JAZZ PHARMACEUTICALS INC
Form 10-Q
August 10, 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 Exchange Act of 1934
For the quarterly period ended June 30, 2007

or

¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 001-33500

JAZZ PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**05-0563787**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

3180 Porter Drive

Palo Alto, CA 94304

(650) 496-3777

(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 ¨ No x

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 ¨ Non-accelerated filer x

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 July 31, 2007, 24,550,554 shares of the registrant s Common Stock, $.0001 par value, were outstanding.

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FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2007

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

JAZZ PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

	June 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 148,000	$ 78,948
Restricted cash	275	275
Accounts receivable, net	6,462	5,380
Inventories	3,216	3,026
Prepaid expenses	2,655	3,447
Other current assets	547	487
Total current assets	161,155	91,563
Property and equipment, net	3,025	2,107
Intangible assets	60,952	69,140
Goodwill	38,213	38,213
Long-term restricted cash and investments	12,085	12,000
Other long-term assets	1,440	1,548
Total assets	$ 276,870	$ 214,571
LIABILITIES, CONVERTIBLE PREFERRED STOCK, AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Line of credit	$ 3,134	$ 2,191
Accounts payable	4,268	5,443
Accrued liabilities	22,198	12,943
Deferred revenue	2,027	1,422
Preferred stock warrant liability (including $5,965 as of December 31, 2006 held by related parties)		8,521
Total current liabilities	31,627	30,520
Deferred rent and other non-current liabilities	452	534
Deferred revenue, non-current	13,037	13,495
Liability under government settlement, non-current	14,881	
Senior secured notes	74,622	74,283
Commitments and contingencies (Note 7)		
Convertible preferred stock		263,852
Common stock subject to repurchase	13,174	8,183
Stockholders equity (deficit):		
Common stock	2	
Additional paid-in capital	366,165	1,335
Accumulated other comprehensive income		12

Accumulated deficit	(237,090)	(177,643)
Total stockholders equity (deficit)	129,077	(176,296)
Total liabilities, convertible preferred stock and stockholders equity (deficit)	$ 276,870	$ 214,571

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

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JAZZ PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Revenues:				
Product sales, net	$ 13,615	$ 10,454	$ 25,240	$ 20,225
Royalties, net	360	120	571	186
Contract revenue	289	500	2,541	500
Total revenues	14,264	11,074	28,352	20,911
Operating expenses:				
Cost of product sales (excluding amortization of acquired developed technology)	1,679	1,754	3,682	3,323
Research and development	17,407	14,280	32,274	27,174
Selling, general and administrative	18,175	13,716	32,514	25,935
Amortization of intangible assets	2,287	2,400	4,649	4,800
Provision for government settlement	17,469		17,469	
Total operating expenses	57,017	32,150	90,588	61,232
Loss from operations	(42,753)	(21,076)	(62,236)	(40,321)
Interest income	1,300	591	2,391	1,172
Interest expense (including $2,287 and $2,255 for the three months ended June 30, 2007 and 2006, respectively, and $4,541 and $4,440 for the six months ended June 30, 2007 and 2006, respectively, pertaining to related parties)	(3,314)	(3,769)	(6,582)	(7,546)
Other income, net	4,904	120	1,835	182
Gain on sale of product rights			5,145	
Net loss	(39,863)	(24,134)	(59,447)	(46,513)
Beneficial conversion feature				(3,501)
Loss attributable to common stockholders	$ (39,863)	$ (24,134)	$ (59,447)	$ (50,014)
Loss per share attributable to common stockholders, basic and diluted	$ (5.27)	$ (2,194.00)	$ (15.59)	$ (5,001.40)
Weighted-average common shares used in computing loss per share attributable to common stockholders, basic and diluted	7,561	11	3,813	10

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

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JAZZ PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended June 30,	
	2007	2006
Operating activities		
Net loss	$ (59,447)	$ (46,513)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	589	329
Amortization of intangible assets	4,649	4,800
Loss on disposal of property and equipment	6	481
Fair value adjustment to acquired finished goods	54	560
Stock-based compensation expense	1,980	1,664
Excess of cash paid over accrued for interest	487	400
Revaluation of preferred stock warrant liability	(1,846)	(182)
Interest on development financing		1,147
Gain on sale of product rights	(5,145)	
Changes in assets and liabilities:		
Accounts receivable	(1,073)	(7,209)
Inventories	(565)	(361)
Prepaid expenses and other current assets	732	543
Other assets	(52)	320
Accounts payable	(1,535)	(950)
Accrued liabilities	8,522	2,180
Deferred revenue	147	5,000
Deferred rent	(43)	(102)
Liability under government settlement	14,881	
Net cash used in operating activities	(37,659)	(37,893)
Investing activities		
Purchases of property and equipment	(1,513)	(660)
Increase in restricted cash and investments	(85)	
Proceeds from sale of product rights	9,000	
Net cash provided by (used in) investing activities	7,402	(660)
Financing activities		
Proceeds from issuances of convertible preferred stock, net of issuance costs		34,994
Proceeds from issuances of common stock, net of issuance costs	76	
Proceeds from sale of common stock in initial public offering, net of issuance costs	98,290	
Proceeds from line of credit	12,758	
Repayments under line of credit	(11,815)	
Proceeds from development financing		15,000
Net cash provided by financing activities	99,309	49,994
Net increase in cash and cash equivalents	69,052	11,441
Cash and cash equivalents, at beginning of period	78,948	20,614

Cash and cash equivalents, at end of period	$ 148,000	$ 32,055
Supplemental disclosure of cash flow information:		
Cash paid for interest (including $4,200 and $4,163 for the six months ended June 30, 2007 and 2006, respectively, paid to related parties)	$ 6,081	$ 6,000
Supplemental disclosure of non-cash financing activities:		
Beneficial conversion feature - deemed dividend attributable to preferred stockholders	$	$ 3,501
Conversion of preferred stock warrant liability to stockholders equity	$ 6,675	$

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

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JAZZ PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

These unaudited Condensed Consolidated Financial Statements have been prepared following the requirements of the Securities and Exchange Commission (SEC) for interim reporting. As permitted under those rules, certain footnotes and other financial information that are normally required by U.S. generally accepted accounting principles (GAAP) can be condensed or omitted. The information included in this quarterly report on Form 10 Q should be read in conjunction with the Consolidated Financial Statements and accompanying notes included in the Form S-1/A of Jazz Pharmaceuticals, Inc. (the Company or Jazz Pharmaceuticals) filed with the SEC on May 31, 2007. In the opinion of management, these financial statements have been prepared on the same basis as the annual financial statements and include all adjustments, consisting only of normal and recurring adjustments, considered necessary for the fair presentation of the Company s financial position and operating results. The results for the three and six months ended June 30, 2007 are not necessarily indicative of the results to be expected for the year ended December 31, 2007 or for any other interim period or for any future year.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Orphan Medical, Inc. (Orphan Medical), after elimination of intercompany transactions and balances.

Significant Risks and Uncertainties

The Company has incurred significant losses from operations since its inception and expects losses to continue for the next several years. To achieve profitable operations, the Company must successfully identify, develop and commercialize its products and product candidates. Products developed by the Company will require approval of the United States Food and Drug Administration (FDA) and/or a foreign regulatory authority prior to commercial sale. The regulatory approval process is expensive, time consuming and uncertain, and any denial or delay of approval could have a material adverse effect on the Company. Even if approved, the Company s products may not achieve market acceptance and will face competition from both generic and branded pharmaceutical products. The Company will need to raise additional funds to support its operations, and such funding may not be available on acceptable terms, or at all, which could materially and adversely affect its business, financial condition, results of operations and growth prospects. The Company may seek additional sources of financing through development financings, collaborations or public or private debt or equity financings.

Concentration of Credit Risks

The Company monitors its exposure within accounts receivable and records a reserve against uncollectible accounts receivable as necessary. The Company extends credit to pharmaceutical companies, pharmaceutical wholesale distributors and a specialty pharmaceutical distribution company primarily in the United States in the normal course of business. Customer creditworthiness is monitored and collateral is not normally required. Historically, the Company has not experienced significant credit losses on its accounts receivable. The Company s five largest customers accounted for an aggregate of approximately 90% and 93% of gross accounts receivable as of December 31, 2006 and June 30, 2007, respectively.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts and disclosures reported in the consolidated financial statements and accompanying notes. Management bases its estimates on historical experience and on assumptions believed to be reasonable under the circumstances. Actual results could differ materially from those estimates.

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Reverse Stock Split

On May 15, 2007, the Company filed a third amended and restated certificate of incorporation with the Delaware Secretary of State effecting a 1-for-11.06701 reverse split of the Company s preferred and common stock. All share and per share amounts have been retroactively restated in these financial statements and notes for all periods presented.

Initial Public Offering

On May 31, 2007, the Company s Registration Statement on Form S-1/A was declared effective for its initial public offering, pursuant to which the Company sold 6,000,000 shares of its common stock at a public offering price of $18.00 per share. Net cash proceeds from the initial public offering are expected to be approximately $97.2 million, after deducting underwriting discounts and commissions and estimated offering expenses, not all of which had been paid as of June 30, 2007. In connection with the closing of the initial public offering, all of the Company s shares of preferred stock outstanding at the time of the offering were automatically converted into 17,921,551 shares of common stock, and all of the Company s warrants to purchase Series BB preferred stock outstanding at the time of the offering were converted into warrants to purchase common stock.

Of the 17,921,551 shares of preferred stock that converted into common stock, 278,069 shares were held by the Company s executive officers and were subject to the terms of their employment agreements. Under the terms of these employment agreements, the Company may be required to purchase these shares of common stock at fair market value. Effective upon the conversion of the preferred stock into common stock, the Company recorded an additional $4.2 million as common stock subject to repurchase, which represents the fair market value of the shares on the date of the employment agreements.

Changes to Authorized Shares

On June 6, 2007, the Company filed a fourth amended and restated certificate of incorporation with the Delaware Secretary of State under which the Company is authorized to issue 150,000,000 shares of common stock and 20,000,000 shares of preferred stock each having a par value of $0.0001. As of the filing of the fourth amended and restated certificate of incorporation, 24,550,554 shares of common stock and no shares of preferred stock were issued and outstanding.

Income Taxes

The Company utilizes the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and the tax bases of assets and liabilities and are measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. A valuation allowance is provided when it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainties in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48) effective January 1, 2007. FIN 48 requires that the Company recognize the financial statement effects of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. No cumulative adjustment to the Company s accumulated deficit was required upon adoption of FIN 48.

As of June 30, 2007, the Company had approximately $1.5 million of unrecognized tax benefits, substantially all of which would, if recognized, affect the Company s tax expense. The Company does not anticipate that the amount of existing unrecognized tax benefits will significantly increase or decrease within the next 12 months. Because of net operating loss carryforwards, substantially all of the Company s tax years remain open to federal tax examination. The Company files a United States federal income tax return and various state income tax returns, all of which typically have three tax years open at any point in time.

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Loss Per Common Share

Basic and diluted loss per common share is computed using the weighted average number of shares of common stock outstanding during the period as follows (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Numerator:				
Loss attributable to common stockholders	$ (39,863)	$ (24,134)	$ (59,447)	$ (50,014)
Denominator:				
Weighted-average common shares outstanding	8,252	618	4,461	618
Less: weighted-average common shares outstanding subject to repurchase	(691)	(607)	(648)	(608)
Weighted-average common shares used in computing loss per share attributable to common stockholders, basic and diluted	7,561	11	3,813	10
Loss per share attributable to common stockholders, basic and diluted	$ (5.27)	$ (2,194.00)	$ (15.59)	$ (5,001.40)

The following securities were excluded from the computation of diluted loss per share attributable to common stockholders for the periods presented because including them would have an antidilutive effect (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Series A preferred stock (as if converted)		1,355		1,355
Series B preferred stock (as if converted)		5,884		5,884
Series B Prime preferred stock (as if converted)		6,375		6,375
Warrants to purchase Series BB preferred stock (as if exercised and converted)		786		786
Warrants to purchase common stock (as if exercised and converted)	786		786	
Options to purchase common stock	1,945	1,538	1,945	1,538
Early exercise of options and unvested restricted common stock	8	139	8	139
Common stock subject to repurchase	594	467	594	467

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Recent Accounting Pronouncements

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 establishes an approach that requires quantification of financial statement errors based on the effects on each of the Company s balance sheets and statement of operations and the related financial statement disclosures. SAB 108 was adopted by the Company in the first quarter of 2007. The Company has determined that the adoption of SAB 108 did not have a material effect on its results of operations and financial position.

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 provides guidance for using fair value to measure assets and liabilities. It also responds to investors requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value, and does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and is required to be adopted by the Company effective January 1, 2008. The Company is currently evaluating the effect that the adoption of SFAS 157 will have on its results of operations and financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. Most of the provisions in Statement 159 are elective; however, the amendment to FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. SFAS 159 is effective as of the beginning of an entity s first fiscal year beginning after November 15, 2007 and is required to be adopted by the Company by January 1, 2008. The Company is currently evaluating the effect that the adoption of SFAS 159 will have on its results of operations and financial position.

2. Inventory

The components of inventory were as follows (in thousands):

	June 30, 2007	December 31, 2006
Raw materials	$ 454	$ 541
Finished goods	2,762	2,485
Total inventories	$ 3,216	$ 3,026

3. Goodwill and Intangible Assets

The gross carrying amount and net book value of goodwill and intangible assets were as follows (in thousands):

	June 30, 2007			December 31, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Developed technology - Xyrem	$ 39,700	$ 8,413	$ 31,287	$ 39,700	$ 6,327	$ 33,373
Developed technology - Antizol	31,100	6,590	24,510	31,100	4,956	26,144
Developed technology - Cystadane				4,300	687	3,613
Agreements not to compete	5,600	2,716	2,884	5,600	2,042	3,558

Trademarks	2,600	551	2,049	2,600	414	2,186
Other	400	178	222	400	134	266
Amortizable intangible assets	79,400	$ 18,448	$ 60,952	83,700	$ 14,560	$ 69,140
Goodwill	38,213			38,213		
Total	$ 117,613			$ 121,913		

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In March 2007, as more fully discussed in Note 10, the Company sold its rights to its Cystadane® (betaine anhydrous) product, and as a result reduced the gross carrying amount and accumulated amortization of this intangible asset by $4.3 million and $761,000, respectively.

Future amortization costs per year for the Company s existing intangible assets other than goodwill as of June 30, 2007 were estimated as follows (in thousands):

Year Ending December 31,	Estimated Amortization Expense
2007 (remaining portion)	$ 4,574
2008	8,855
2009	8,581
2010	8,090
2011	7,713

4. Preferred Stock Warrant Liability

In June 2005, in connection with the issuance of the Company s $80.0 million aggregate principal amount senior secured notes, the Company issued warrants to purchase 785,728 shares of Series BB preferred stock at an exercise price of $20.36 per share. The warrants are exercisable, at the option of the holders, at any time until June 24, 2012, and were recorded as a preferred stock warrant liability. Prior to the Company s initial public offering, the preferred stock warrant liability was revalued at the end of each reporting period to fair value using the Black Scholes option pricing model. On June 6, 2007, upon completion of the Company s initial public offering, the warrants became exercisable for common stock and the liability was reclassified to stockholders equity at its then fair value.

The Company recorded benefits of $4.9 million and $120,000, in other income, during the three months ended June 30, 2007 and 2006, respectively, to reflect decreases in the fair value of the preferred stock warrant liability. The Company recorded benefits of $1.8 million and $182,000, in other income, during the six months ended June 30, 2007 and 2006, respectively, to reflect decreases in the fair value of the preferred stock warrant liability.

The fair value of the warrants was estimated to be $6.7 million at June 6, 2007, the date the liability was reclassified to stockholders equity, and $8.5 million at December 31, 2006. The following assumptions were used to estimate the fair value of the warrants:

	June 6, 2007	December 31, 2006
Series BB preferred stock fair value	$ 17.59	$ 19.37
Volatility	54%	59%
Contractual term (years)	5.1	5.5
Risk-free rate	4.9%	4.7%
Expected dividend yield	0.0%	0.0%

5. Stock-Based Compensation

The Company accounts for employee stock-based compensation under SFAS No. 123(R), *Share-Based Payment* (SFAS 123R), which requires compensation expense related to share-based transactions, including employee stock options, to be measured and recognized in the financial statements based on fair value. Employee stock-based compensation expense recognized in the three and six months ended June 30, 2007 and 2006 was calculated based on awards ultimately expected to vest, and has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

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Employee stock based compensation expense recognized under SFAS 123R was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Cost of product sales	$ 11	$ 1	$ 22	$ 2
Research and development	220	164	414	308
Selling, general and administrative	809	679	1,544	1,354
Total stock-based compensation expense	$ 1,040	$ 844	$ 1,980	$ 1,664

Employee stock-based compensation costs of $22,000 and $18,000 as of June 30, 2007 and December 31, 2006, respectively, were capitalized as a component of inventory and included in the Company s Condensed Consolidated Balance Sheets.

As of June 30, 2007, total compensation cost related to unvested stock options not yet recognized was $6.9 million, which is expected to be allocated to expense and production costs over a weighted-average period of 2.75 years.

The employee stock-based compensation expense recognized under SFAS 123R was determined using the Black Scholes option valuation model. Option valuation models require the input of subjective assumptions, and these assumptions can vary over time. The fair value of stock options was estimated at the grant date using the following weighted-average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Weighted-average volatility	56%	61%	60%	61%
Weighted-average expected term	6.0	6.0	6.4	6.0
Range of risk-free rates	4.9%	5.0-5.1%	4.5-4.9%	4.6-5.1%
Expected dividend yield	0.0%	0.0%	0.0%	0.0%

The Company issued 5,017 shares of common stock as a result of stock option exercises during the six months ended June 30, 2007.

Effective upon the Company s initial public offering, employees became eligible to participate in an employee stock purchase plan (the ESPP). However, for logistical reasons, the Company did not communicate the details of the ESPP and employees were not able to notify the Company of their payroll withholdings until July 20, 2007. As a result, the Company and the employees did not have a mutual understanding of the terms of the awards until July 20, 2007 and, in accordance with SFAS 123R, the Company will not record any stock-based compensation expense related to the ESPP until the third quarter of 2007.

6. Comprehensive Loss

Comprehensive loss includes net loss and all changes in stockholders deficit during a period, except for those changes resulting from investments by stockholders or distributions to stockholders. For the three and six months ended December 31, 2007 and 2006, the difference between comprehensive loss and net loss represented unrealized gains on available-for-sale securities and was not material.

7. Commitments and Contingencies

Settlement of Investigation

In April 2006, the Company and Orphan Medical received subpoenas from the United States Department of Justice requiring both entities to provide the Department of Justice with certain information relating to Xyrem® (sodium oxybate), including information regarding the promotion and marketing of Xyrem.

On July 13, 2007, the Company entered into (i) a civil settlement agreement (the Civil Settlement Agreement) with the United States of America, acting through the United States Department of Justice, the United States Attorney s Office for the Eastern District of New York, the Office of Inspector General of the Department of Health and Human Services (HHS-OIG), the United States Office of Personnel Management and the United States Department of Defense TRICARE Management Activity to resolve the governmental investigation related to the promotion of Xyrem and (ii) a non-prosecution agreement with the United States Attorney s Office for the Eastern District of New York (the Non-prosecution Agreement)

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under which the United States Attorney s Office agreed that the Company would not be prosecuted for the matters that were the subject of the investigation. Orphan Medical, which was acquired by the Company in June 2005, entered into (i) a plea agreement with the United States Attorney s Office for the Eastern District of New York (the Plea Agreement), under which Orphan Medical pled guilty, on July 13, 2007, to one felony count of introducing a misbranded drug into interstate commerce and (ii) the Civil Settlement Agreement. The Company expects that it and Orphan Medical will also enter into agreements with Medicaid participating states.

Pursuant to the Civil Settlement Agreement and the Plea Agreement, payments totaling approximately $20.0 million are required to be made over the period from July 20, 2007 through January 15, 2012. The total includes payments to Federal healthcare programs and Medicaid participating states, as well as restitution and fines. In addition, under the Non-prosecution Agreement, the Company agreed to guarantee payment by Orphan Medical of the amounts due under the Plea Agreement. The total payments due under the Civil Settlement Agreement and the Plea Agreement are payable as follows: $1.0 million in 2007; $2.0 million in 2008; $2.5 million in 2009; $3.0 million in 2010; $3.0 million in 2011 and $8.5 million in 2012. All remaining amounts due under the Civil Settlement Agreement could be accelerated if the Company is acquired, or in the event of an uncured default resulting from the failure to make payments when due. In addition, all or a portion of the remaining amounts due under the Civil Settlement Agreement could be accelerated if the Company has net income in any year. Orphan Medical, which no longer directly markets products, may be excluded from participation in Federal healthcare programs as a result of the settlement.

The Company also entered into a five-year corporate integrity agreement with HHS-OIG (the Corporate Integrity Agreement) pursuant to which Jazz Pharmaceuticals agreed, among other things, to keep in place and continue its current compliance program which includes a compliance committee, a compliance officer, a code of conduct, comprehensive compliance policies, training and monitoring, a compliance hotline, an open door policy and a disciplinary process for compliance violations. The Company has agreed to provide periodic reports to HHS-OIG and an independent review organization will review its compliance program.

The settlement is neither an admission of liability by the Company nor a concession by the United States that its claims are not well founded. Participation in Federal healthcare programs by the Company, which was not prosecuted, will not be affected by the settlement. In the event of an uncured material breach or deliberate violation, as the case may be, of the Civil Settlement Agreement, the Corporate Integrity Agreement or the Non-prosecution Agreement, the Company could be excluded from participation in Federal healthcare programs and/or subject to prosecution.

The Plea Agreement was approved by the United States District Court for the Eastern District of New York on July 13, 2007.

The Company recorded a charge of $17.5 million during the three and six months ended June 30, 2007, which represents the present value of the settlement payments discounted at an interest rate of 4.6%. The non-current portion of this provision as of June 30, 2007 was $14.9 million and the current portion, which is included in accrued liabilities, was $2.6 million.

Indemnification

In the normal course of business, the Company enters into contracts and agreements that contain a variety of representations and warranties and provide for general indemnification, including indemnification associated with product liability or infringement of intellectual property rights. The Company s exposure under these agreements is unknown because it involves future claims that may be made against the Company that have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to these indemnification obligations except as set forth under Legal Proceedings below.

The Company has agreed to indemnify its officers and directors, and the officers and directors of Orphan Medical, for losses and costs incurred in connection with certain events or occurrences, including advancing money to cover certain costs, subject to certain limitations. The maximum potential amount of future payments the Company could be required to make under this indemnification is unlimited; however, the Company maintains insurance policies that may limit its exposure and may enable it to recover a portion of any future amounts paid. Assuming the applicability of coverage, the willingness of the insurer to assume coverage, and subject to certain retention, loss limits and other policy provisions, the Company believes the fair value of these indemnification obligations is not material. Accordingly, the Company has not recognized any liabilities relating to these obligations as of December 31, 2006 and June 30, 2007. No assurances can be given that the covering insurers will not attempt to dispute the validity, applicability, or amount of coverage without expensive litigation against these insurers, in which case the Company may incur substantial liabilities as a result of these indemnification obligations.

Legal Proceedings

See Settlement of Investigation above.

On April 10, 2006, Little Gem Life Sciences LLC, individually and purportedly on behalf of a class of persons similarly situated, filed a complaint against Orphan Medical and former officers of Orphan Medical in the United States District Court

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for the District of Minnesota. The complaint alleges that the defendants made false and misleading statements in the proxy statement prepared by Orphan Medical in connection with the solicitation of proxies to be voted at the special meeting of Orphan Medical stockholders held on June 22, 2005. The purpose of the special meeting was to consider and vote upon a proposal to adopt the definitive merger agreement pursuant to which the Company acquired Orphan Medical. The plaintiff seeks damages for itself and the putative class, in an unspecified amount, together with interest, litigation costs and expenses, and its attorneys fees and other disbursements, as well as unspecified other and further relief. On October 25, 2006, the defendants filed a motion to dismiss the complaint and oral argument on the motion was heard by the United States District Court for the District of Minnesota. On February 16, 2007, the United States District Court for the District of Minnesota granted the defendants motion to dismiss the complaint, with leave to amend. On March 14, 2007, the plaintiff filed an amended complaint, and the defendants responded with a motion to dismiss on March 16, 2007. Oral argument on the motion was heard on June 8, 2007; the judge has not yet ruled on the motion. The Company cannot predict or determine the outcome of this matter or reasonably estimate the amount of any judgments or payments that might result from an adverse outcome. Therefore, in accordance with SFAS 5, the Company has not recorded an associated liability. The Company will recognize a liability, if any, when it has an adequate basis to estimate any probable exposure, if any.

From time to time the Company is involved in legal proceedings arising in the ordinary course of business. The Company believes there is no other litigation pending that could have, individually or in the aggregate, a material adverse effect on the Company s results of operations or financial condition.

8. Segment Information

Management has determined that the Company operates in one business segment, which is the development and commercialization of pharmaceutical products.

The following table presents a summary of product sales, net (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Xyrem	$ 9,628	$ 7,202	$ 18,252	$ 13,355
Antizol	3,987	3,007	6,623	6,138
Cystadane (1)		245	365	732
Total	$ 13,615	$ 10,454	$ 25,240	$ 20,225

(1) We sold our rights to Cystadane to an unrelated third party in March 2007.

The following table presents a summary of total revenues attributed to domestic and foreign sources (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
United States	$ 13,621	$ 10,495	$ 25,134	$ 19,845
Europe	553	579	3,077	810
All other	90		141	256
Total	$ 14,264	$ 11,074	$ 28,352	$ 20,911

The following table presents a summary of revenues from significant customers as a percentage of the Company s total revenues:

	Three Months Ended June 30,	Six Months Ended June 30,

	2007	2006	2007	2006
Express Scripts	67%	65%	64%	64%
Cardinal Health	*	11%	*	13%
UCB	*	*	10%	*

* Represented less than 10% of revenues.

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9. Product License Agreement

In January 2007, the Company entered into a product license agreement with Solvay Pharmaceuticals, Inc. (Solvay) for the rights to market Luvox® CR and Luvox® in the United States. The Company made a $2.0 million payment upon execution of the agreement, and agreed to make additional payments of up to $138.0 million upon achievement of development and commercial milestones. Up to $41.0 million of these milestone payments are payable at or prior to commercial launch of Luvox CR, and $2.0 million of these milestone payments are payable if the Company commercially launches Luvox. As the initial $2.0 million payment has no alternative future use, the Company expensed this amount as research and development expense in the three months ended March 31, 2007. In addition, the Company is required to pay Solvay royalties on commercial sales at specified rates.