

MANKIND CORP
Form 10-Q
May 12, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended March 31, 2014

Or

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

For the transition period from _____ to _____.

Commission file number: 000-50865

MannKind Corporation
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of	13-3607736 (I.R.S. Employer
incorporation or organization)	Identification No.)
28903 North Avenue Paine	
Valencia, California (Address of principal executive offices)	91355 (Zip Code)
(661) 775-5300	
(Registrant's telephone number, including area code)	

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

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

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

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

As of May 5, 2014, there were 388,615,163 shares of the registrant's common stock, \$0.01 par value per share, outstanding.

Table of Contents

MANNKIND CORPORATION

Form 10-Q

For the Quarterly Period Ended March 31, 2014

TABLE OF CONTENTS

	Page
<u>PART I: FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Balance Sheets: March 31, 2014 and December 31, 2013</u>	2
<u>Condensed Consolidated Statements of Operations: Three months ended March 31, 2014 and 2013 and the period from February 14, 1991 (date of inception) to March 31, 2014</u>	3
<u>Condensed Consolidated Statements of Comprehensive Loss: Three months ended March 31, 2014 and 2013 and the period from February 14, 1991 (date of inception) to March 31, 2014</u>	4
<u>Condensed Consolidated Statements of Cash Flows: Three months ended March 31, 2014 and 2013 and the period from February 14, 1991 (date of inception) to March 31, 2014</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	20
<u>Item 4. Controls and Procedures</u>	20
<u>PART II: OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	20
<u>Item 1A. Risk Factors</u>	20
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	37
<u>Item 3. Defaults Upon Senior Securities</u>	37
<u>Item 4. Mine Safety Disclosures</u>	37
<u>Item 5. Other Information</u>	37
<u>Item 6. Exhibits</u>	38
<u>SIGNATURES</u>	40

AFREZZA[®], MedTone[®] and Technosphere[®] are our registered trademarks in the United States. We have also applied for and have registered company trademarks in other jurisdictions, including Europe and Japan.

Table of Contents**PART 1: FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****MANNKIND CORPORATION AND SUBSIDIARIES****(A Development Stage Company)****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)****(In thousands, except share data)**

	March 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 35,759	\$ 70,790
Prepaid expenses and other current assets	3,640	5,485
Total current assets	39,399	76,275
Property and equipment net	176,337	176,557
State research and development credit exchange receivable net of current portion	380	298
Other assets	8,437	5,516
Total	\$ 224,553	\$ 258,646
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	\$ 3,638	\$ 3,860
Accrued expenses and other current liabilities	15,006	21,634
Facility financing obligation	25,871	102,300
Total current liabilities	44,515	127,794
Senior convertible notes	98,662	98,439
Note payable to principal stockholder	49,521	49,521
Other liabilities	14,319	13,605
Total liabilities	207,017	289,359

Commitments and contingencies

Stockholders equity (deficit):

Undesignated preferred stock, \$0.01 par value 10,000,000 shares authorized; no shares issued or outstanding at March 31, 2014 and December 31, 2013

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Common stock, \$0.01 par value 550,000,000 shares authorized at March 31, 2014 and December 31, 2013; 386,934,914 and 369,391,972 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively	3,869	3,697
Additional paid-in capital	2,362,129	2,261,996
Accumulated other comprehensive loss	(4)	(4)
Deficit accumulated during the development stage	(2,348,458)	(2,296,402)
Total stockholders equity (deficit)	17,536	(30,713)
Total	\$ 224,553	\$ 258,646

See notes to condensed consolidated financial statements.

Table of Contents**MANKIND CORPORATION AND SUBSIDIARIES****(A Development Stage Company)****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)****(In thousands, except per share data)**

	Three months ended		Cumulative period
	March 31,		from February 14,
	2014	2013	1991 (date of
			inception) to
			March 31, 2014
Revenue	\$	\$	\$ 3,166
Operating expenses:			
Research and development	26,182	26,398	1,603,474
General and administrative	15,229	10,039	500,615
In-process research and development costs			19,726
Goodwill impairment			151,428
Total operating expenses	41,411	36,437	2,275,243
Loss from operations	(41,411)	(36,437)	(2,272,077)
Other income (expense)	(5,890)	23	(8,792)
Interest expense on note payable to principal stockholder	(714)	(1,689)	(45,848)
Interest expense on notes	(4,042)	(2,863)	(59,128)
Interest income	1	1	37,005
Loss before benefit for income taxes	(52,056)	(40,965)	(2,348,840)
Income tax benefit			382
Net loss	(52,056)	(40,965)	(2,348,458)
Deemed dividend related to beneficial conversion feature of convertible preferred stock			(22,260)
Accretion on redeemable preferred stock			(952)
Net loss applicable to common stockholders	\$ (52,056)	\$ (40,965)	\$ (2,371,670)
Net loss per share applicable to common stockholders basic and diluted	\$ (0.14)	\$ (0.15)	

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Shares used to compute basic and diluted net loss per share applicable to common stockholders	368,784	280,058
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See notes to condensed consolidated financial statements.

Table of Contents**MANKIND CORPORATION AND SUBSIDIARIES****(A Development Stage Company)****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS****(Unaudited)****(In thousands)**

	Three months ended		Cumulative period
	March 31,		from February 14,
	2014	2013	1991 (date of
			inception) to
			March 31, 2014
Net loss	\$ (52,056)	\$ (40,965)	\$ (2,348,458)
Other comprehensive loss:			
Cumulative translation (loss) gain		(2)	(4)
Unrealized gain (loss) on investments:			
Unrealized holding gain (loss) during the period			48
Less: reclassification adjustment for gains (losses) included in net loss			(48)
Net unrealized (loss) gain on investments			
Other comprehensive loss		(2)	(4)
Comprehensive loss	\$ (52,056)	\$ (40,967)	\$ (2,348,462)

See notes to condensed consolidated financial statements.

Table of Contents**MANKIND CORPORATION AND SUBSIDIARIES****(A Development Stage Company)****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(In thousands)**

	Three months ended		Cumulative Period
	March 31,	March 31,	from February 14,
	2014	2013	1991 (Date of
			Inception) to
			March 31, 2014
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	\$ (52,056)	\$ (40,965)	\$ (2,348,458)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and accretion	9,394	3,348	150,228
Stock-based compensation expense	10,937	5,189	194,042
Stock expense for shares issued pursuant to research agreement			3,018
(Gain) loss on sale, abandonment/disposal or impairment of property and equipment			25,070
Accrued interest on investments, net of amortization of discounts			(191)
In-process research and development			19,726
Goodwill impairment			151,428
Loss on available-for-sale securities			990
Litigation settlement in stock			6,494
Fair value of forward purchase contract			1,237
Other, net		(2)	1,101
Changes in assets and liabilities:			
State research and development credit exchange receivable	(82)	(78)	(379)
Prepaid expenses and other current assets	1,845	690	(1,690)
Other assets			(230)
Accounts payable	(1,038)	(924)	2,309
Accrued expenses and other current liabilities	(6,704)	715	32,019
Other liabilities	714		1,303
Net cash used in operating activities	(36,990)	(32,027)	(1,761,983)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of marketable securities			(796,779)

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Sales and maturities of marketable securities			796,393
Purchase of property and equipment	(1,409)	(1,459)	(337,142)
Proceeds from sale of property and equipment			454
Net cash used in investing activities	(1,409)	(1,459)	(337,074)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issuance of common stock and warrants, net of issuance costs	1,463	78	1,451,640
Collection of Series C convertible preferred stock subscriptions receivable			50,000
Issuance of Series B convertible preferred stock for cash			15,000
Cash received for common stock to be issued			3,900
Repurchase of common stock			(1,028)
Put shares sold to majority stockholder			623
Exercise of warrants for common stock	1,938		96,085
Borrowings under lines of credit			4,220
Payment of 2013 notes			(115,000)
Proceeds from notes receivables			1,742
Proceeds from issuance of facility financing obligation & milestone rights			119,500
Facility financing obligation & milestone rights issuance costs			(598)
Borrowings on notes payable to principal stockholder			387,750
Principal payments on notes payable to principal stockholder			(70,000)
Borrowings on notes payable			3,460
Principal payments on notes payable			(1,667)
Proceeds from senior convertible notes			207,050
Payment of employment taxes related to vested restricted stock units	(33)	(427)	(17,861)
Net cash provided by (used in) financing activities	3,368	(349)	2,134,816

Table of Contents

	Three months ended		Cumulative Period
	March 31,		from February 14,
	2014	2013	1991 (Date of
			Inception) to
			March 31, 2014
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	\$ (35,031)	\$ (33,835)	\$ 35,759
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	70,790	61,840	
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 35,759	\$ 28,005	\$ 35,759
SUPPLEMENTAL CASH FLOWS DISCLOSURES:			
Cash paid for income taxes	\$	\$	\$ 26
Interest paid in cash, net of amounts capitalized	4,678	2,863	77,282
Accretion on redeemable convertible preferred stock			(952)
Issuance of common stock upon conversion of notes payable			3,331
Increase in additional paid-in capital resulting from merger			171,154
Issuance of common stock for notes receivable			2,758
Issuance of common stock pursuant to conversion of facility financing obligation	86,000		92,500
Issuance of put option by stockholder			(2,949)
Put option redemption by stockholder			1,921
Issuance of Series C convertible preferred stock subscriptions			50,000
Issuance of Series A redeemable convertible preferred stock			4,296
Conversion of Series A redeemable convertible preferred stock			(5,248)
Non-cash construction in progress and property and equipment	1,700	3,863	1,700
Capitalization of interest on note payable to principal stockholder			22,105
Reduction of principal on note payable to principal stockholder upon issuance of common stock and exercise of warrants			290,334
Forward purchase contract contribution to APIC			29,317
Reclassification of forward purchase contract to APIC			28,080
Tranche B Commitment Asset	2,921		2,921

In connection with the Company's initial public offering, all shares of Series B and Series C convertible preferred stock, in the amount of \$15.0 million and \$50.0 million, respectively, automatically converted into common stock in August 2004.

See notes to condensed consolidated financial statements.

Table of Contents

MANKIND CORPORATION AND SUBSIDIARIES

(A Development Stage Company)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Description of business and basis of presentation

The accompanying unaudited condensed consolidated financial statements of MannKind Corporation and its subsidiaries (MannKind or the Company), have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (the SEC). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The information included in this quarterly report on Form 10-Q should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s annual report on Form 10-K for the fiscal year ended December 31, 2013 filed with the SEC on March 3, 2014 (the Annual Report).

In the opinion of management, all adjustments, consisting only of normal, recurring adjustments, considered necessary for a fair presentation of the results of these interim periods have been included. The results of operations for the three months ended March 31, 2014 may not be indicative of the results that may be expected for the full year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates or assumptions. The more significant estimates reflected in these accompanying financial statements involve assessing long-lived assets for impairment, accrued expenses, including clinical study expenses, valuation of forward purchase contracts, valuation of the facility financing obligation, commitment asset, milestone rights, valuation of stock-based compensation and the determination of the provision for income taxes and corresponding deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets. The estimation process often may yield a range of potentially reasonable estimates of the ultimate future outcomes and management must select an amount that falls within that range of reasonable estimates. This process may result in actual results differing materially from those estimated amounts used in the preparation of the financial statements.

Business The Company is a biopharmaceutical company focused on the discovery and development of therapeutic products for diseases such as diabetes. The Company s lead product candidate, AFREZZA (insulin human [rDNA origin]) inhalation powder, is an ultra rapid-acting insulin therapy that is in late-stage clinical investigation for the treatment of adults with type 1 or type 2 diabetes for the control of hyperglycemia.

Last October, the Company resubmitted a New Drug Application (NDA) for AFREZZA to the U.S. Food and Drug Administration (FDA), which included data from two completed Phase 3 studies 171 and 175, both of which met their primary efficacy endpoints and safety objectives. On April 1, 2014 the Endocrinologic and Metabolic Drugs Advisory Committee (EMDA) of the FDA voted 13 to 1 to recommend that AFREZZA inhalation powder be granted approval by the FDA to improve glycemic control in adults with type 1 diabetes and voted 14 to 0 to recommend that AFREZZA be granted approval by the FDA to improve glycemic control in adults with type 2 diabetes.

Subsequent to the EMDA meeting, the FDA extended the Prescription Drug User Fee Act (PDUFA) date for AFREZZA by three months from April 15, 2014 to July 15, 2014 in order to provide time for a full review of

information submitted by the Company in response to the FDA's requests.

Basis of Presentation The Company is considered to be in the development stage as its primary activities since incorporation have been establishing its facilities, recruiting personnel, conducting research and development, business development, business and financial planning, and raising capital. It is costly to develop therapeutic products and conduct clinical studies for these products. From its inception through March 31, 2014, the Company has reported accumulated net losses of \$2.3 billion, which include a goodwill impairment charge of \$151.4 million and cumulative negative cash flow from operations of \$1.8 billion. At March 31, 2014, the Company's capital resources consisted of cash and cash equivalents of \$35.8 million. These factors raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

As of March 31, 2014, the Company had \$30.1 million principal amount of available borrowings under its loan arrangement (the Loan Arrangement) with The Mann Group LLC (The Mann Group) although the Company anticipates using a portion of these available borrowings to capitalize accrued interest into principal as it becomes due and payable under the Loan Arrangement, upon mutual agreement of the parties. As of March 31, 2014, the Company had accrued \$1.3 million of interest related to the Loan Arrangement.

On July 1, 2013, the Company entered into a facility agreement (the Facility Agreement) with Deerfield Private Design Fund II, L.P. (Deerfield Private Design Fund) and Deerfield Private Design International II, L.P. (collectively, Deerfield), providing for the sale of up to \$160.0 million of Senior Convertible Notes due 2019 (the 2019 notes) to Deerfield in four equal tranches of \$40.0 million principal amount. As of March 31, 2014, Deerfield had purchased the first three tranches of 2019 notes in the aggregate principal amount of \$120.0 million; therefore, only \$40.0 million remain unsold. Deerfield's obligation to purchase the fourth tranche of 2019 notes is subject to the receipt of marketing approval of AFREZZA by the FDA and the shares of common stock issuable upon conversion of all previously sold 2019 notes being freely tradable pursuant to an effective registration statement filed with the SEC or pursuant to Rule 144 under the Securities Act. On February 28, 2014, the Company entered into a First Amendment to Facility Agreement and Registration Rights Agreement (the Amendment). The Amendment modified the terms of the Facility Agreement that was entered into on July 1, 2013 with Deerfield to provide for the issuance of an additional tranche of

Table of Contents

notes (the Tranche B notes) to Deerfield in a maximum principal amount equal to (x) if the FDA approves the NDA for AFREZZA and Deerfield purchased the fourth tranche of 2019 notes, 150% of the aggregate principal amount of the 2019 notes that Deerfield has converted into the Company's common stock on and after the effective date of the Amendment, up to \$90.0 million, and (y) otherwise, 33.33% of the aggregate principal amount of the 2019 notes that Deerfield has converted into the Company's common stock on and after the effective date of the Amendment, up to \$20.0 million, in each case subject to the satisfaction of certain other conditions. The Facility Agreement contains a financial covenant that requires the Company's cash and cash equivalents, which include available borrowings under the Loan Arrangement, on the last day of each fiscal quarter to not be less than \$25 million. Based on its current expectations, the Company believes that its existing capital resources will enable it to continue planned operations at least into the third quarter of 2014. However, the Company cannot provide assurances that its plans will not change or that changed circumstances will not result in the depletion of its capital resources more rapidly than it currently anticipates. The Company will need to raise additional capital, whether through the sale of equity or debt securities, a strategic business collaboration with a pharmaceutical company, the establishment of other funding facilities, licensing arrangements, asset sales or other means, in order to continue the development of and to commercialize AFREZZA and other product candidates and to support its other ongoing activities. However, the Company cannot provide assurances that such additional capital will be available on favorable terms, or at all.

Capital resources potentially available to the Company include proceeds from the exercise of warrants issued in its February 2012 public offering, the Company's at-the-market issuance sales agreements, and issuance of additional 2019 notes and/or Tranche B notes to Deerfield (see Note 11 Facility financing agreement).

Fair Value of Financial Instruments The carrying amounts reported in the accompanying financial statements for cash and cash equivalents, accounts payable and accrued liabilities approximate their fair value due to their relatively short maturities. The fair value of the cash equivalents, note payable to related party, senior convertible notes, and the Facility Agreement are discussed in Note 13, Fair Value Measurements.

Recently Issued Accounting Standards In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit when a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force)*. The amendments in this ASU provide guidance on the financial statements presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. An unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward with certain exceptions, in which case such an unrecognized tax benefit should be presented in the financial statements as a liability. The amendments in this ASU do not require new recurring disclosures. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of the new requirement did not have a significant impact on the Company's consolidated financial statements.

2. Accrued expenses and other current liabilities

Accrued expenses and other current liabilities are comprised of the following (in thousands):

	March 31, 2014	December 31, 2013
Salary and related expenses	\$ 6,650	\$ 12,193
Research and clinical trial costs	1,304	1,311

Accrued interest	958	2,082
Construction in progress	370	342
Other	5,724	5,706
Accrued expenses and other current liabilities	\$ 15,006	\$ 21,634

3. Accounting for stock-based compensation

Total stock-based compensation expense recognized in the accompanying condensed consolidated statements of operations for the three months ended March 31, 2014 and 2013 was as follows (in thousands):

	Three months ended	
	March 31,	
	2014	2013
Stock-based compensation	\$ 10,937	\$ 5,189

The Company issued stock awards to employees during the three months ended March 31, 2014 with a four-year vesting schedule. The grant date fair value of the 46,400 restricted stock units and 17,700 stock options issued was \$296,000 and \$81,000, respectively, with a grant date fair value per share of \$6.39 and \$4.58, respectively.

Table of Contents

As of March 31, 2014, there was \$9.9 million and \$14.0 million of unrecognized compensation cost related to options and restricted stock units, respectively, which are expected to be recognized over the remaining weighted average vesting period of 1.85 years. The Company evaluates stock awards with performance conditions as to the probability that the performance conditions will be met and estimates the date at which the performance conditions will be met in order to properly recognize stock-based compensation expense over the requisite service period. As of March 31, 2014, there were \$107,000 and \$3.7 million of unrecognized expenses related to performance options and restricted stock units, respectively, for milestones not considered probable of achievement.

4. Net loss per common share

Basic net loss per share excludes dilution for potentially dilutive securities and is computed by dividing net loss applicable to common stockholders by the weighted average number of common shares outstanding during the period excluding the shares loaned to Bank of America, N.A. under a share lending arrangement (see Note 7 – Common and preferred stock). As of March 31, 2014, 9,000,000 shares of the Company's common stock, which were loaned to Bank of America, N.A. pursuant to the terms of a share lending agreement as described in Note 7, were issued and are outstanding, and holders of the borrowed shares have all the rights of a holder of the Company's common stock. However, because the share borrower must return all borrowed shares to the Company (or, in certain circumstances, the cash value thereof), the borrowed shares are not considered outstanding for the purpose of computing and reporting basic or diluted earnings (loss) per share. Diluted net loss per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Potentially dilutive securities are excluded from the computation of diluted net loss per share for all of the periods presented in the accompanying condensed consolidated statements of operations because the reported net loss in each of these periods results in their inclusion being antidilutive. Antidilutive securities, which consist of stock options, restricted stock units, warrants, and shares that could be issued upon conversion of the senior convertible notes and conversion of the facility financing obligation, that are not included in the diluted net loss per share calculation consisted of an aggregate of 67,791,150 shares and 133,500,568 shares as of March 31, 2014 and 2013, respectively, and exclude the 9,000,000 shares loaned under the share lending arrangement.

5. State research and development credit exchange receivable

The State of Connecticut provides certain companies with the opportunity to exchange certain research and development income tax credit carryforwards for cash in exchange for forgoing the carryforward of the research and development income tax credits. The program provides for an exchange of research and development income tax credits for cash equal to 65% of the value of corporation tax credit available for exchange. There were no current estimated amounts receivable under the program at March 31, 2014 and December 31, 2013, respectively. Long-term estimated amounts receivable under the program were \$380,000 and \$298,000 at March 31, 2014 and December 31, 2013, respectively.

6. Property and equipment

Property and equipment net consist of the following (dollar amounts in thousands):

Estimated Useful Life (Years)	March 31, 2014	December 31, 2013
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Land		\$ 5,273	\$ 5,273
Buildings	39-40	54,948	54,948
Building improvements	5-40	114,099	114,099
Machinery and equipment	3-15	82,189	82,189
Furniture, fixtures and office equipment	5-10	5,046	5,046
Computer equipment and software	3	11,306	11,289
Leasehold improvements	4	17	17
Construction in progress		17,041	14,756
		289,919	287,617
Less accumulated depreciation and amortization		(113,582)	(111,060)
Property and equipment net		\$ 176,337	\$ 176,557

Leasehold improvements are amortized over four years which is the shorter of the term of the lease or the service lives of the improvements.

Table of Contents

Depreciation and amortization expense related to property and equipment for the three months ended March 31, 2014 and 2013 was as follows (in thousands):

	Three months ended	
	March 31,	
	2014	2013
Depreciation and amortization expense	\$ 2,522	\$ 2,990

7. Common and preferred stock

The Company is authorized to issue 550,000,000 shares of common stock, par value \$0.01 per share, and 10,000,000 shares of undesignated preferred stock, par value \$0.01 per share, issuable in one or more series designated by the Company's board of directors. No other class of capital stock is authorized. As of March 31, 2014 and December 31, 2013, 386,934,914 and 369,391,972 shares of common stock, respectively, were issued and outstanding and no shares of preferred stock were outstanding. Included in the common stock outstanding as of March 31, 2014 and December 31, 2013 are 9,000,000 shares of common stock loaned to Bank of America under a share lending agreement in connection with the offering of \$100.0 million aggregate principal amount of 2015 notes (see Note 10 Senior convertible notes). Bank of America is obligated to return the borrowed shares (or, in certain circumstances, the cash value thereof) to the Company on or about the 45th business day following the date as of which the entire principal amount of the 2015 notes ceases to be outstanding, subject to extension or acceleration in certain circumstances or early termination at Bank of America's option. The Company did not receive any proceeds from the sale of the borrowed shares by Bank of America, but the Company did receive a nominal lending fee of \$0.01 per share from Bank of America for the use of borrowed shares.

On July 1, 2013, the Company entered into the Facility Agreement with Deerfield providing for the sale of up to \$160.0 million of 2019 notes to Deerfield in four equal tranches of \$40.0 million principal amount. A portion of the principal amount of the 2019 notes were convertible into shares of the Company's common stock at the note holder's option.

On February 28, 2014, the Company amended the Facility Agreement to, among other things, allow Deerfield, subject to certain limitations, to convert up to an additional \$60.0 million principal amount under the then-outstanding 2019 notes into common stock after the effective date of the Amendment, at a minimum conversion price of \$5.00 per share unless the Company otherwise consents. The Company also agreed to register for resale up to 12,000,000 shares of common stock issuable upon conversion of the outstanding 2019 notes, with a minimum conversion price of \$5.00 per share unless the Company otherwise consents. The conversion price will be determined by the average of the volume weighted average prices per share during the three trading days immediately preceding the election to convert. As of March 31, 2014, Deerfield had converted a portion of the outstanding 2019 notes into common stock (see Note 11 Facility financing agreement).

8. Commitments and contingencies

Guarantees and Indemnifications In the ordinary course of its business, the Company makes certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. The Company, as permitted under Delaware law and in accordance with its Bylaws, indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company's request in such capacity. The term of the indemnification period is for the officer's or director's lifetime.

The maximum amount of potential future indemnification is unlimited; however, the Company has a director and officer insurance policy that may enable it to recover a portion of any future amounts paid. The Company believes the fair value of these indemnification agreements is minimal. The Company has not recorded any liability for these indemnities in the accompanying condensed consolidated balance sheets. However, the Company accrues for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is probable and the amount can be reasonably estimated.

Litigation The Company is subject to legal proceedings and claims which arise in the ordinary course of its business. As of the date hereof, the Company believes that the final disposition of such matters will not have a material adverse effect on the financial position, results of operations or cash flows of the Company. The Company maintains liability insurance coverage to protect the Company's assets from losses arising out of or involving activities associated with ongoing and normal business operations. In accordance with ASC 450 *Contingencies*, the Company would record a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

Contingencies In connection with the Facility Agreement, on July 1, 2013 the Company also entered into a Milestone Rights Purchase Agreement (the Milestone Agreement) with Deerfield Private Design Fund and Horizon Santé FLML SÁRL (collectively, the Milestone Purchasers), pursuant to which the Company sold the Milestone Purchasers certain rights (the Milestone Rights) to receive payments of up to \$90.0 million upon the occurrence of specified strategic and sales milestones, including the first commercial sale of an AFREZZA product and the achievement of specified net sales figures (see Note 11 Facility financing agreement).

9. Related-party arrangements

In October 2007, the Company entered into a \$350.0 million loan arrangement with its principal stockholder. The Loan Arrangement has been amended from time to time. On October 31, 2013, the promissory note underlying the Loan Arrangement was amended to, among other things, extend the maturity date of the loan to January 5, 2020, extend the date through which the Company

Table of Contents

can borrow under the Loan Arrangement to December 31, 2019, increase the aggregate borrowing amount under the Loan Arrangement from \$350.0 million to \$370.0 million and provide that repayments or cancellations of principal under the Loan Arrangement will not be available for reborrowing.

As of March 31, 2014, the total principal amount outstanding under the Loan Arrangement was \$49.5 million, and the amount available for future borrowings was \$30.1 million. Interest, at a fixed rate of 5.84%, is due and payable quarterly in arrears on the first day of each calendar quarter for the preceding quarter, or at such other time as the Company and The Mann Group mutually agree. All or any portion of accrued and unpaid interest that becomes due and payable may be paid-in-kind and capitalized as additional borrowings at any time and would be classified as non-current upon mutual agreement of both parties. As of March 31, 2014, the Company had accrued \$1.3 million of interest in other liabilities related to the Loan Arrangement. The Mann Group can require the Company to prepay up to \$200.0 million in advances that have been outstanding for at least 12 months (less approximately \$105.0 million aggregate principal amount that has been cancelled in connection with two common stock purchase agreements). If The Mann Group exercises this right, the Company will have 90 days after The Mann Group provides written notice (or the number of days to maturity of the note if less than 90 days) to prepay such advances. However, pursuant to a letter agreement entered into in August 2010, The Mann Group has agreed to not require the Company to prepay amounts outstanding under the amended and restated promissory note if the prepayment would require the Company to use its working capital resources. In addition, The Mann Group entered into a subordination agreement with Deerfield pursuant to which The Mann Group agreed with Deerfield not to demand or accept any payment under the Loan Arrangement until the Company's payment obligations to Deerfield under the Facility Agreement have been satisfied in full. Subject to the foregoing, in the event of a default under the Loan Arrangement, all unpaid principal and interest either becomes immediately due and payable or may be accelerated at The Mann Group's option, and the interest rate will increase to the one-year LIBOR calculated on the date of the initial advance or in effect on the date of default, whichever is greater, plus 5% per annum. All borrowings under the Loan Arrangement are unsecured. The Loan Arrangement contains no financial covenants.

During the first quarter of 2014, there were no borrowings under or amendments to the Loan Arrangement.

10. Senior convertible notes

Senior convertible notes consist of the following (in thousands):

	March 31, 2014	December 31, 2013
2015 notes		
Principal amount	\$ 100,000	\$ 100,000
Unaccreted debt issuance expense	(1,338)	(1,561)
Net carrying amount	\$ 98,662	\$ 98,439

On August 18, 2010, the Company completed a Rule 144A offering of \$100.0 million aggregate principal amount of 5.75% Senior Convertible Notes due 2015 (the "2015 notes"). The 2015 notes are governed by the terms of an indenture dated as of August 24, 2010 (the "2015 Note Indenture"). The 2015 notes bear interest at the rate of 5.75% per year on the principal amount, payable in cash semi-annually in arrears on February 15 and August 15 of each year, beginning February 15, 2011. In connection with the 2015 notes, the Company had accrued interest of \$1.0 million and \$2.4 million as of March 31, 2014 and December 31, 2013, respectively. The 2015 notes are general, unsecured, senior

obligations of the Company and effectively rank junior in right of payment to all of the Company's secured debt, to the extent of the value of the assets securing such debt, and to the debt and all other liabilities of the Company's subsidiaries. The maturity date of the 2015 notes is August 15, 2015 and payment is due in full on that date for unconverted securities. Holders of the 2015 notes may convert, at any time prior to the close of business on the business day immediately preceding the stated maturity date, any outstanding principal into shares of the Company's common stock at an initial conversion rate of 147.0859 shares per \$1,000 principal amount, which is equal to a conversion price of approximately \$6.80 per share, subject to adjustment. Except in certain circumstances, if the Company undergoes a fundamental change: (1) the Company will pay a make-whole premium on the 2015 notes converted in connection with a fundamental change by increasing the conversion rate on such 2015 notes, which amount, if any, will be based on the Company's common stock price and the effective date of the fundamental change, and (2) each holder of 2015 notes will have the option to require the Company to repurchase all or any portion of such holder's 2015 notes at a repurchase price of 100% of the principal amount of the 2015 notes to be repurchased plus accrued and unpaid interest, if any. The Company may elect to redeem some or all of the 2015 notes if the closing stock price has equaled 150% of the conversion price for at least 20 of the 30 consecutive trading days ending on the trading day before the Company's redemption notice. The redemption price will equal 100% of the principal amount of the 2015 notes to be redeemed, plus accrued and unpaid interest, if any, to, but excluding, the redemption date, plus a make-whole payment equal to the sum of the present values of the remaining scheduled interest payments through and including August 15, 2015 (other than interest accrued up to, but excluding, the redemption date). The Company will be obligated to make the make-whole payment on all the 2015 notes called for redemption and converted during the period from the date the Company mailed the notice of redemption to and including the redemption date. The Company may elect to make the make-whole payment in cash or shares of its common stock, subject to certain limitations. Under the

Table of Contents

terms of the 2015 Note Indenture, the conversion option can be net-share settled and the maximum number of shares that could be required to be delivered under the contract, including the make-whole shares, is fixed and less than the number of authorized and unissued shares less the maximum number of shares that could be required to be delivered during the contract period under existing commitments. Applying the Company's sequencing policy, the Company performed an analysis at the time of the offering of the 2015 notes and each reporting date since and has concluded that the number of available authorized shares at the time of the offering and each subsequent reporting date was sufficient to deliver the number of shares that could be required to be delivered during the contract period under existing commitments.

The Company incurred approximately \$4.2 million in issuance costs which are recorded as an offset to the 2015 notes in the accompanying condensed consolidated balance sheets. These costs are being accreted to interest expense using the effective interest method over the term of the 2015 notes.

The 2015 notes provide that upon an acceleration of certain indebtedness, which would include the 2019 notes or the Tranche B notes described in Note 11, the holders may elect to accelerate the Company's repayment obligations under the notes if such acceleration is not cured, waived, rescinded or annulled. There can be no assurance that the holders would not choose to exercise these rights in the event such events were to occur.

Accretion of debt issuance expense in connection with the 2015 notes during the three months ended March 31, 2014 and 2013 was \$223,000 and \$209,000, respectively.

11. Facility financing agreement

The components and activity from initial recording of the facility financing agreement recorded through March 31, 2014 consist of the following (in thousands):

	March 31, 2014
2019 notes	
Initial principal amount	\$ 120,000
Principal converted to equity	(92,500)
Debt discount-net of amortization	(1,546)
Unaccreted debt issuance expense	(83)
Net carrying amount of facility financing agreement	\$ 25,871
Milestone Rights	
Initial milestone rights fair value	\$ 16,276
Debt discount-net of amortization	(51)
Unaccreted debt issuance expense	(61)
Less current portion of milestone rights included in other current liabilities	(3,151)
Net carrying amount included in other liabilities	\$ 13,013
Commitment Asset	

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Initial commitment asset fair value	\$ 13,393
Tranche B commitment asset fair value	\$ 2,921
Less Tranche 2 portion of commitment asset	(3,656)
Less Tranche 3 portion of commitment asset	(4,580)
Commitment asset value included in other assets	\$ 8,078

Accretion of debt issuance cost and debt discount in connection with the Facility financing agreement during the three months ended March 31, 2014 are as follows (in thousands):

	Three months ended March 31, 2014
Accretion expense- debt issuance cost	\$ 282
Accretion expense- debt discount	\$ 6,367

On July 1, 2013, the Company entered into the Facility Agreement providing for the sale of up to \$160.0 million of 2019 notes to Deerfield in four equal tranches of \$40.0 million principal amount. The 2019 notes accrue interest at a rate of 9.75% per annum until maturity in 2019 or their earlier repayment, repurchase, or conversion. As of March 31, 2014, Deerfield had purchased the first three tranches of 2019 notes in the aggregate principal amount of \$120.0 million; therefore, only \$40.0 million remain unsold. Deerfield's obligation to purchase the fourth tranche of 2019 notes is subject to receipt of marketing approval of AFREZZA by the FDA and the shares of common stock issuable upon conversion of all previously sold 2019 notes being freely tradable pursuant to an effective registration statement filed with the SEC or pursuant to Rule 144 under the Securities Act.

Table of Contents

On February 28, 2014, the Company entered into the Amendment, which modified the terms of the Facility Agreement to provide for the issuance of Tranche B notes to Deerfield in a maximum principal amount equal to (i) if the FDA approves the NDA for AFREZZA and Deerfield purchased the fourth tranche of 2019 notes, 150% of the aggregate principal amount of the 2019 notes that Deerfield has converted into the Company's common stock on and after the effective date of the Amendment, up to \$90.0 million, and (ii) otherwise, 33.33% of the aggregate principal amount of the 2019 notes that Deerfield has converted into the Company's common stock on and after the effective date of the Amendment, up to \$20.0 million, in each case subject to the satisfaction of certain other conditions. The Tranche B notes bear interest at the rate of 9.75% per year, subject to reduction to 8.75% if the Company enters into a collaboration with a third party to commercialize AFREZZA, on the outstanding principal amount, payable in cash quarterly in arrears on the last business day of March, June, September and December of each year. The Company is required to repay 25% of the original principal amount of any Tranche B notes on the third, fourth, fifth and sixth anniversaries of the applicable issue dates of such notes, provided that the entire outstanding principal amount of all Tranche B notes will become due and payable no later than December 31, 2019. The Tranche B notes can be prepaid without penalty or premium commencing two years after issuance thereof.

In addition, pursuant to the Amendment, the outstanding first tranche of 2019 notes (the Tranche 1 notes) and third tranche of 2019 notes (the Tranche 3 notes) held by Deerfield were amended and restated such that Deerfield may, subject to certain limitations, convert up to an additional \$60.0 million principal amount under such 2019 notes into common stock after the effective date of the Amendment, at a minimum conversion price of \$5.00 per share. The Company also agreed to register for resale up to 12,000,000 shares of common stock issuable upon conversion of the outstanding 2019 notes, as amended and restated, as of the date of the Amendment.

Commitment Asset

In connection with the issuance of the Tranche 1 notes and the Milestone Rights, the Company recorded a commitment asset, or the Commitment Asset, on July 1, 2013. As a result of the Amendment, the Company recorded an additional commitment asset with an estimated fair value equal to \$2.9 million. The Commitment Asset remaining as of March 31, 2014 represents the right to receive \$40.0 million funding under tranche 4 of 2019 notes and up to \$90 million of funding under Tranche B notes, subject to the achievement of certain milestones, pursuant to the Facility Agreement, as amended. The Commitment Asset is derecognized and recorded as a debt discount on the 2019 notes and Tranche B notes when issued and amortized using the effective interest rate method over the life of the notes. Prior to derecognition occurring, the Company monitors the Commitment Asset on an ongoing basis to determine whether an impairment indicator is present that would result in a full or partial write down of the Commitment Asset as a result of events that may lead to the subsequent tranches of notes not being issued. Based on the monitoring procedures performed through March 31, 2014, the Company did not identify any indicators of impairment.

Amendment to the outstanding Tranche 1 and Tranche 3 notes

The amendment and restatement of the outstanding Tranche 1 and Tranche 3 notes, pursuant to the Amendment, did not represent a troubled debt restructuring in the notes because the Amendment did not result in Deerfield granting a concession to the Company. In addition, the Amendment did not result in a substantial modification to the terms of the Tranche 1 and Tranche 3 notes.

The impact of the Amendment to the Tranche 1 and Tranche 3 notes will be accounted for as a prospective yield adjustment. Specifically the value of the Tranche B Commitment Asset was considered a fee received from the creditor as consideration for the Amendment and will be amortized as an adjustment of interest expense over the remaining term of the Tranche 1 and Tranche 3 notes using the effective interest method. As a result of the Amendment, the value of the Tranche B Commitment Asset was allocated between the Tranche 1 and Tranche 3

notes, which decreased the amount of debt discount on the Tranche 1 and Tranche 3 notes.

Conversion Option

For accounting purposes, the Company evaluated the embedded conversion option in the 2019 notes as a redemption feature because the number of shares issuable upon conversion is based on the volume weighted average prices for specified periods prior to the conversion date (as opposed to being fixed). Accordingly, conversions by Deerfield were treated as redemptions of the 2019 notes and, as discussed below, the Company analyzed whether the conversion option required bifurcation as an embedded redemption feature. As of December 31, 2013, Deerfield had converted \$6.5 million principal amount of the second tranche of 2019 notes (the Tranche 2 notes) for equity, resulting in an issuance of 1,293,224 shares of the Company's common stock. Upon the conversion, the principal balance of the notes were recorded in equity and an expense was recognized in the Statement of Operations in the amount of \$0.6 million for the difference between the principal amount of the notes converted and their carrying amount (which included unamortized discount and debt issuance costs).

During January 2014, Deerfield elected to convert the remaining \$33.5 million of Tranche 2 notes, which resulted in the issuance of 6,559,251 shares of the Company's common stock. During the three months ended March 31, 2014, the Company recorded an expense of \$3.0 million for the difference between the principal amount of the notes converted and their carrying amount (which included unamortized discount and debt issuance costs).

In March 2014, following the Amendment, which allowed Deerfield to convert up to an additional \$60 million principal amount under the outstanding Tranche 1 and Tranche 3 notes, Deerfield elected to convert the full \$40.0 million of outstanding principal amount of the Tranche 3 notes and \$12.5 million of principal amount of the Tranche 1 notes, pursuant to which the Company issued Deerfield 7,121,120 and 2,142,709 shares of the Company's common stock, respectively. As a result of these conversions, the Company recorded the principal balance of the notes in equity and an expense of \$3.0 million for the difference between the principal amount of the notes converted and their carrying amount (which included the unamortized discount and debt issuance costs) and the write-off of the derivative liability that was previously bifurcated from the Tranche 3 notes.

Table of Contents

In addition, the Company considered whether the amendment to the 2019 notes would result in the bifurcation of the conversion option in the Tranche 1 notes. Upon the issuance of the Tranche 1 notes on July 1, 2013 and as of March 31, 2014, the Company concluded that the conversion option was not required to be separated primarily due to the discount in the Tranche 1 notes not being deemed substantial under ASC 815-15-25-26.

12. Income taxes

As required by ASC 740 *Income Taxes* (ASC 740), management of the Company has evaluated the positive and negative evidence bearing upon the realizability of its deferred tax assets and concluded, in accordance with the applicable accounting standards, that net deferred tax assets should be fully reserved.

ASC 740-10-25 *Income Taxes Recognition* clarifies the accounting and disclosure for uncertainty in tax positions, as defined. This guidance seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. The Company believes that its income tax filing positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to this guidance. Tax years since 1993 remain subject to examination by the major tax jurisdictions in which the Company is subject to tax.

13. Fair Value of Financial Instruments

The Company applies various valuation approaches in determining the fair value of its financial assets and liabilities within a hierarchy that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the inputs that market participants would use in pricing the asset or liability and are developed based on the best information available in the circumstances. The fair value hierarchy is broken down into three levels based on the source of inputs as follows:

Level 1 Quoted prices for identical instruments in active markets.

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Significant inputs to the valuation model are unobservable.

The availability of observable inputs can vary among the various types of financial assets and liabilities. To the extent that the valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for financial statement disclosure purposes, the level in the fair value hierarchy within which the fair value measurement is categorized is based on the lowest level input that is significant to the overall fair value measurement.

Cash and cash equivalents

Cash equivalents consist of highly liquid investments with original or remaining maturities of 90 days or less at the time of purchase, that are readily convertible into cash. As of March 31, 2014 and December 31, 2013, the Company

held \$35.8 million and \$70.8 million, respectively, of cash and cash equivalents, consisting primarily of money market funds of \$34.9 million and \$67.7 million, respectively, and the remaining in non-interest bearing checking accounts. The fair value of these money market funds was determined by using quoted prices for identical investments in an active market (Level 1 in the fair value hierarchy).

The following is a summary of the carrying values and estimated fair values of the Company's 5.75% Senior Convertible Notes due 2015 (the 2015 notes) and the 2019 notes (in millions).

	March 31, 2014		December 31, 2013	
	Carrying	Estimated	Carrying	Estimated
	value	fair	value	fair
	value	value	value	value
2015 notes	\$ 98.7	\$ 95.1	\$ 98.4	\$ 102.2
2019 notes	\$ 25.9	\$ 25.7	\$ 102.3	\$ 107.0

Table of Contents*Senior Convertible Notes*

The estimated fair value of the 2015 notes was calculated based on model-derived valuations whose inputs were observable, such as the Company's stock price, and non-observable, such as the Company's longer-term historical volatility (Level 3 in the fair value hierarchy). As there is no current observable market for the 2015 notes, the Company determined the estimated fair value using a convertible bond valuation model within a lattice framework. The convertible bond valuation model combined expected cash outflows with market-based assumptions regarding risk-adjusted yields, stock price volatility and recent price quotes and trading information regarding Company issued debt instruments and shares of common stock into which the notes are convertible.

Facility financing agreement

As discussed in Note 11 Facility financing agreement, in connection with the Facility Agreement, the Company issued 2019 notes and Milestone Rights and recorded the Commitment Asset on July 1, 2013. As there is no current observable market for the 2019 notes, the Company determined the estimated fair value using a bond valuation model based on a discounted cash flow methodology. The bond valuation model combined expected cash flows associated with principal repayment and interest based on the contractual terms of the debt agreement discounted to present value using a selected market discount rate of 12.7% (Level 3 in the fair value hierarchy). On March 31, 2014, the market discount rate was recalculated at 12.5% for the Tranche 1 notes. The Tranche 2 and Tranche 3 notes were fully converted by the end of the first quarter.

The estimated fair value of the Milestone Rights was calculated using the income approach in which the cash flows associated with the specified contractual payments were adjusted for both the expected timing and the probability of achieving the milestones discounted to present value using a selected market discount rate (Level 3 in the fair value hierarchy). The expected timing and probability of achieving the milestones, starting in 2014, was developed with consideration given to both internal data, such as progress made to date and assessment of criteria required for achievement, and external data, such as market research studies. The discount rate (17.5%) was selected based on an estimation of required rate of returns for similar investment opportunities using available market data.

The fair value of the Commitment Asset was estimated using the income approach by estimating the fair value of the future tranches using a market debt rate (12%) commensurate with the risk of the future tranches and the fair value of the cash expected to be received by the Company and assessing the probability of the commitments being funded in the future based on the operational hurdles required for funding being met (Level 3 in the fair value hierarchy).

At March 31, 2014, as there had been no material changes to the established estimates, the carrying value of the Milestone Rights and Commitment Asset approximates their respective estimated fair values.

Also as discussed in Note 11 Facility financing agreement, on February 28, 2014, the Company entered into the Amendment to Facility Agreement, and recorded an additional commitment asset which represented the increase in borrowing capacity that the Company received as consideration for the modifications made to the Facility Agreement and the Tranche 1 notes and Tranche 3 notes. The fair value of the additional commitment asset was estimated using a discounted cash flow analysis under the income approach. Specifically, the fair value of the additional commitment asset was determined by estimating the fair value of the future tranche using a market yield (11.9%) commensurate with the risk of the future tranche and the fair value of the cash expected to be received by the Company and assessing the probability of the commitment being funded in the future based on the operational hurdles required for funding being met as well as consideration of alternative funding options (Level 3 in the fair value hierarchy). As of February 28, 2014, the additional commitment asset was valued at \$2.9 million. At March 31, 2014, as there have been no material changes to the established estimates, the carrying value of the Tranche B Commitment Asset

approximates its respective estimated fair values.

There were no material re-measurements to fair value during the three months ended March 31, 2014 and 2013 of financial assets and liabilities that are not measured at fair value on a recurring basis. There were no transfers of assets or liabilities between the fair value measurement levels during the three months ended March 31, 2014 and 2013.

14. Subsequent Events

On April 1, 2014 the EMDA voted 13 to 1 to recommend that AFREZZA inhalation powder be granted approval by the FDA to improve glycemic control in adults with type 1 diabetes and voted 14 to 0 to recommend that AFREZZA be granted approval by the FDA to improve glycemic control in adults with type 2 diabetes.

Subsequent to the EMDA meeting, the FDA extended the PDUFA date for AFREZZA by three months from April 15, 2014 to July 15, 2014 in order to provide time for a full review of information submitted by MannKind in response to the FDA's requests.

On April 2, 2014, Deerfield elected to convert an aggregate of \$7.5 million of principal amount of the Tranche 1 notes, pursuant to which the Company issued Deerfield 1,500,000 shares of the Company's common stock. As a result of this election, Deerfield has fully exercised the conversion option under the Amendment by converting the additional \$60.0 million of the Tranche 1 and Tranche 3 notes allowable, into 10,763,829 shares of the Company's common stock in the aggregate.

On May 6, 2014, Deerfield purchased an aggregate principal amount of \$20.0 million in Tranche B notes in accordance with the provisions of the Facility Agreement, as amended.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion contains forward-looking statements, which involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth below in Part II, Item 1A Risk Factors and elsewhere in this quarterly report on Form 10-Q. The preceding interim condensed consolidated financial statements and this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the financial statements and related notes for the year ended December 31, 2013 and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Annual Report. Readers are cautioned not to place undue reliance on forward-looking statements. The forward-looking statements speak only as of the date on which they are made, and we undertake no obligation to update such statements to reflect events that occur or circumstances that exist after the date on which they are made.

OVERVIEW

We are a biopharmaceutical company focused on the discovery and development of therapeutic products for diseases such as diabetes. Our lead product candidate, AFREZZA, is an ultra rapid-acting insulin therapy that is intended to improve glycemic control in adults with type 1 or type 2 diabetes.

In October 2013, we resubmitted a New Drug Application, or NDA, for AFREZZA to the U.S. Food and Drug Administration, or FDA, which included data from two completed Phase 3 studies 171 and 175, both of which met their primary efficacy endpoints and safety objectives. On April 1, 2014 the Endocrinologic and Metabolic Drugs Advisory Committee, or EMDA, of the FDA voted 13 to 1 to recommend that AFREZZA inhalation powder be granted approval by the FDA to improve glycemic control in adults with type 1 diabetes and voted 14 to 0 to recommend that AFREZZA be granted approval by the FDA to improve glycemic control in adults with type 2 diabetes.

Subsequent to the EMDA meeting, the FDA extended the Prescription Drug User Fee Act, or PDUFA, date for AFREZZA by three months to July 15, 2014 in order to provide time for a full review of information submitted by MannKind in response to the FDA's requests.

We are a development stage enterprise and have incurred significant losses since our inception in 1991. As of March 31, 2014, we have incurred a cumulative net loss of \$2.3 billion and have stockholders' equity of \$17.5 million. To date, we have not generated any product revenues and have funded our operations through the sale of equity securities and convertible debt securities, through our facility agreement dated July 1, 2013, and through borrowings under our loan arrangement with The Mann Group LLC, or the Loan Arrangement. As discussed below in Liquidity and Capital Resources, if we are unable to obtain additional funding in the future, there will continue to be substantial doubt about our ability to continue as a going concern.

We do not expect to make sales of any product prior to regulatory approval and commercialization of AFREZZA. We currently do not have the required approvals to market any of our product candidates, and we may not receive such approvals. We may not be able to achieve positive cash flow from operations even if we succeed in commercializing any of our product candidates. We expect to make substantial expenditures and to incur additional operating losses for at least the next several years as we:

continue the clinical development of AFREZZA and new inhalation systems for the treatment of diabetes;

seek regulatory approval to sell AFREZZA in the United States and other markets;

seek development and commercialization collaborations for AFREZZA; and

develop additional applications of our proprietary Technosphere formulation technology for the pulmonary delivery of other drugs.

Our business is subject to significant risks, including but not limited to the risks inherent in our ongoing clinical trials and the regulatory approval process, our potential inability to enter into sales and marketing collaborations or to commercialize AFREZZA in a timely manner. Additional significant risks also include the results of our research and development efforts, competition from other products and technologies and uncertainties associated with obtaining and enforcing patent rights.

RESEARCH AND DEVELOPMENT EXPENSES

Our research and development expenses consist mainly of costs associated with the clinical trials of our product candidates that have not yet received regulatory approval for marketing and for which no alternative future use has been identified. This includes the salaries, benefits and stock-based compensation of research and development personnel, raw materials, such as insulin purchases, laboratory supplies and materials, facility costs, costs for consultants and related contract research, licensing fees, and depreciation of equipment. We track research and development costs by the type of cost incurred. We partially offset research and development expenses with the recognition of estimated amounts receivable from the State of Connecticut pursuant to a program under which we can exchange qualified research and development income tax credits for cash.

Our research and development staff conducts our internal research and development activities, which include research, product development, clinical development, manufacturing and related activities. This staff is located in our facilities in Valencia, California; Paramus, New Jersey; and Danbury, Connecticut. We expense research and development costs as we incur them.

Table of Contents

Clinical development timelines, likelihood of success and total costs vary widely. We are focused on advancing AFREZZA through regulatory filings.

At this time, due to the risks inherent in the clinical trial process and given the early stage of development of our product candidates other than AFREZZA, we are unable to estimate with any certainty the costs that we will incur in the continued development of our product candidates for commercialization. The costs required to complete the development of AFREZZA will be largely dependent on the cost and efficiency of our clinical trial operations and discussions with the FDA regarding its requirements.

GENERAL AND ADMINISTRATIVE EXPENSES

Our general and administrative expenses consist primarily of salaries, benefits and stock-based compensation for administrative, finance, business development, human resources, legal and information systems support personnel. In addition, general and administrative expenses include professional service fees and business insurance costs.

CRITICAL ACCOUNTING POLICIES

The preparation of our condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the notes to the financial statements. Some of those judgments can be subjective and complex, and therefore, actual results could differ materially from those estimates under different assumptions or conditions. A summary of our critical accounting policies is presented in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2013. There have been no material changes to our critical accounting policies during the three months ended March 31, 2014.

Recently Issued Accounting Standards In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit when a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force)*. The amendments in this ASU provide guidance on the financial statements presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. An unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward with certain exceptions, in which case such an unrecognized tax benefit should be presented in the financial statements as a liability. The amendments in this ASU do not require new recurring disclosures. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of the new requirement did not have a significant impact on the Company's consolidated financial statements.

RESULTS OF OPERATIONS

Three months ended March 31, 2014 and 2013

Revenue

We did not recognize any revenue for the three months ended March 31, 2014 or 2013. We do not anticipate sales of any product prior to regulatory approval and commercialization of AFREZZA.

Research and Development Expenses

The following table provides a comparison of the research and development expense categories for the three months ended March 31, 2014 and 2013 (dollars in thousands):

	Three months ended March 31,			
	2014	2013	\$ Change	% Change
Clinical	\$ 9,179	\$ 13,282	\$ (4,103)	(31%)
Manufacturing	10,748	9,390	1,358	14%
Research	1,490	1,316	174	13%
Research and development tax credit	(83)	(78)	(5)	(6%)
Stock-based compensation expense	4,848	2,488	2,360	95%
Research and development expenses	\$ 26,182	\$ 26,398	\$ (216)	(1%)

The decrease in research and development expenses for the three months ended March 31, 2014 compared to the three months ended March 31, 2013 was driven by a decrease of \$4.1 million in clinical spending driven by the completion of two Phase 3 studies in the second quarter of 2013. The decrease in research and development was offset by an increase in stock-based compensation expense of \$2.4 million in connection with the award of company-wide performance-based grants in the first and second quarters of 2013 and an increase in manufacturing spending of \$1.4 million driven by supplies purchases related to commercialization preparation and non-capital spare parts.

Table of Contents

We anticipate that our overall research and development expenses will increase in 2014 compared to 2013 due to the preparation for commercialization of AFREZZA.

General and Administrative Expenses

The following table provides a comparison of the general and administrative expense categories for the three months ended March 31, 2014 and 2013 (dollars in thousands):

	Three months ended			
	March 31,			
	2014	2013	\$ Change	% Change
Salaries and employee related expenses	\$ 4,068	\$ 3,437	\$ 631	18%
Professional fees and other general expenses	5,073	3,901	1,172	30%
Stock-based compensation expense	6,088	2,701	3,387	125%
General and administrative expenses	\$ 15,229	\$ 10,039	\$ 5,190	52%

General and administrative expenses for the three months ended March 31, 2014 increased compared to the three months ended March 31, 2013 primarily due to an increase in stock-based compensation expense of \$3.4 million in connection with the award of company-wide performance-based grants made in the first and second quarters of 2013. Additionally, in the first quarter of 2014 there was an increase of \$1.2 million in consulting and legal fees related to costs associated with filings, financing, and other legal matters and an increase of \$0.6 million in salaries and employee related expenses resulting from the Chief Executive Officer voluntarily declining his 2012 bonus payment and accepting the 2013 bonus, which is paid out in the first quarter of the following year.

We expect general and administrative expenses overall to be higher in 2014 as compared to 2013 as a result of increased stock compensation expense due to anticipated milestone achievements.

Other Income (Expense)

Other income decreased from \$23,000 for the three months ended March 31, 2013 to an expense of \$5.9 million for the three months ended March 31, 2014. The decrease was primarily due to a \$6.0 million expense associated with the unamortized discount and debt issuance costs upon conversion of the remaining balance of the Tranche 2 notes, the full conversion of the Tranche 3 notes, and the partial conversion of the Tranche 1 notes.

Interest Income and Expense

Interest expense on notes increased from \$4.6 million for the three months ended March 31, 2013 to \$4.8 million for the three months ended March 31, 2014. The increase of \$0.2 million was primarily due to higher interest expense associated with the 9.75% Senior Convertible Notes due 2019, or 2019 notes, issued in the second half of 2013, which was partially offset by lower interest expense on the Loan Arrangement with The Mann Group due to a lower carrying value in 2014 compared to prior year.

LIQUIDITY AND CAPITAL RESOURCES

We have funded our operations through the sale of equity securities and convertible debt securities and borrowings under the loan Arrangement with The Mann Group.

As of March 31, 2014, the total principal amount outstanding under the Loan Arrangement was \$49.5 million, and the amount available for future borrowings was \$30.1 million. We anticipate using a portion of these available borrowings to capitalize accrued interest into principal, upon mutual agreement of the parties, as it becomes due and payable under the Loan Arrangement.

On July 1, 2013, we entered into a facility agreement, or the Facility Agreement, with Deerfield Private Design Fund II, L.P. and Deerfield Private Design International II, L.P., referred to collectively as Deerfield, providing for the sale of up to \$160.0 million of 2019 notes in four equal tranches of \$40.0 million principal amount.

On February 28, 2014, we amended the Facility Agreement to provide for the issuance of an additional tranche of notes, or the Tranche B notes, to Deerfield in a maximum aggregate principal amount equal to i) if the FDA approves the NDA for AFREZZA and Deerfield purchases the fourth tranche of 2019 notes originally issuable pursuant to the Facility Agreement, 150% of the aggregate principal amount of 2019 notes that Deerfield has converted into our common stock on and after the effective date of the amendment, up to \$90.0 million, and (ii) otherwise, 33.33% of the aggregate principal amount of 2019 notes that Deerfield has converted into our common stock on and after the effective date of the amendment, up to \$20.0 million, in each case subject to the satisfaction of certain other conditions. The Tranche B notes bear interest at the rate of 9.75% per year, subject to reduction to 8.75% if we enter into a collaboration with a third party to commercialize AFREZZA, on the outstanding principal amount, payable in cash quarterly in arrears on the last business day of March, June, September and December of each year. The amended Facility Agreement also provided Deerfield with the option, subject to certain limitations, to convert up to an additional \$60.0 million of the 2019 notes issued and outstanding on the date of the amendment into shares of our common stock following the effective date of the amendment.

Table of Contents

On April 2, 2014, Deerfield elected to convert an aggregate of \$7.5 million of principal amount of the Tranche 1 notes, pursuant to which we issued Deerfield 1,500,000 shares of our common stock. As a result of this election, Deerfield has fully exercised the conversion option under the Facility Agreement, as amended, by converting the additional \$60.0 million of the Tranche 1 and Tranche 3 notes allowable into 10,763,829 shares of our common stock in the aggregate. As of March 31, 2014, Deerfield had purchased the first three tranches of 2019 notes in the aggregate principal amount of \$120.0 million; therefore, only \$40.0 million remain unsold under the initial Financing Agreement. Deerfield's obligation to purchase the fourth tranche of 2019 notes is subject to receipt of marketing approval of AFREZZA by the FDA and the shares of common stock issuable upon conversion of all previously sold 2019 notes being freely tradable pursuant to an effective registration statement filed with the SEC or pursuant to Rule 144 under the Securities Act. There can be no assurance that the conditions required for the purchase of additional 2019 notes pursuant to the amendment will be met or met in a timeframe necessary to support our liquidity needs.

On March 3, 2014, we entered into an At-The-Market Issuance Sales Agreement with MLV & Co. LLC, or MLV, and an At-The-Market Issuance Sales Agreement with Meyers Associates, L.P. (doing business as Brinson Patrick, a division of Meyers Associates, L.P.), or Brinson Patrick. We refer to the foregoing agreements as the ATM Agreements. Under each ATM Agreement, we may issue or sell shares of our common stock having an aggregate offering price of up to \$50.0 million from time to time through MLV or Brinson Patrick, as our sales agents. We expect that all or substantially all sales of common stock made under the ATM Agreements will be made in the market offerings as defined in Rule 415 of the Securities Act. We have not yet sold or issued any shares of our common stock under the ATM Agreements. There can be no assurance that we will be able to access capital through the ATM Agreements on a timely basis, or at all.

During the three months ended March 31, 2014, we used \$37.0 million of cash for our operations and had a net loss of \$52.1 million, which included \$20.3 million of non-cash charges consisting of depreciation and accretion, and stock-based compensation. By comparison, during the three months ended March 31, 2013, we used \$32.0 million of cash for our operations and had a net loss of \$41.0 million, which included \$8.5 million of non-cash charges consisting of depreciation and accretion, stock-based compensation. The operating cash flow decreased by \$5.7 million primarily due to decreases in accrued expenses associated with the clinical trials and accrued interest associated with our loan arrangement with The Mann Group. The change is also due to incremental expenses associated with employee compensation. We expect our negative operating cash flow to continue at least until we obtain regulatory approval and achieve commercialization of AFREZZA.

We used \$1.4 million of cash for investing activities during the three months ended March 31, 2014, compared to \$1.5 million of cash used for the three months ended March 31, 2013.

Our financing activities generated \$3.4 million of cash for the three months ended March 31, 2014, as compared to negative cash flow of \$0.3 million for the three months ended March 31, 2013. For the three months ended March 31, 2014, cash provided by financing activities was from \$1.9 million in warrant exercises and \$1.5 million from the exercise of stock options.

As of March 31, 2014, we had \$35.8 million in cash and cash equivalents. We believe that our existing capital resources will enable us to continue planned operations at least into the third quarter of 2014. However, we cannot provide assurances that our plans will not change or that changed circumstances will not result in the depletion of the capital resources more rapidly than we currently anticipate. We will need to raise additional capital, whether through a sale of equity or debt securities, a strategic business collaboration with a pharmaceutical company, the establishment of other funding facilities, licensing arrangements, asset sales or other means, in order to continue the development and commercialization of AFREZZA and other product candidates and to support our other ongoing activities. However, we cannot provide assurances that such additional capital will be available whether through the sale of

equity or debt securities, a strategic business collaboration with a pharmaceutical company, the establishment of other funding facilities, licensing arrangements, asset sales or other means.

We intend to use our capital resources to continue the development and commercialization of AFREZZA, if approved. We are expending a portion of our capital resources to scale up our manufacturing capabilities in our Danbury facilities. We also intend to use our capital resources for general corporate purposes.

We have held extensive discussions with a number of pharmaceutical companies concerning a potential strategic business collaboration for AFREZZA. We cannot predict when, if ever, we will conclude an agreement with a partner. There can be no assurance that any such collaboration will be entered on a timely basis or on acceptable terms, or at all.

If we enter into a strategic business collaboration with a pharmaceutical or biotechnology company, we would expect, as part of the transaction, to receive additional capital. In addition, we expect to pursue the sale of equity and/or debt securities, including sales of our common stock through the ATM Agreements, or the establishment of other funding facilities. Issuances of debt or additional equity could impact the rights of our existing stockholders, dilute the ownership percentages of our existing stockholders and may impose restrictions on our operations. These restrictions could include limitations on additional borrowing, specific restrictions on the use of our assets as well as prohibitions on our ability to create liens, pay dividends, redeem our stock or make investments. We also may seek to raise additional capital by pursuing opportunities for the licensing, sale or divestiture of certain intellectual property and other assets, including our Technosphere technology platform. There can be no assurance, however, that any strategic collaboration, sale of securities or sale or license of assets will be available to us on a timely basis or on acceptable terms, if at all. If we are unable to raise additional capital, we may be required to enter into agreements with third parties to develop or commercialize products or technologies that we otherwise would have sought to develop independently, and any such agreements may not be on terms as commercially favorable to us.

We cannot provide assurances that our plans will not change or that changed circumstances will not result in the depletion of our capital resources more rapidly than we currently anticipate. If planned operating results are not achieved or we are not successful in raising additional capital through equity or debt financing or entering a business collaboration, we may be required to reduce expenses through the delay, reduction or curtailment of our projects, including AFREZZA development activities, or further reduction of costs for facilities and administration, and there will continue to be substantial doubt about our ability to continue as a going concern.

Table of Contents

Off-Balance Sheet Arrangements

As of March 31, 2014, we did not have any off-balance sheet arrangements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk related to changes in interest rates impacting our short-term investment portfolio. The interest rate on amounts borrowed under our loan arrangement with The Mann Group for the year ended December 31, 2013 and three months ended March 31, 2014 was a fixed rate equal to 5.84%. As of December 31, 2013, the total principal amount outstanding under the Loan Arrangement was \$49.5 million. We also have debt related to the 2015 notes at a fixed interest rate of 5.75% and debt related to the Facility Agreement at a fixed interest rate of 9.75%. Due to the fixed interest rates of our debt, we do not currently have any exposure to changes in our interest expense as a result of changes in interest rates. Our current policy requires us to maintain a highly liquid short-term investment portfolio consisting mainly of U.S. money market funds and investment-grade corporate, government and municipal debt. None of these investments are entered into for trading purposes. Our cash is deposited in and invested through highly rated financial institutions in North America. As of March 31, 2014, the amount available for borrowing under our loan arrangement with The Mann Group was \$30.1 million. If a 10% change in interest rates were to have occurred on March 31, 2014, this change would not have had a material effect on the value of our short-term investment portfolio or on our interest expense obligations with respect to outstanding borrowed amounts.

ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our chief executive and financial officers, evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of March 31, 2014. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of March 31, 2014, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at a reasonable assurance level.

Management determined that, as of March 31, 2014, there were no changes in our internal control over financial reporting that occurred during the fiscal quarter then ended 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

None.

Item 1A. Risk Factors

You should consider carefully the following information about the risks described below, together with the other information contained in this quarterly report on Form 10-Q before you decide to buy or maintain an investment in our common stock. We believe the risks described below are the risks that are material to us as of the date of this quarterly report. Additional risks and uncertainties that we are unaware of may also become important factors that affect us. The risk factors set forth below with an asterisk () next to the title contain changes to the description of the risk factors previously disclosed in Item 1A to our Annual Report. If any of the following risks actually occur, our business, financial condition, results of operations and future growth prospects would likely be materially and adversely affected. In these circumstances, the market price of our common stock could decline, and you may lose all or part of the money you paid to buy our common stock.*

Table of Contents

RISKS RELATED TO OUR BUSINESS

We depend heavily on the successful development and commercialization of our lead product candidate, AFREZZA, which is not yet approved.*

To date, we have not commercialized any product candidates. We have expended significant time, money and effort in the development of our lead product candidate, AFREZZA, which has not yet received regulatory approval and which may not be approved by the FDA in a timely manner, or at all. Our other product candidates are generally in early clinical or preclinical development. We anticipate that in the near term, our ability to generate revenues will depend on the successful development and commercialization of AFREZZA.

Last October, we resubmitted a NDA for AFREZZA to the FDA, which included data from two completed Phase 3 studies 171 and 175, both of which met their primary efficacy endpoints and safety objectives. On April 1, 2014 the EMDA voted 13 to 1 to recommend that AFREZZA inhalation powder be granted approval by the FDA to improve glycemic control in adults with type 1 diabetes and voted 14 to 0 to recommend that AFREZZA be granted approval by the FDA to improve glycemic control in adults with type 2 diabetes.

Subsequent to the Advisory Committee meeting, the FDA extended the PDUFA date for AFREZZA by three months to July 15, 2014 in order to provide time for a full review of information submitted by MannKind in response to the FDA's requests.

We must receive the necessary approvals from the FDA before AFREZZA can be marketed and sold in the United States and must receive the necessary approvals from similar foreign regulatory agencies before AFREZZA can be marketed outside of the United States. Even if we were to receive regulatory approval, we ultimately may be unable to gain market acceptance of AFREZZA for a variety of reasons, including the treatment and dosage regimen, potential adverse effects, the availability of alternative treatments and lack of coverage or adequate reimbursement. If we fail to commercialize AFREZZA, our business, financial condition and results of operations will be materially and adversely affected.

We have sought to develop our product candidates through our internal research programs. All of our product candidates will require additional research and development and, in some cases, significant preclinical, clinical and other testing prior to seeking regulatory approval to market them. Accordingly, these product candidates will not be commercially available for a number of years, if at all.

A significant portion of the research that we have conducted involves new and unproven compounds and technologies, including AFREZZA and our Technosphere platform technology. Even if our research programs identify candidates that initially show promise, these candidates may fail to progress to clinical development for any number of reasons, including discovery upon further research that these candidates have adverse effects or other characteristics that indicate they are unlikely to be effective. In addition, the clinical results we obtain at one stage are not necessarily indicative of future testing results. If we fail to successfully complete the development and commercialization of AFREZZA or develop or expand our other product candidates, or are significantly delayed in doing so, our business and results of operations will be harmed and the value of our stock could decline.

We have a history of operating losses, we expect to continue to incur losses and we may never generate positive cash flow from operations.*

We are a development stage company with no commercial products. All of our product candidates are still being developed, and all but AFREZZA are still in the early stages of development. Our product candidates will require

significant additional development, clinical studies, regulatory clearances and additional investment before they can be commercialized. We cannot be certain when AFREZZA may be approved or if it will be approved.

We have never been profitable or generated positive cash flow from operations and, as of March 31, 2014, we had incurred a cumulative net loss of \$2.3 billion. The cumulative net loss has resulted principally from costs incurred in our research and development programs, the write-off of goodwill and general operating expenses. We expect to make substantial expenditures and to incur increasing operating losses in the future in order to further develop and commercialize our product candidates, including costs and expenses to complete clinical studies, seek regulatory approvals and market our product candidates, including AFREZZA. Our cumulative net loss may increase significantly as we continue development and clinical study efforts. Our losses have had, and are expected to continue to have, an adverse impact on our working capital, total assets and stockholders' equity. As of March 31, 2014, we had stockholders' equity of \$17.5 million. Our ability to achieve and sustain positive cash flow from operations and profitability depends upon obtaining regulatory approvals for and successfully commercializing AFREZZA, either alone or with third parties. We do not currently have the required approvals to market any of our product candidates, and we may not receive them. We may not generate positive cash flow from operations or be profitable even if we succeed in commercializing any of our product candidates. As a result, we cannot be sure when we will generate positive cash flow from operations or become profitable, if at all.

We will be required to raise additional capital to fund our operations, and our inability to do so could raise substantial doubt about our ability to continue as a going concern.*

Based on our current expectations, we believe that our existing capital resources will enable us to continue planned operations at least into the third quarter of 2014. We cannot assure you that our plans will not change or that changed circumstances will not result in the depletion of our capital resources more rapidly than we currently anticipate. We will need to raise additional funds, through the

Table of Contents

sale of equity or debt securities, the entry into strategic business collaborations, the establishment of other funding facilities, licensing arrangements, asset sales, through additional borrowings from The Mann Group, or other means, in order to continue the development and commercialization of AFREZZA and other product candidates and to support our other ongoing activities. It may be difficult for us to raise additional funds on favorable terms, or at all. As of March 31, 2014, we had stockholders' equity of \$17.5 million which may raise concerns about our solvency and affect our ability to raise additional capital. The amount of additional funds we need will depend on a number of factors, including:

the election of any or all of the holders of the 2015 notes, to require us to repay or repurchase such notes if and when required;

our ability to refinance existing indebtedness, including indebtedness under the 2015 notes which mature in August 2015;

the satisfaction of the conditions to the sale and purchase of 2019 notes and/or additional Tranche B notes under the Facility Agreement, or failing the satisfaction of such conditions, whether Deerfield chooses to waive satisfaction of such conditions and purchase additional 2019 notes and/or additional Tranche B notes;

the extent to which the 2015 notes are converted into shares of our common stock;

rate of progress and costs of our clinical studies and research and development activities, including costs of procuring clinical materials and operating our manufacturing facilities;

our obligation to make milestone payments pursuant to the milestone rights issued to Deerfield Private Design Fund II, L.P. and Horizon Santé FLML SÁRL, referred to collectively as the Milestone Purchasers pursuant to our Milestone Rights Purchase Agreement dated July 1, 2013, or the Milestone Agreement;

our success in establishing strategic business collaborations or other sales or licensing of assets, and the timing and amount of any payments we might receive from any such transactions;

the costs of preparing applications for regulatory approvals for our product candidates, including AFREZZA, either ourselves or with any commercialization partner;

actions taken by the FDA and other regulatory authorities affecting our product candidates and competitive products;

our degree of success in commercializing AFREZZA assuming receipt of required regulatory approvals;

the emergence of competing technologies and products and other market developments;

the costs of preparing, filing, prosecuting, maintaining and enforcing patent claims and other intellectual property rights or defending against claims of infringement by others;

the level of our legal expenses;

the costs associated with litigation; and

the costs of discontinuing projects and technologies, and/or decommissioning existing facilities, if we undertake any such activities.

We have raised capital in the past through the sale of equity and debt securities. We may in the future pursue the sale of additional equity and/or debt securities, including sales of our common stock through the ATM Agreements, or the establishment of other funding facilities including asset based borrowings. There can be no assurances, however, that we will be able to raise additional capital on acceptable terms, or at all. Issuances of additional debt or equity securities or the conversion of any of our currently outstanding convertible debt securities into shares of our common stock or the exercise of our currently outstanding warrants for shares of our common stock could impact the rights of the holders of our common stock and may dilute their ownership percentage. Moreover, the establishment of other funding facilities may impose restrictions on our operations. These restrictions could include limitations on additional borrowing and specific restrictions on the use of our assets, as well as prohibitions on our ability to create liens, pay dividends, redeem our stock or make investments. We also may seek to raise additional capital by pursuing opportunities for the licensing or sale of certain intellectual property and other assets. We cannot offer assurances, however, that any strategic collaborations, sales of securities or sales or licenses of assets will be available to us on a timely basis or on acceptable terms, if at all. We may be required to enter into relationships with third parties to develop or commercialize products or technologies that we otherwise would have sought to develop independently, and any such relationships may not be on terms as commercially favorable to us as might otherwise be the case.

In the event that sufficient additional funds are not obtained through strategic collaboration opportunities, sales of securities, funding facilities, licensing arrangements and/or asset sales on a timely basis, we will be required to reduce expenses through the delay, reduction or curtailment of our projects, including AFREZZA development activities, or further reduction of costs for facilities and administration. Moreover, if we do not obtain such additional funds, there will be substantial doubt about our ability to continue as a going concern and increased risk of insolvency and loss of investment to the holders of our securities. As of the date hereof, we have not obtained a solvency opinion or otherwise conducted a valuation of our properties to determine whether our debts exceed the fair value of our property within the meaning of applicable solvency laws. If we are or become insolvent, investors in our stock may lose the entire value of their investment.

We do not anticipate generating operating cash flow before AFREZZA is commercialized, which we expect will require us to reach an agreement with a commercialization partner, and therefore cannot provide assurances that changed or unexpected circumstances,

Table of Contents

including, among other things, delays in obtaining regulatory approval and in identifying and reaching agreements with a commercialization partner, will not result in the depletion of our capital resources more rapidly than we currently anticipate, in which case we may be required to raise additional capital. There can be no assurances that we will be able to raise additional capital on favorable terms, or at all. If planned operating results are not achieved or we are not successful in raising additional capital through equity or debt financings or entering into a strategic business collaboration with a pharmaceutical or biotechnology company, we will be required to reduce expenses through the delay, reduction or curtailment of our projects, including AFREZZA development activities, or further reduction of costs for facilities and administration, and there will be continued substantial doubt about our ability to continue as a going concern.

We have a substantial amount of debt pursuant to our 2015 notes and 2019 notes and may be unable to make required payments of interest and principal as they become due.*

As of March 31, 2014, we had \$127.5 million of outstanding debt pursuant to our 2015 notes and 2019 notes, consisting of:

\$100.0 million principal amount of 2015 notes bearing interest at 5.75% per annum and maturing on August 15, 2015; and

\$27.5 million principal amount of 2019 notes bearing interest at 9.75% per annum and maturing between 2016 and December 31, 2019.

In addition, pursuant to the Facility Agreement, we may issue up to \$40.0 million principal amount of additional 2019 notes subject to receipt of approval of AFREZZA from the FDA prior to December 30, 2014 and, pursuant to the February 28, 2014 Amendment to the Facility Agreement, additional Tranche B notes in a maximum principal amount up to \$90.0 million, subject to the satisfaction of certain other conditions. There can be no assurance that we will have sufficient resources to make any required repayments of principal under the 2015 notes, 2019 notes or, Tranche B notes when required. Further, if we undergo a fundamental change, as that term is defined in the indentures governing the terms of the 2015 notes, or certain Major Transactions as defined in the Facility Agreement in respect of the 2019 notes and Tranche B notes, the holders of the notes will have the option to require us to repurchase all or any portion of the notes at a repurchase price of 100% of the principal amount of such notes to be repurchased plus accrued and unpaid interest, if any. The 2015 notes bear interest at the rate of 5.75% per year on the outstanding principal amount, payable in cash semiannually in arrears on February 15 and August 15 of each year, and the 2019 notes bear interest at the rate of 9.75% per year on the outstanding principal amount, payable in cash quarterly in arrears on the last business day of March, June, September and December of each year. The Tranche B notes bear interest at the rate of 9.75% per year, subject to reduction to 8.75% if we enter into a collaboration with a third party to commercialize AFREZZA, on the outstanding principal amount, payable in cash quarterly in arrears on the last business day of March, June, September and December of each year. While we have been able to timely make our required interest payments to date, we cannot guarantee that we will be able to do so in the future. If we fail to pay interest on the 2015 notes, 2019 notes or Tranche B notes, or if we fail to repay or repurchase the 2015 notes, 2019 notes or Tranche B notes when required, we will be in default under the indenture or other applicable instrument for such note(s), and may also suffer an event of default under the terms of other borrowing arrangements that we may enter into from time to time. Any of these events could have a material adverse effect on our business, results of operations and financial condition, up to and including the note holders initiating bankruptcy proceedings or causing us to cease operations altogether.

Our agreements with Deerfield relating to our 2019 notes, Tranche B notes and the Milestone Rights contain covenants that we may not be able to meet and place restrictions on our operating and financial flexibility.

Our indebtedness under the Facility Agreement, including any indebtedness under the 2019 notes and any future indebtedness we incur as the result of our sale of additional 2019 notes and/or Tranche B notes is secured by substantially all of our assets, including our intellectual property, accounts receivables, equipment, general intangibles, inventory (excluding the insulin inventory) and investment property, and all of the proceeds and products of the foregoing. Our obligations under the Facility Agreement and the Milestone Agreement are also secured by certain mortgages on our facilities in Danbury, Connecticut and Valencia, California.

The Facility Agreement includes customary representations, warranties and covenants by us, including restrictions on our ability to incur additional indebtedness, grant certain liens, engage in certain mergers and acquisitions, make certain distributions and make certain voluntary prepayments. Events of default under the Facility Agreement include: our failure to timely make payments due under the 2019 notes or the Tranche B notes; inaccuracies in our representations and warranties to Deerfield; our failure to comply with any of our covenants under any of the Facility Agreement, Milestone Agreement or certain other related security agreements and documents entered into in connection with the Facility Agreement, subject to a cure period with respect to most covenants; our insolvency or the occurrence of certain bankruptcy-related events; certain judgments against us; the suspension, cancellation or revocation of governmental authorizations that are reasonably expected to have a material adverse effect on our business; the acceleration of a specified amount of our indebtedness; our cash and cash equivalents, including amounts available to us under our loan arrangement with The Mann Group, falling below \$25.0 million as of the last day of any fiscal quarter; our failure to timely deliver any shares issuable upon conversion of the 2019 notes; and our failure to cause the shares issuable upon conversion of the 2019 notes to be freely tradable within certain agreed upon timeframes. If one or more events of default under the Facility Agreement occurs and continues beyond any applicable cure period, the holders of the 2019 notes and Tranche B notes may declare all or any portion of the 2019 notes and Tranche B notes to be immediately due and payable. The Milestone Agreement includes customary representations and warranties and covenants by us, including restrictions on transfers of intellectual property related to AFREZZA. The milestones are subject to acceleration in the event we transfer our intellectual property related to AFREZZA in violation of the terms of the Milestone Agreement.

Table of Contents

There can be no assurance that we will be able to comply with the covenants under any of the foregoing agreements, and we cannot predict whether the holders of the 2019 notes or Tranche B notes would demand repayment of the outstanding balance of the 2019 notes or Tranche B notes or exercise any other remedies available to such holders if we were unable to comply with these covenants. The covenants and restrictions contained in the foregoing agreements could significantly limit our ability to respond to changes in our business or competitive activities or take advantage of business opportunities that may create value for our stockholders. In addition, our inability to meet or otherwise comply with the covenants under these agreements could have an adverse impact on our financial position and results of operations and could result in an event of default under the terms of our other indebtedness, including our indebtedness under the 2015 notes. In the event of certain future defaults under the foregoing agreements for which we are not able to obtain waivers, the holders of the 2015 notes, 2019 notes and Tranche B notes may accelerate all of our repayment obligations, and, with respect to the 2019 notes and Tranche B notes, take control of our pledged assets, potentially requiring us to renegotiate the terms of our indebtedness on terms less favorable to us, or to immediately cease operations.

If we enter into additional debt arrangements, the terms of such additional arrangements could further restrict our operating and financial flexibility. In the event we must cease operations and liquidate our assets, the rights of any holders of our outstanding debt would be senior to the rights of the holders of our common stock to receive any proceeds from the liquidation.

If we do not achieve our projected development and commercialization goals in the timeframes we announce and expect, our business will be harmed and the market price of our common stock could decline.

For planning purposes, we estimate the timing of the accomplishment of various scientific, clinical, regulatory and other product development goals, which we sometimes refer to as milestones. These milestones may include the commencement or completion of scientific studies and clinical studies and the submission of regulatory filings. From time to time, we publicly announce the expected timing of some of these milestones. All of these milestones are based on a variety of assumptions. The actual timing of the achievement of these milestones can vary dramatically from our estimates, in many cases for reasons beyond our control, depending on numerous factors, including:

the rate of progress, costs and results of our clinical studies and research and development activities;

our ability to identify and enroll patients who meet clinical study eligibility criteria;

our ability to access sufficient, reliable and affordable supplies of components used in the manufacture of our product candidates, including insulin and other materials for AFREZZA;

the costs of expanding and maintaining manufacturing operations, as necessary;

the extent to which our clinical studies compete for clinical sites and eligible subjects with clinical studies sponsored by other companies;

our ability to enter into sales and marketing collaborations for AFREZZA; and

actions by regulators.

In addition, if we do not obtain sufficient additional funds through sales of securities, strategic collaborations or the license or sale of certain of our assets on a timely basis, we will be required to reduce expenses by delaying, reducing or curtailing our development of AFREZZA. If we fail to commence or complete, or experience delays in or are forced to curtail, our proposed clinical programs or otherwise fail to adhere to our projected development goals in the timeframes we announce and expect (or within the timeframes expected by analysts or investors), our business and results of operations will be harmed and the market price of our common stock may decline.

We face substantial competition in the development of our product candidates and may not be able to compete successfully, and our product candidates may be rendered obsolete by rapid technological change.

A number of established pharmaceutical companies have or are developing technologies for the treatment of diabetes. We also face substantial competition for the development of our other product candidates.

Many of our existing or potential competitors have, or have access to, substantially greater financial, research and development, production, and sales and marketing resources than we do and have a greater depth and number of experienced managers. As a result, our competitors may be better equipped than we are to develop, manufacture, market and sell competing products. In addition, gaining favorable reimbursement is critical to the success of AFREZZA. Many of our competitors have existing infrastructure and relationships with managed care organizations and reimbursement authorities which can be used to their advantage.

The rapid rate of scientific discoveries and technological changes could result in one or more of our product candidates becoming obsolete or noncompetitive. Our competitors may develop or introduce new products that render our technology and AFREZZA less competitive, uneconomical or obsolete. Our future success will depend not only on our ability to develop our product candidates but to improve them and keep pace with emerging industry developments. We cannot assure you that we will be able to do so.

Table of Contents

We also expect to face competition from universities and other non-profit research organizations. These institutions carry out a significant amount of research and development in the areas of diabetes and cancer. These institutions are becoming increasingly aware of the commercial value of their findings and are more active in seeking patent and other proprietary rights as well as licensing revenues.

If we fail to enter into a strategic collaboration with respect to AFREZZA, we may not be able to execute on our business model.

We have held extensive discussions with a number of pharmaceutical companies concerning a potential strategic business collaboration for AFREZZA. To date we have not reached an agreement on a collaboration with any of these companies. We cannot predict when, if ever, we will conclude an agreement with a partner. There can be no assurance that any such collaboration will be available to us on a timely basis or on acceptable terms. If we are not able to enter into a collaboration on terms that are favorable to us, we may be unable to undertake and fund product development, clinical studies, manufacturing and/or marketing activities at our own expense, which would delay or otherwise impede the commercialization of AFREZZA. Our product candidates are intended to be used by a large number of healthcare professionals who will require substantial education and support. For example, a broad base of physicians, including primary care physicians and endocrinologists, treat patients with diabetes. A large sales force would be required in order to educate these physicians about the benefits and advantages of AFREZZA and to provide adequate support for them. With respect to the commercialization of AFREZZA, if approved, if we fail to enter into collaborations, we would be required to establish our own direct sales, marketing and distribution capabilities. Establishing these capabilities can be time-consuming and expensive and would delay our ability to commercialize AFREZZA. Because we lack experience in selling pharmaceutical products to the diabetes market, we would be at a disadvantage compared to our potential competitors, many of whom have substantially more resources and experience than we do. We, acting alone, would not initially be able to field a sales force as large as our competitors or provide the same degree of marketing support. Also, we would not be able to match our competitors' spending levels for pre-launch marketing preparation, including medical education. We cannot assure you that we will succeed in entering into acceptable collaborations, that any such collaboration will be successful or, if not, that we will successfully develop our own sales, marketing and distribution capabilities.

We will face similar challenges as we seek to develop our other product candidates. Our current strategy for developing, manufacturing and commercializing our other product candidates includes evaluating the potential for collaborating with pharmaceutical and biotechnology companies at some point in the drug development process and for these collaborators to undertake the advanced clinical development and commercialization of our product candidates. It may be difficult for us to find third parties that are willing to enter into collaborations on economic terms that are favorable to us, or at all. Failure to enter into a collaboration with respect to any other product candidate could substantially increase our requirements for capital and force us to substantially reduce our development efforts.

If we enter into collaborative agreements with respect to AFREZZA and if our third-party collaborators do not perform satisfactorily or if our collaborations fail, development or commercialization of AFREZZA may be delayed and our business could be harmed.

We may enter into license agreements, partnerships or other collaborative arrangements to support the financing, development and marketing of AFREZZA. We may also license technology from others to enhance or supplement our technologies. These various collaborators may enter into arrangements that would make them potential competitors. These various collaborators also may breach their agreements with us and delay our progress or fail to perform under their agreements, which could harm our business.

If we enter into collaborative arrangements, we will have less control over the timing, planning and other aspects of our clinical studies, and the sale and marketing of AFREZZA and our other product candidates. We cannot offer assurances that we will be able to enter into satisfactory arrangements with third parties as contemplated or that any of our existing or future collaborations will be successful.

Continued testing of AFREZZA or our other product candidates may not yield successful results, and even if it does, we may still be unable to commercialize our product candidates.*

Our research and development programs are designed to test the safety and efficacy of our product candidates through extensive nonclinical and clinical testing. We may experience numerous unforeseen events during, or as a result of, the testing process that could delay or prevent commercialization of any of our product candidates, including the following:

safety and efficacy results obtained in our nonclinical and early clinical testing may be inconclusive or may not be predictive of results that we may obtain in our future clinical studies or following long-term use, and we may as a result be forced to stop developing a product candidate;

the analysis of data collected from clinical studies of our product candidates may not reach the statistical significance necessary, or otherwise be sufficient to support FDA or other regulatory approval for the claimed indications;

after reviewing preclinical and/or clinical data, we or any potential collaborators may abandon projects that we previously believed were promising; and

our product candidates may not produce the desired effects or may result in adverse health effects or other characteristics that preclude regulatory approval or limit their commercial use if approved.

Table of Contents

Forecasts about the effects of the use of drugs, including AFREZZA, over terms longer than the clinical studies or in much larger populations may not be consistent with the clinical results. If use of a drug results in adverse health effects or reduced efficacy or both, the FDA or other regulatory agencies may terminate our ability to market and sell the drug, may narrow the approved indications for use or otherwise require restrictive product labeling or marketing, or may require further clinical studies, which may be time-consuming and expensive and may not produce favorable results.

As a result of any of these events, we, any collaborator, the FDA, or any other regulatory authorities, may suspend or terminate clinical studies or marketing of the drug at any time. Any suspension or termination of our clinical studies or marketing activities may harm our business and results of operations and the market price of our common stock may decline.

If our suppliers fail to deliver materials and services needed for the production of AFREZZA in a timely and sufficient manner, or they fail to comply with applicable regulations, our business and results of operations would be harmed and the market price of our common stock could decline.

For AFREZZA to be commercially viable, we need access to sufficient, reliable and affordable supplies of insulin, our AFREZZA inhaler, the related cartridges and other materials. We must rely on our suppliers to comply with relevant regulatory and other legal requirements, including the production of insulin in accordance with the FDA's current Good Manufacturing Practices, or cGMP for drug products, and the production of the AFREZZA inhaler and related cartridges in accordance with Quality System Regulations, or QSRs. The supply of any of these materials may be limited or any of the manufacturers may not meet relevant regulatory requirements, and if we are unable to obtain any of these materials in sufficient amounts, in a timely manner and at reasonable prices, or if we encounter delays or difficulties in our relationships with manufacturers or suppliers, the development or manufacturing of AFREZZA may be delayed. Any such events could delay market introduction and subsequent sales of AFREZZA and, if so, our business and results of operations will be harmed and the market price of our common stock may decline.

We have never manufactured AFREZZA or any other product candidates in commercial quantities, and if we fail to develop an effective manufacturing capability for our product candidates or to engage third-party manufacturers with this capability, we may be unable to commercialize these products.

We use our Danbury, Connecticut facility to formulate AFREZZA inhalation powder, fill plastic cartridges with the powder, package the cartridges in blister packs, and place the blister packs into foil pouches. We will utilize a contract packager to do the final kitting and cartoning of foil pouched blisters containing cartridges, as well as inhalers and the package insert. Although the Danbury facility has been qualified and undergone two inspections by the FDA, our facility may need to undergo further inspection before we can distribute AFREZZA commercially. The manufacture of pharmaceutical products requires significant expertise and capital investment, including the development of advanced manufacturing techniques and process controls. Manufacturers of pharmaceutical products often encounter difficulties in production, especially in scaling up initial production. These problems include difficulties with production costs and yields, quality control and assurance and shortages of qualified personnel, as well as compliance with strictly enforced federal, state and foreign regulations. If we engage a third-party manufacturer, we would need to transfer our technology to that third-party manufacturer and gain FDA approval, potentially causing delays in product delivery. In addition, our third-party manufacturer may not perform as agreed or may terminate its agreement with us.

Any of these factors could cause us to delay or suspend clinical studies, regulatory submissions or required approvals of our product candidates, could entail higher costs and may result in our being unable to effectively commercialize our products. Furthermore, if we or a third-party manufacturer fail to deliver the required commercial quantities of any product on a timely basis, and at commercially reasonable prices and acceptable quality, and we were unable to

promptly find one or more replacement manufacturers capable of production at a substantially equivalent cost, in substantially equivalent volume and quality on a timely basis, we would likely be unable to meet demand for such products and we would lose potential revenues.

If any product that we develop does not become widely accepted by physicians, patients, third-party payors and the healthcare community, we may be unable to generate significant revenue, if any.

AFREZZA and our other product candidates are new and unproven. Even if any of our product candidates obtain regulatory approval, they may not gain market acceptance among physicians, patients, third-party payors and the healthcare community. Failure to achieve market acceptance would limit our ability to generate revenue and would adversely affect our results of operations.

The degree of market acceptance of AFREZZA and our other product candidates will depend on many factors, including the:

claims for which FDA approval can be obtained, including superiority claims;

effectiveness of our or our third party collaborator(s) efforts to educate physicians about the benefits and advantages of AFREZZA or our other products and to provide adequate support for them, and the perceived advantages and disadvantages of competitive products;

willingness of the healthcare community and patients to adopt new technologies;

Table of Contents

ability to manufacture the product in sufficient quantities with acceptable quality and cost;

perception of patients and the healthcare community, including third-party payors, regarding the safety, efficacy and benefits compared to competing products or therapies;

convenience and ease of administration relative to existing treatment methods;

coverage and pricing and reimbursement relative to other treatment therapeutics and methods; and

marketing and distribution support.

Because of these and other factors, any product that we may develop may not gain market acceptance, which would materially harm our business, financial condition and results of operations.

If third-party payors do not cover any products for which we receive regulatory approval or adequately reimburse consumers for any such products, our products might not be used or purchased, which would adversely affect our revenues.

Our future revenues and ability to generate positive cash flow from operations may be affected by the continuing efforts of governments and third-party payors to contain or reduce the costs of healthcare through various means. For example, in certain foreign markets the pricing of prescription pharmaceuticals is subject to governmental control. In the United States, there has been, and we expect that there will continue to be, a number of federal and state proposals to implement similar governmental controls. We cannot be certain what legislative proposals will be adopted or what actions federal, state or private payors for healthcare goods and services may take in response to any drug pricing reform proposals or legislation. Such reforms may make it difficult to complete the development and testing of AFREZZA and our other product candidates, and therefore may limit our ability to generate revenues from sales of our product candidates and achieve profitability. Further, to the extent that such reforms have a material adverse effect on the business, financial condition and profitability of other companies that are prospective collaborators for some of our product candidates, our ability to commercialize our product candidates under development may be adversely affected.

In the United States and elsewhere, sales of prescription pharmaceuticals still depend in large part on the availability of reimbursement to the consumer from third-party payors, such as governmental and private insurance plans. Third-party payors are increasingly challenging the prices charged for medical products and services. The market for our product candidates for which we may receive regulatory approval will depend significantly on access to third-party payors' drug formularies, or lists of medications for which third-party payors provide coverage and reimbursement. The industry competition to be included in such formularies often leads to downward pricing pressures on pharmaceutical companies. Also, third-party payors may refuse to include a particular branded drug in their formularies or otherwise restrict patient access to a branded drug when a less costly generic equivalent or other alternative is available. In addition, because each third-party payor individually approves coverage and reimbursement levels, obtaining coverage and adequate reimbursement is a time-consuming and costly process. We would be required to provide scientific and clinical support for the use of any product to each third-party payor separately with no assurance that approval would be obtained. This process could delay the market acceptance of any product and could have a negative effect on our future revenues and operating results. Even if we succeed in bringing one or more products to market, we cannot be certain that any such products would be considered cost-effective or that coverage

and adequate reimbursement to the consumer would be available. Patients will be unlikely to use our products unless coverage is provided and reimbursement is adequate to cover a significant portion of the cost of our products.

In addition, in many foreign countries, particularly the countries of the European Union, the pricing of prescription drugs is subject to government control. In some non-U.S. jurisdictions, the proposed pricing for a drug must be approved before it may be lawfully marketed. The requirements governing drug pricing vary widely from country to country. For example, the EU provides options for its member states to restrict the range of medicinal products for which their national health insurance systems provide reimbursement and to control the prices of medicinal products for human use. A member state may approve a specific price for the medicinal product or it may instead adopt a system of direct or indirect controls on the profitability of the company placing the medicinal product on the market. We may face competition for our product candidates from lower-priced products in foreign countries that have placed price controls on pharmaceutical products. In addition, there may be importation of foreign products that compete with our own products, which could negatively impact our profitability.

If we are unable to obtain coverage of, and adequate payment levels for, our product candidates from third-party payors, physicians may limit how much or under what circumstances they will prescribe or administer them and patients may decline to purchase them. This in turn could affect our ability to successfully commercialize our products and impact our profitability, results of operations, financial condition, and future success.

Table of Contents

Healthcare legislation may make it more difficult to receive revenues, even if we have products that are approved.

In both the United States and certain foreign jurisdictions, there have been a number of legislative and regulatory proposals in recent years to change the healthcare system in ways that could impact our ability to sell our products profitably. In March 2010, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Affordability Reconciliation Act, or collectively, PPACA, became law in the United States. PPACA substantially changes the way healthcare is financed by both governmental and private insurers and significantly affects the healthcare industry. Among the provisions of PPACA of importance to our potential product candidates are the following:

an annual, nondeductible fee on any entity that manufactures or imports certain branded prescription drugs and biologic agents, apportioned among these entities according to their market share in certain government healthcare programs;

a 2.3% medical device excise tax on certain transactions, including many U.S. sales of medical devices, which currently includes and we expect will continue to include U.S. sales of drug-device combination products;

an increase in the statutory minimum rebates a manufacturer must pay under the Medicaid Drug Rebate Program, retroactive to January 1, 2010, to 23% and 13% of the average manufacturer price for most branded and generic drugs, respectively;

expansion of healthcare fraud and abuse laws, including the False Claims Act and the Anti-Kickback Statute, new government investigative powers, and enhanced penalties for noncompliance;

a new Medicare Part D coverage gap discount program, in which manufacturers must agree to offer 50% point-of-sale discounts off negotiated prices of applicable brand drugs to eligible beneficiaries during their coverage gap period, as a condition for the manufacturer's outpatient drugs to be covered under Medicare Part D;

extension of manufacturers' Medicaid rebate liability to covered drugs dispensed to individuals who are enrolled in Medicaid managed care organizations;

expansion of eligibility criteria for Medicaid programs by, among other things, allowing states to offer Medicaid coverage to additional individuals beginning in 2014 and by adding new mandatory eligibility categories for certain individuals with income at or below 133% of the Federal Poverty Level, thereby potentially increasing manufacturers' Medicaid rebate liability;

expansion of the entities eligible for discounts under the Public Health Service pharmaceutical pricing program;

new requirements to report certain financial arrangements with physicians and teaching hospitals, as defined in PPACA and its implementing regulations, including reporting any payments or transfers of value made or distributed to prescribers, teaching hospitals and other healthcare providers and reporting any ownership and investment interests held by physicians and their immediate family members and applicable group purchasing organizations during the preceding calendar year, with reporting to the Centers for Medicare & Medicaid Services, or CMS, required by March 31, 2014 and by the 90th day of each subsequent calendar year;

a new requirement to annually report drug samples that manufacturers and distributors provide to physicians; and

a new Patient-Centered Outcomes Research Institute to oversee, identify priorities in, and conduct comparative clinical effectiveness research, along with funding for such research.

In addition, other legislative changes have been proposed and adopted since PPACA was enacted. On August 2, 2011, the Budget Control Act of 2011, among other things, created measures for spending reductions by Congress. A Joint Select Committee on Deficit Reduction, tasked with recommending a targeted deficit reduction of at least \$1.2 trillion for the years 2013 through 2021, was unable to reach required goals, thereby triggering the legislation's automatic reduction to several government programs. This includes aggregate reductions to Medicare payments to providers of up to 2% per fiscal year, starting in 2013. On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012, or the ATRA, which, among other things, reduced Medicare payments to several providers, including hospitals, imaging centers and cancer treatment centers, and increased the statute of limitations period for the government to recover overpayments to providers from three to five years. These new laws may result in additional reductions in Medicare and other healthcare funding, which could have a material adverse effect on our customers and accordingly, our financial operations.

We expect that PPACA, as well as other healthcare reform measures that may be adopted in the future, may result in more rigorous coverage criteria and in additional downward pressure on the price that we receive for any approved product, and could seriously harm our future revenues. Any reduction in reimbursement from Medicare or other government programs may result in a similar reduction in payments from private payors. The implementation of cost containment measures or other healthcare reforms may prevent us from being able to generate revenue, attain profitability, or commercialize our products.

If we fail to comply with federal and state healthcare laws, including fraud and abuse and health information privacy and security laws, we could face substantial penalties and our business, results of operations, financial condition and prospects could be adversely affected.

As a biopharmaceutical company, even though we do not and will not control referrals of healthcare services or bill directly to Medicare, Medicaid or other third-party payors, certain federal and state healthcare laws and regulations pertaining to fraud and abuse and patients' rights are and will be applicable to our business. We could be subject to healthcare fraud and abuse and patient privacy regulation by both the federal government and the states in which we conduct our business. The laws that may affect our ability to operate include:

the federal Anti-Kickback Statute, which constrains our marketing practices, educational programs, pricing policies, and relationships with healthcare providers or other entities, by prohibiting, among other things, soliciting, receiving, offering or paying remuneration, directly or indirectly, to induce, or in return for, either the referral of an individual or the purchase or recommendation of an item or service reimbursable under a federal healthcare program, such as the Medicare and Medicaid programs;

Table of Contents

federal civil and criminal false claims laws and civil monetary penalty laws, which prohibit, among other things, individuals or entities from knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid, or other third-party payors that are false or fraudulent;

the federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, which created new federal criminal statutes that prohibit executing a scheme to defraud any healthcare benefit program or making false statements relating to healthcare matters;

HIPAA, as amended by the Health Information Technology for Economic and Clinical Health Act of 2009, or HITECH, and its implementing regulations, which imposes certain requirements relating to the privacy, security and transmission of individually identifiable health information; and

state and foreign law equivalents of each of the above federal laws, such as anti-kickback and false claims laws which may apply to items or services reimbursed by any third-party payor, including commercial insurers, and state and foreign laws governing the privacy and security of health information in certain circumstances, many of which differ from each other in significant ways and often are not preempted by HIPAA, thus complicating compliance efforts.

Because of the breadth of these laws and the narrowness of available statutory and regulatory exceptions, it is possible that some of our business activities could be subject to challenge under one or more of such laws. To the extent that any of our product candidates is ultimately sold in a foreign country, we may be subject to similar foreign laws and regulations. If we or our operations are found to be in violation of any of the laws described above or any other governmental regulations that apply to us, we may be subject to penalties, including civil and criminal penalties, damages, fines, imprisonment, exclusion of products from reimbursement under U.S. federal or state healthcare programs, and the curtailment or restructuring of our operations. Any penalties, damages, fines, curtailment or restructuring of our operations could materially adversely affect our ability to operate our business and our financial results. Although compliance programs can mitigate the risk of investigation and prosecution for violations of these laws, the risks cannot be entirely eliminated. Any action against us for violation of these laws, even if we successfully defend against it, could cause us to incur significant legal expenses and divert our management's attention from the operation of our business. Moreover, achieving and sustaining compliance with applicable federal and state privacy, security and fraud laws may prove costly.

If product liability claims are brought against us, we may incur significant liabilities and suffer damage to our reputation.

The testing, manufacturing, marketing and sale of AFREZZA and our other product candidates expose us to potential product liability claims. A product liability claim may result in substantial judgments as well as consume significant financial and management resources and result in adverse publicity, decreased demand for a product, injury to our reputation, withdrawal of clinical studies volunteers and loss of revenues. We currently carry worldwide liability insurance in the amount of \$10.0 million. In addition, we carry local policies per study in each country in which we conduct clinical studies that require us to carry coverage based on local statutory requirements. We intend to obtain product liability coverage for commercial sales in the future if AFREZZA is approved. However, we may not be able to obtain insurance coverage that will be adequate to satisfy any liability that may arise, and because insurance coverage in our industry can be very expensive and difficult to obtain, we cannot assure you that we will be able to obtain sufficient coverage at an acceptable cost, if at all. If losses from such claims exceed our liability insurance coverage, we may ourselves incur substantial liabilities. If we are required to pay a product liability claim our business

and results of operations would be harmed and the market price of our common stock may decline.

If we lose any key employees or scientific advisors, our operations and our ability to execute our business strategy could be materially harmed.

We face intense competition for qualified employees among companies in the biotechnology and biopharmaceutical industries. Our success depends upon our ability to attract, retain and motivate highly skilled employees. We may be unable to attract and retain these individuals on acceptable terms, if at all. In addition, in order to commercialize our product candidates successfully, we may be required to expand our work force, particularly in the areas of manufacturing, and, if we are unable to enter into collaborations with third parties to commercialize AFREZZA or any other approved products, sales and marketing. These activities will require the addition of new personnel, including management, and the development of additional expertise by existing personnel, and we cannot assure you that we will be able to attract or retain any such new personnel on acceptable terms, if at all.

The loss of the services of any principal member of our management and scientific staff could significantly delay or prevent the achievement of our scientific and business objectives. All of our employees are at will and we currently do not have employment agreements with any of the principal members of our management or scientific staff, and we do not have key person life insurance to

Table of Contents

cover the loss of any of these individuals. Replacing key employees may be difficult and time-consuming because of the limited number of individuals in our industry with the skills and experience required to develop, gain regulatory approval of and commercialize our product candidates successfully.

We have relationships with scientific advisors at academic and other institutions to conduct research or assist us in formulating our research, development or clinical strategy. These scientific advisors are not our employees and may have commitments to, and other obligations with, other entities that may limit their availability to us. We have limited control over the activities of these scientific advisors and can generally expect these individuals to devote only limited time to our activities. Failure of any of these persons to devote sufficient time and resources to our programs could harm our business. In addition, these advisors are not prohibited from, and may have arrangements with, other companies to assist those companies in developing technologies that may compete with our product candidates.

If our Chairman and Chief Executive Officer is unable to devote sufficient time and attention to our business, our operations and our ability to execute our business strategy could be materially harmed.

Alfred Mann, our Chairman and Chief Executive Officer, is involved in many other business and charitable activities. As a result, the time and attention Mr. Mann devotes to the operation of our business varies, and he may not expend the same time or focus on our activities as other, similarly situated chief executive officers. If Mr. Mann is unable to devote the time and attention necessary to running our business, we may not be able to execute our business strategy and our business could be materially harmed.

If our internal controls over financial reporting are not considered effective, our business and stock price could be adversely affected.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate the effectiveness of our internal controls over financial reporting as of the end of each fiscal year, and to include a management report assessing the effectiveness of our internal controls over financial reporting in our annual report on Form 10-K for that fiscal year. Section 404 also requires our independent registered public accounting firm to attest to, and report on, our internal controls over financial reporting.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal controls over financial reporting will prevent all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud involving a company have been, or will be, detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. We cannot assure you that we or our independent registered public accounting firm will not identify a material weakness in our internal controls in the future. A material weakness in our internal controls over financial reporting would require management and our independent registered public accounting firm to evaluate our internal controls as ineffective. If our internal controls over financial reporting are not considered effective, we may experience a loss of public confidence, which could have an adverse effect on our business and on the market price of our common stock.

Our operations might be interrupted by the occurrence of a natural disaster or other catastrophic event.

We expect that at least for the foreseeable future, our manufacturing facility in Danbury, Connecticut will be the sole location for the manufacturing of AFREZZA. This facility and the manufacturing equipment we use would be costly to replace and could require substantial lead time to repair or replace. In addition, we are headquartered in Valencia, California. This facility contains our principal executive offices and is used to provide support for the development of our AFREZZA programs. We depend on our facilities and on collaborators, contractors and vendors for the continued operation of our business, some of whom are located in Europe. Natural disasters or other catastrophic events, including interruptions in the supply of natural resources, political and governmental changes, severe weather conditions, wildfires and other fires, explosions, actions of animal rights activists, terrorist attacks, volcanic eruptions, earthquakes and wars could disrupt our operations or those of our collab