by the end of 2009 and 25% of all municipalities by the end of 2011. Failure to meet these requirements on time may result in the German telecommunications regulatory authority, the Bundesnetzagentur (“BNetzA”), withdrawing the licenses. As a result, we are under extreme time pressure to address this requirement, particularly in light of our decision not to engage in any build outs in Europe.

***We may not have complete control over our transition of BRS and EBS spectrum, which could impact compliance with FCC rules.***

The FCC’s rules require transition of BRS and EBS spectrum to the new band plan on a Basic Trading Area (“BTA”) basis. See “Government Regulation-BRS-EBS License Conditions.” All of our EBS and BRS spectrum has been transitioned to the new band plan except for our BRS spectrum in Albuquerque, New Mexico. Sprint filed an initiation plan on February 12, 2008 to transition the Albuquerque BTA. We do not hold all of the BRS and EBS spectrum in Albuquerque BTA. Consequently, we will need to coordinate with other BRS and EBS licensees in order to transition spectrum we hold or lease. Disagreements with other BRS or EBS licensees about how the spectrum should be transitioned may delay our efforts to transition spectrum, could result in increased costs to transition the spectrum, and could impact our efforts to comply with applicable FCC rules. The FCC rules permit us to self-transition to the reconfigured band plan if other spectrum holders in our BTAs do not timely transition their spectrum.

45

***Our use of EBS spectrum is subject to privately negotiated lease agreements. Changes in FCC rules governing such lease agreements, contractual disputes with EBS licensees, or failures by EBS licensees to comply with FCC rules could impact our use of the spectrum.***

With few exceptions, commercial enterprises are restricted from holding licenses for EBS spectrum. Eligibility for EBS spectrum is limited to accredited educational institutions, governmental organizations engaged in the formal education of enrolled students (e.g., school districts), and nonprofit organizations whose purposes are educational. Access to EBS spectrum can only be gained by commercial enterprises through privately-negotiated EBS lease agreements. FCC regulation of EBS leases, private interpretation of EBS lease terms, private contractual disputes, and failure of an EBS licensee to comply with FCC regulations all could impact our use of EBS spectrum and the value of our leased EBS spectrum. The FCC rules permit EBS licensees to enter into lease agreements with a maximum term of 30 years; lease agreements with terms longer than 15 years must contain a right of review" by the EBS licensee every five years beginning in year 15. The right of review must afford the EBS licensee with an opportunity to review its educational use requirements in light of changes in educational needs, technology, and other relevant factors and to obtain access to such additional services, capacity, support, and/or equipment as the parties shall agree upon in the spectrum leasing arrangement to advance the EBS licensee's educational mission. A spectrum leasing arrangement may include any mutually agreeable terms designed to accommodate changes in the EBS licensee's educational use requirements and the commercial lessee's wireless broadband operations. In addition, the terms of EBS lease agreements are subject to contract interpretation and disputes could arise with EBS licensees. There can be no assurance that EBS leases will continue for the full lease term, or be extended beyond the current term, or be renewed or extended on terms that are satisfactory to us. Similarly, since we are not eligible to hold EBS licenses, we must rely on EBS licensees with whom we contract to comply with FCC rules. The failure of an EBS licensee from whom we lease spectrum to comply with the terms of their FCC authorization or FCC rules could result in termination, forfeiture or non-renewal of their authorization, which would negatively impact the amount of spectrum available for our use.

***We have no guarantee that the licenses we hold or lease will be renewed.***

The FCC generally grants wireless licenses for terms of ten or 15 years, which are subject to renewal and revocation. FCC rules require all wireless licensees to comply with applicable FCC rules and policies and the Communications Act in order to retain their licenses. For example, licensees must meet certain construction requirements, including making substantial service demonstrations, in order to retain and renew FCC licenses. Failure to comply with FCC requirements with respect to any license could result in revocation or non-renewal of a license. In general, most wireless licensees who meet their construction and/or substantial service requirements are afforded a renewal expectancy, however, all FCC license renewals can be challenged in various ways, regardless of whether such challenges have any legal merit. Under FCC rules, licenses continue in effect during the pendency of timely filed renewal applications. Challenges to license renewals, while uncommon, may impact the timing of renewal grants and may impose legal costs. Accordingly, there is no guarantee that licenses we hold or lease will remain in full force and effect or be renewed.

We hold 30 licenses issued by the FCC for WCS spectrum. Renewal applications for all 2.3 GHz WCS licenses, including those issued to us, were due to be filed with the FCC on July 21, 2007. We filed our WCS renewal applications on April 23, 2007. Under FCC rules, licenses continue in effect during the pendency of timely file renewal applications. At least three parties about which we are aware made filings purporting to be "competing applications" in response to the renewal applications we, AT&T, and perhaps others filed. The basis on which the third-party filings were made was the alleged failure of WCS licensees to deploy service on WCS spectrum and satisfy substantial service requirements by July 21, 2007. However, on December 1, 2006, the FCC issued a waiver order extending the substantial service deadline for WCS licensees to July 21, 2010. The FCC's rules contain no procedures for processing "competing applications" filed for WCS spectrum and the FCC has not accepted them for filing. We have no knowledge of the status of these filings and cannot predict how the FCC may address them or how these filings may impact our renewal applications.

***Interference could negatively impact our use of wireless spectrum we hold, lease or use.***

Under applicable FCC and equivalent international rules, users of wireless spectrum must comply with technical rules that are intended to eliminate or diminish harmful radiofrequency interference between wireless users. Licensed spectrum is generally entitled to interference protection, subject to technical rules applicable to the radio service, while unlicensed spectrum has no interference protection rights and must accept interference caused by other users.

***Wireless devices utilizing WCS, BRS and EBS spectrum may be susceptible to interference from Satellite Digital Audio Radio Services ("SDARS").***

Since 1997, the FCC has considered a proposal to permanently authorize terrestrial repeaters for SDARS operations adjacent to the C and D blocks of the WCS band. The FCC has permitted a large number of these SDARS terrestrial repeaters to operate on a special temporary authorization since 2001. Permanently authorizing SDARS repeaters adjacent to the WCS band could cause interference to WCS, BRS and EBS receivers. The extent of the interference from SDARS repeaters is unclear and is subject to the FCC's final resolution of pending proceedings. Because WCS C and D block licenses are adjacent to the SDARS spectrum, the potential for interference to this spectrum is of greatest concern. There is a lesser magnitude concern regarding interference from SDARS to WCS A and B block licenses, and BRS and EBS licenses. Central to the FCC's evaluation of this proposal has been the technical specifications for the operation of such repeaters. SDARS licensees are seeking rule

changes that

would both unfavorably alter WCS technical operating requirements and permit all existing SDARS repeaters to continue to operate at their current operating parameters. Through their representative association, the WCS Coalition, the majority of affected WCS licensees, including NextWave, also have proposed technical rules for SDARS terrestrial repeaters and WCS operations to the FCC. Final technical rules will determine the potential interference conditions and requirements for mitigation. If SDARS repeaters result in interference to our WCS, BRS or EBS spectrum, our ability to realize value from this spectrum may be impaired.

***Increasing regulation of the tower industry may make it difficult to deploy new towers and antenna facilities which could adversely affect the value of certain of our wireless spectrum assets.***

The FCC, together with the FAA, regulates tower marking and lighting. In addition, tower construction and deployment of antenna facilities is impacted by federal, state and local statutes addressing zoning, environmental protection and historic preservation.

The FCC adopted significant changes to its rules governing historic preservation review of new tower projects, which makes it more difficult and expensive to deploy towers and antenna facilities. The FCC also is considering changes to its rules regarding when routine environmental evaluations will be required to determine compliance of antenna facilities with its radiofrequency radiation exposure limits. If adopted, these regulations could make it more difficult to deploy facilities. In addition, the FAA has proposed modifications to its rules that would impose certain notification requirements upon entities seeking to (i) construct or modify any tower or transmitting structure located within certain proximity parameters of any airport or heliport, and/or (ii) construct or modify transmission facilities using the 2500-2700 MHz radiofrequency band, which encompasses virtually all of the BRS/EBS frequency band. If adopted, these requirements could impose new administrative burdens upon use of BRS/EBS spectrum.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**ITEM 3. Default Upon Senior Securities**

None.

**ITEM 4. Submission of Matters to a Vote of Security Holders**

None.

**ITEM 5. Other Information**

On October 30, 2009, the Board of Directors of WiMAX Telecom GmbH, the holding company for NextWave’s discontinued WiMAX Telecom business in Austria and Croatia, filed an insolvency proceeding in Austria in accordance with local law to permit the orderly wind-down of such entity. The court in Austria has entered an order appointing an administrator to manage the insolvency of WiMAX Telecom GmbH. As a result of the appointment of the administrator, NextWave no longer controls WiMAX Telecom GmbH and its subsidiaries and will not receive any proceeds from the assets of the WiMAX entities. NextWave has obtained a waiver of events of default resulting from the insolvency filing under its Senior Notes, Second Lien Notes and Third Lien Notes, including a rescission of the acceleration of maturity triggered as a result of such filing.

**ITEM 6. Exhibits**

| Exhibit No. | Description |
|---|---|
| 4.1 | Second Lien Incremental Indebtedness Agreement, dated July 2, 2009, among NextWave Wireless Inc., as parent guarantor, NextWave Wireless LLC, as issuer, NextWave Broadband Inc., NW Spectrum Co., AWS Wireless Inc. and WCS Wireless License Subsidiary, LLC, as subsidiary guarantors, Avenue AIP US, L.P., as the note purchaser and The Bank of New York Mellon, as collateral agent (incorporated by reference to Exhibit 4.1 of the Quarterly Report on Form 10-Q for the fiscal quarter ended June 27, 2009 (the "Second Quarter 10-Q")). |
| 4.2 | Warrant Agreement, dated July 2, 2009, between NextWave Wireless Inc. and Avenue AIP US, L.P. (incorporated by reference to Exhibit 4.2 of the Second Quarter 10-Q) |
| 4.3 | Acknowledgment to Registration Rights Agreement, dated July 2, 2009, by NextWave Wireless Inc. (incorporated by reference to Exhibit 4.3 of the Second Quarter 10-Q). |

| | |
|---|---|
| 10.1 | Stock Purchase Agreement, dated July 2, 2009, by and among PacketVideo Corporation, NextWave Wireless Inc., NextWave Broadband Inc. and NTT DOCOMO, Inc. (incorporated by reference to Exhibit 10.1 of the Second Quarter 10-Q). |
| 10.2 | Stockholders' Agreement, dated as of July 2, 2009 by and among PacketVideo Corporation, NextWave Wireless Inc., NextWave Broadband Inc. and NTT DOCOMO, Inc. (incorporated by reference to Exhibit 10.2 of the Second Quarter 10-Q). |
| 10.3 | Amended and Restated Certificate of Incorporation of PacketVideo Corporation (incorporated by reference to Exhibit 10.3 of the Second Quarter 10-Q). . |
| 31.1 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for James Brailean. |
| 31.2 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Francis J. Harding. |
| 32.1 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for James Brailean. |
| 32.2 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Francis J. Harding. |

**SIGNATURES**

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

**NEXTWAVE WIRELESS INC.** (Registrant)

November 5, 2009
(Date)

By: /s/ Francis J. Harding
Francis J. Harding
Executive Vice President and
Chief Financial Officer

49

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