TERCICA INC
Form 10-Q
May 04, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly report pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934
For the quarterly period ended March 31, 2007

OR

¨ Transition report pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934
Commission File Number 000-50461

TERCICA, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**26-0042539**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

2000 Sierra Point Parkway, Suite 400

Brisbane, San Francisco, CA 94005

(650) 624-4900

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (Check one):

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

As of May 1, 2007, there were 50,162,610 shares of the Registrant s Common Stock outstanding.

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TERCICA, INC.

FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2007

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

TERCICA, INC.

CONDENSED BALANCE SHEETS

(In thousands)

(Unaudited)

	March 31, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 31,592	$ 40,339
Short-term investments	79,136	85,236
Accounts receivable, net	552	335
Inventories	7,490	5,092
Prepaid expenses and other current assets	1,552	1,948
Total current assets	120,322	132,950
Property and equipment, net	3,691	3,861
Restricted cash	340	340
Other assets	543	536
Total assets	$ 124,896	$ 137,687
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 1,950	$ 2,457
Accrued expenses	4,805	6,214
Liability for early exercise of stock options	21	32
Other current liabilities	298	290
Deferred revenue, less long-term portion	776	776
Total current liabilities	7,850	9,769
Long-term convertible note	25,328	25,172
Deferred rent	1,286	1,363
Deferred revenue, long-term portion	11,257	11,452
Commitments and contingencies		
Stockholders equity:		
Common stock	50	50
Additional paid-in capital	340,247	338,608
Accumulated other comprehensive income	10	11
Accumulated deficit	(261,132)	(248,738)
Total stockholders equity	79,175	89,931

Total liabilities and stockholders equity	$ 124,896	$ 137,687

See accompanying notes.

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TERCICA, INC.

CONDENSED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Net revenues		
Net product sales	$ 1,091	$ 85
License revenue	194	
Total net revenues	1,285	85
Costs and expenses:		
Cost of sales	553	83
Research and development*	4,912	4,630
Selling, general and administrative*	9,597	10,504
Total costs and expenses	15,062	15,217
Loss from operations	(13,777)	(15,132)
Interest expense	(188)	
Interest and other income, net	1,571	863
Net loss	(12,394)	(14,269)
Basic and diluted net loss per share	$ (0.25)	$ (0.40)
Shares used to compute basic and diluted net loss per share	50,145	35,641

* Includes non-cash stock-based compensation expense as follows:

Research and development	$ 525	$ 429
Selling, general and administrative	976	688
Total	$ 1,501	$ 1,117

See accompanying notes.

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TERCICA, INC.

CONDENSED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Cash flows from operating activities:		
Net cash used in operating activities	$ (15,012)	$ (13,578)
Cash flows from investing activities:		
Purchases of property and equipment	(188)	(275)
Purchases of available-for-sale securities	(33,490)	(18,787)
Proceeds from sales and maturities of available-for-sale securities	39,943	22,150
Net cash provided by (used in) investing activities	6,265	3,088
Cash flows from financing activities:		
Net proceeds from issuance of common stock		34,291
Net proceeds from public offerings of common stock		
Net cash provided by financing activities		34,291
Net increase in cash and cash equivalents	(8,747)	23,801
Cash and cash equivalents, beginning of period	40,339	14,817
Cash and cash equivalents, end of period	$ 31,592	$ 38,618
Supplemental schedule of noncash activities:		
Reversal of deferred stock compensation upon adoption of SFAS No. 123R	$	$ (2,591)
Other, net		25

See accompanying notes.

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TERCICA, INC.

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1. Company and Basis of Presentation

Company

Tercica, Inc. (the Company) is a biopharmaceutical company developing and marketing a portfolio of endocrine products. The Company s predecessor, Tercica Limited, a New Zealand company, was formed in October 2000. Tercica Medica, Inc. was incorporated in Delaware in December 2001, and subsequently changed its name to Tercica, Inc.

Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared in accordance with the requirements of the U.S. Securities and Exchange Commission (SEC) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by U.S. generally accepted accounting principles (GAAP) can be condensed or omitted. In the opinion of management, the financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of the Company s financial position and operating results. The condensed balance sheet at December 31, 2006 has been derived from the audited financial statements at that date.

The results of the Company s operations can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year or any future periods. The information included in this quarterly report on Form 10-Q should be read in conjunction with the audited financial statements for the year ended December 31, 2006, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006, filed with the SEC on March 9, 2007.

The preparation of financial statements in conformity with GAAP for interim financial reporting requires management to make estimates and assumptions that affect the amounts reported in the condensed financial statements and accompanying notes. Actual results could differ from those estimates.

Significant Accounting Policies

On January 1, 2007, we adopted a new policy related to income taxes, as described more fully below. Other than this change, there have been no significant changes in our significant accounting policies during the three months ended March 31, 2007 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

Accounting for Income Taxes

The Company adopted FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), on January 1, 2007. As a result of the implementation of FIN 48, the Company did not recognize any adjustment to the liability for uncertain tax positions and therefore did not record any adjustment to the beginning balance of retained earnings on the balance sheet. The Company s continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense, although there have been no such interest or penalties charged to the Company with the adoption of FIN 48. The Company had no unrecognized tax benefits as of March 31, 2007 and expects no significant changes in unrecognized tax benefits in the next twelve months.

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TERCICA, INC.

NOTES TO THE CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, or SFAS No. 157. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact of adopting SFAS No. 157 on its financial position or results of operations.

2. Balance Sheet Information

	March 31, 2007	December 31, 2006
	(in thousands)	
Accounts receivable, net:		
Receivables	$ 564	$ 343
Less: allowance for doubtful accounts	(12)	(8)
	$ 552	$ 335
Inventories		
Raw materials	$ 1,864	$ 1,477
Work-in-process	4,275	3,280
Finished goods	1,351	335
	$ 7,490	$ 5,092
Property and equipment, net:		
Office equipment	$ 316	$ 316
Furniture and fixtures	635	635
Computer equipment and software	2,489	2,291
Manufacturing equipment	1,255	1,240
Leasehold improvements	1,302	1,302
Construction in progress	98	216
	6,095	6,000
Less: accumulated depreciation and amortization	(2,404)	(2,139)
	$ 3,691	$ 3,861
Accrued expenses:		
Accrued compensation and related liabilities	$ 2,298	$ 2,938
Accrued professional fees	740	1,691
Accrued contract manufacturing expenses	895	629
Clinical trial costs	301	335
Other accrued liabilities	571	621

	$ 4,805	$ 6,214

3. Comprehensive Loss

Comprehensive loss is comprised of net loss and unrealized gains/losses on available-for-sale securities in accordance with SFAS No. 130, *Reporting Comprehensive Income*. The following table presents the calculation of comprehensive loss, net of tax:

TERCICA, INC.

NOTES TO THE CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

	Three months ended March 31, 2007	2006
	(in thousands)	
Net loss, as reported	$ (12,394)	$ (14,269)
Change in unrealized gains (losses) on marketable securities, net of tax	(1)	(8)
Comprehensive loss	$ (12,395)	$ (14,277)

4. Long-Term Debt

In October 2006, the Company issued to Ipsen a convertible note in the principal amount of $25,037,000 (the First Convertible Note). The First Convertible Note accrues interest at a rate of 2.5% per year, compounded quarterly, and is convertible into the Company s common stock at an initial conversion price of $7.41 per share, subject to adjustment, which represents 3,418,036 shares at March 31, 2007. The conversion price of the First Convertible Note is subject to certain weighted-average price-based antidilution adjustments, that, if triggered, would result in an increase of the number of shares of common stock issuable upon conversion of the First Convertible Note. The entire principal balance and accrued interest under the First Convertible Note is due and payable on the later to occur of October 13, 2011 or the second anniversary of the date on which Ipsen (or a subsequent holder of the First Convertible Note) notifies the Company that it will not convert the First Convertible Note in full. Notwithstanding the foregoing, Ipsen (or a subsequent holder of the First Convertible Note) is entitled to declare all amounts outstanding under the First Convertible Note immediately due and payable: (i) if an event of default occurs (as set forth in the First Convertible Note); (ii) for so long as Ipsen s approval rights as set forth in the affiliation agreement the Company entered into pursuant to its collaboration with Ipsen remain in effect, if any other person or group acquires beneficial ownership of greater than 9.9% of the Company s common stock (or if such person or group that already has beneficial ownership of greater than 9.9% of the Company s common stock increases its beneficial ownership); or (iii) in the event that the Company s approval rights as set forth in the affiliation agreement with Ipsen cease to remain effective, if any other person or group acquires beneficial ownership of greater than 50% of the Company s common stock.

As of March 31, 2007, the Company accrued $291,000 of cumulative interest expense on the First Convertible Note, of which $155,000 was recorded as interest expense in the three months ended March 31, 2007. If not earlier converted or repaid, the amount payable under the First Convertible Note on October 13, 2011 would be $28,362,000, would include cumulative interest of $3,325,000.

5. Equity

Warrant Issued to Ipsen

Concurrently with the issue of the First Convertible Note, the Company issued a warrant to Ipsen, which is exercisable for such number of shares of the Company s common stock equal to the greater of (i) 4,948,795 shares of the Company s common stock (the Baseline Amount) or (ii) the Baseline Amount plus a variable amount of shares of the Company s common stock, which variable amount will fluctuate throughout the term of the warrant. The number of shares of the Company s common stock issuable upon exercise of the warrant as of October 13, 2006, the date of issue, was 5,026,712, with a fair value of $13,622,000, estimated using the Black-Scholes-Merton valuation model, which was recorded to additional paid-in capital. The number of shares of the Company s common stock issuable upon exercise of the warrant as of March 31, 2007 was 4,987,488. The exercise term of the warrant is five years beginning on October 13, 2006, and the warrant is exercisable, in full or in part, at an initial exercise price of $7.41 per share, subject to adjustment, including certain weighted-average price-based antidilution adjustments.

Committed Equity Financing Facility

On October 14, 2005, the Company entered into a committed equity financing facility (CEFF) with Kingsbridge Capital Limited (Kingsbridge), which entitles the Company to sell and obligates Kingsbridge to purchase, a maximum of approximately 6,000,000 newly issued shares of the Company s common stock over a period of three years for cash up to an aggregate of $75,000,000, subject to certain conditions and restrictions. The Company may draw down under the CEFF in

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TERCICA, INC.

NOTES TO THE CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

tranches of up to the lesser of $7,000,000 or 2% of the Company s market capitalization at the time of the draw down of such tranche, subject to certain conditions. The common stock to be issued for each draw down will be issued and priced over an eight-day pricing period at discounts ranging from 6% to 10% from the volume weighted average price of the Company s common stock during the pricing period. During the term of the CEFF, Kingsbridge may not short the Company s stock, nor may it enter into any derivative transaction directly related to the Company s stock. The minimum acceptable purchase price, prior to the application of the appropriate discount for any shares to be sold to Kingsbridge during the eight-day pricing period, is determined by the greater of $3.00 or 90% of the Company s closing share price on the trading day immediately prior to the commencement of each draw down. In connection with the CEFF, the Company issued a warrant to Kingsbridge to purchase up to 260,000 shares of the Company s common stock at an exercise price of $13.12 per share. The exercise term of the warrant is five years beginning on April 14, 2006. The warrant was valued on the date of grant using the Black-Scholes-Merton valuation model using the following assumptions: a risk-free interest rate of 4.1%, a life of 5.5 years, no dividend yield and a volatility factor of 0.5. The estimated value of this warrant was $1,196,000 on the date of grant and was recorded as a contra-equity amount in additional paid-in capital in 2005.

On November 9, 2005 the Company filed a shelf registration statement with the SEC relating to the resale of up to 6,296,912 shares of common stock that the Company may issue to Kingsbridge pursuant to a common stock purchase agreement and warrant agreement noted above. The Company will not sell common stock under this registration statement and will not receive any of the proceeds from the sale of shares by the selling stockholder.

During the three months ended March 31, 2007, the Company did not draw down any funds under the CEFF and had not issued any shares pursuant to the CEFF as of March 31, 2007. Under the terms of an affiliation agreement the Company entered into pursuant to its collaboration with Ipsen, the Company has only a limited ability to raise capital through the sale of its equity securities, including pursuant to the CEFF, without first obtaining Ipsen s approval.

6. Stock-Based Compensation

Stock-based compensation expense is measured at the grant date, based on the fair value of the award, and is recognized as expense over the remaining requisite service period. Total stock-based compensation expense of $1,501,000 and $1,117,000 was recorded during the three months ended March 31, 2007 and 2006, respectively.

The Company has four active stock-based compensation plans, each of which are described below.

2004 Stock Plan

The Company s Board of Directors adopted the 2004 Stock Plan (formerly the 2003 Stock Plan) in September 2003 and the Company s stockholders approved it in October 2003. The 2004 Stock Plan became effective on March 16, 2004. The 2004 Stock Plan provides for the grant of incentive stock options to employees and for the grant of nonstatutory stock options, stock purchase rights, restricted stock, stock appreciation rights, performance units and performance shares to the Company s employees, directors and non-employ