

TreeHouse Foods, Inc.  
Form 10-Q  
August 14, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q**

**(Mark One)**

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934  
For the Quarterly Period Ended June 30, 2006**

**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 001-32504**

**TreeHouse Foods, Inc.**

(Exact name of the registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**20-2311383**

(I.R.S. employer  
identification no.)

**Two Westbrook Corporate Center**

**Suite 1070**

**Westchester, IL 60154**

**(708) 483-1300**

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

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

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

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

As of August 8, 2006 there were 31,202,473 shares of Common Stock, par value \$0.01 per share, outstanding.

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**TREEHOUSE FOODS, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data)

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
	<b>(Unaudited)</b>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 4	\$ 8,001
Receivables, net	56,165	34,636
Inventories	195,417	114,562
Deferred income taxes	2,452	2,569
Prepaid expenses and other current assets	5,835	4,922
Assets of discontinued operations	1,970	1,970
 Total current assets	 261,843	 166,660
Property, plant and equipment, net	214,501	117,438
Goodwill	402,043	293,374
Identifiable intangible and other assets	73,696	32,225
 Total	 \$ 952,083	 \$ 609,697
 <b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 94,918	\$ 61,457
Current portion of long-term debt	248,797	321
Liabilities of discontinued operations	50	93
 Total current liabilities	 343,765	 61,871
Long-term debt	9,163	6,144
Deferred income taxes	8,406	9,421
Other long-term liabilities	52,649	18,906
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Preferred stock, par value \$.01 per share, 10,000,000 shares authorized, none issued		
Common stock, par value \$.01 per share, 40,000,000 shares authorized, 31,202,473 and 31,087,773 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively	312	311
Additional paid-in capital	526,822	516,071
Retained earnings (accumulated deficit)	13,245	(748)
Accumulated other comprehensive loss	(2,279)	(2,279)
 Total stockholders' equity	 538,100	 513,355

Total	\$ 952,083	\$ 609,697
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See Notes to Condensed Consolidated Financial Statements.

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**TREEHOUSE FOODS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(In thousands, except per share data)

	<b>Three Months Ended June 30</b>		<b>Six Months Ended June 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(Unaudited)</b>		<b>(Unaudited)</b>	
Net sales	\$ 232,118	\$ 185,008	\$ 404,842	\$ 351,383
Cost of sales	183,595	144,544	315,929	273,075
Gross profit	48,523	40,464	88,913	78,308
Operating expenses:				
Selling and distribution	18,847	16,675	32,897	30,780
General and administrative	14,797	5,662	28,566	9,239
Management fee paid to Dean Foods		1,470		2,940
Other operating expense, net		7,135		7,279
Amortization expense	845	414	1,309	828
Total operating expenses	34,489	31,356	62,772	51,066
Operating income	14,034	9,108	26,141	27,242
Other (income) expense:				
Interest expense, net	3,252	172	3,413	365
Other income, net		(5)		(66)
Total other (income) expense	3,252	167	3,413	299
Income from continuing operations before income taxes	10,782	8,941	22,728	26,943
Income taxes	4,182	7,404	8,722	14,024
Income from continuing operations	6,600	1,537	14,006	12,919
Loss from discontinued operations, net of tax	(6)	(256)	(13)	(595)
Net income	\$ 6,594	\$ 1,281	\$ 13,993	\$ 12,324
Weighted average common shares:				
Basic	31,145	30,801	31,121	30,801
Diluted	31,231	31,060	31,224	31,060
Basic earnings per common share:				
Income from continuing operations	\$ .21	\$ .05	\$ .45	\$ .42
Loss from discontinued operations, net of tax		(.01)		(.02)
Net income	\$ .21	\$ .04	\$ .45	\$ .40
Diluted earnings per common share:				
Income from continuing operations	\$ .21	\$ .05	\$ .45	\$ .42

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Loss from discontinued operations, net of tax		(.01)			(.02)
Net income	\$	.21	\$	.04	\$ .45 \$ .40

See Notes to Condensed Consolidated Financial Statements.

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**TREEHOUSE FOODS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	<b>Six Months Ended June 30</b>	
	<b>2006</b>	<b>2005</b>
	<b>(Unaudited)</b>	
Cash flows from operating activities:		
Net income	\$ 13,993	\$ 12,324
Loss from discontinued operations	13	595
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,766	8,256
Stock-based compensation	9,238	
Loss on disposition of assets	225	12
Deferred income taxes	(1,490)	753
Changes in operating assets and liabilities, net of impact of acquisitions		
Receivables	(17,293)	(1,529)
Inventories	(5,220)	13,451
Prepaid expenses and other assets	1,404	(1,498)
Accounts payable and accrued expenses	29,101	9,152
Net cash provided by continuing operations	40,737	41,516
Net cash (used in) provided by discontinued operations	(56)	2,320
Net cash provided by operating activities	40,681	43,836
Cash flows from investing activities:		
Additions to property, plant and equipment	(4,387)	(7,736)
Cash outflows for acquisitions	(294,677)	
Proceeds from sale of fixed assets	107	4
Net cash used in continuing operations	(298,957)	(7,732)
Net cash used in discontinued operations		
Net cash used in investing activities	(298,957)	(7,732)
Cash flows from financing activities:		
Proceeds from issuance of debt	250,000	3,672
Payment of debt	(1,828)	(2,295)
Payments of deferred financing costs		(808)
Proceeds from stock option exercises	1,482	
Tax benefit from stock options exercised	625	
Net cash activity with Dean Foods		(34,542)
Net cash (used in) provided by continuing operations	250,279	(33,973)
Net cash (used in) provided by discontinued operations		
Net cash (used in) provided by financing activities	250,279	(33,973)
Increase (decrease) in cash and cash equivalents	(7,997)	2,131



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Cash and cash equivalents, beginning of period	8,001	165
Cash and cash equivalents, end of period	\$ 4	\$ 2,296

See Notes to Condensed Consolidated Financial Statements.

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**TREEHOUSE FOODS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**As of and for the six months ended June 30, 2006**  
**(Unaudited)**

**1. General**

TreeHouse Foods, Inc. ( "TreeHouse" ) was formed on January 25, 2005 by Dean Foods Company ( "Dean Foods" ) in order to accomplish a spin-off to its shareholders of certain specialty businesses. Dean Foods transferred the assets and liabilities of its former Specialty Foods Group segment, in addition to the *Mocha Mix*<sup>®</sup>, *Second Nature*<sup>®</sup> and foodservice salad dressings businesses conducted by other businesses owned by Dean Foods, to TreeHouse. TreeHouse common stock held by Dean Foods was distributed to Dean Foods' stockholders on a distribution ratio of one share of TreeHouse common stock for every five shares of Dean Foods common stock outstanding. The transfer of assets and liabilities and the distribution of shares (the "Distribution" ) were completed on June 27, 2005 and TreeHouse commenced operations as an independent public company. Dean Foods has no continuing stock ownership in TreeHouse.

For periods prior to June 27, 2005, all of the historical assets, liabilities, sales, expenses, income, cash flows, products, businesses and activities of our business that we describe in this report as "ours" are in fact the historical assets, liabilities, sales, expenses, income, cash flows, products, businesses and activities of the businesses transferred to TreeHouse by Dean Foods. References in the accompanying Condensed Consolidated Financial Statements and in these Notes to "TreeHouse", "we", "our" and "us" mean TreeHouse. Our historical financial results as part of Dean Foods do not reflect what our financial results would have been had we been operated as a separate, independent company during the periods presented.

**2. Significant Accounting Policies**

*Basis of Presentation* The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2005. In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments) in order to present fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. As permitted, certain disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted. Our results of operations for the period ended June 30, 2006 may not be indicative of our operating results for the full year. The Condensed Consolidated Financial Statements contained in this Quarterly Report should be read in conjunction with our 2005 Consolidated Financial Statements contained in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 29, 2006.

*Use of Estimates* The preparation of our Condensed Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America ( "GAAP" ) requires us to use our judgment to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements and the reported amounts of net sales and expenses during the reporting period. Actual results could differ from these estimates under different assumptions or conditions.

*Stock-Based Compensation (Post-Distribution)* Effective July 1, 2005, we have adopted the requirements of SFAS 123(R) "Share-Based Payment" . This statement requires that compensation paid with equity instruments be measured at grant-date fair value and that the resulting expense be recognized over the relevant service period. Prior to the quarter beginning July 1, 2005, we elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" . As such, no compensation expense was recognized prior to the quarter beginning July 1, 2005 as stock options were granted at exercise prices that were at or above market value at the grant date.

*Income Taxes* Prior to the Distribution we were included in Dean Foods' consolidated income tax returns and we did not file separate federal tax returns. Our income taxes were determined and recorded in our Consolidated Financial Statements as if we were filing a separate return for federal income tax purposes.

*Recently Adopted Accounting Pronouncements* In November 2004, the FASB issued SFAS No. 151, "Inventory Costs" an Amendment of ARB No. 43, Chapter 4. SFAS No. 151, which is effective for inventory costs incurred

during years beginning after June 15, 2005, clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material, requiring that those items be recognized as current-period charges. In addition, SFAS No. 151 requires that allocation of fixed production overheads be based on the normal capacity of the production facilities. The adoption of this accounting standard did not have a material impact on our Condensed Consolidated Financial Statements.

In December 2004, FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29. SFAS No. 153 is effective for nonmonetary exchanges occurring in years beginning after June 15, 2005. SFAS No. 153 eliminates the rule in APB No. 29 which excluded from fair value measurement exchanges of similar productive assets. Instead SFAS No. 153 excludes from fair value measurement exchanges of nonmonetary assets that do not have commercial substance. The adoption of this accounting standard did not have a material impact on our Condensed Consolidated Financial Statements.

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In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*. SFAS 154 replaces Accounting Principles Board Opinion No. 20 *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements-An Amendment of APB Opinion No. 28*. SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. SFAS 154 requires retrospective application of the direct effect of a voluntary change in accounting principle to prior periods' financial statements where it is practicable to do so. SFAS 154 also redefines the term *restatement* to mean the correction of an error by revising previously issued financial statements. SFAS 154 is effective for accounting changes and error corrections made in fiscal years beginning after December 15, 2005 unless adopted early. The adoption of this accounting standard did not have a material impact on the consolidated financial position, results of operations or cash flows, except to the extent that the statement subsequently requires retrospective application of a future item.

In June 2006, the FASB issued FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact this interpretation will have on our financial statements.

**3. Discontinued Operations**

On September 7, 2004, we announced our decision to exit our nutritional beverages business. Our decision to exit this line of business resulted from significant declines in volume, which we believed could not be replaced. In accordance with generally accepted accounting principles, our financial statements reflect our former nutritional beverages business as discontinued operations. The property and equipment was written down to its estimated fair value of \$1.0 million and held for sale at June 30, 2006.

Net sales and income (loss) before taxes generated by our nutritional beverages business were as follows:

	<b>Six Months Ended June 30</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>	
Net sales	\$ (6)	\$ 99
Loss before tax	\$ (21)	\$ (951)

**4. Facility Closing and Reorganization Costs**

*Facility Closing and Reorganization Costs* We recorded facility closing costs of \$1.0 million in the three months ended June 30, 2006 and \$2.0 million in the six months ended June 30, 2006 related to the closing of the La Junta, Colorado pickle manufacturing facility and distribution center. In addition, the La Junta, Colorado property and equipment, which was written down to its estimated fair value of \$1.6 million in the fourth quarter of 2005, was being held for sale as of June 30, 2006. Subsequently, on July 10, 2006 the distribution center was sold for \$2.0 million.

Activity with respect to these liabilities for 2006 is summarized below:

	<b>(In thousands)</b>
Accrued charges at December 31, 2005	\$ 434
Payments	(2,603)
Provision for the six months ended June 30, 2006	2,312
Accrued charges at June 30, 2006	\$ 143

The accrued charges at June 30, 2006 are for employee severance and maintaining the closed facility in a saleable condition. Future costs related to the facility closing are expected to be \$.6 million in 2006 and \$.3 million in 2007.

**5. Inventories**

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
	<b>(In thousands)</b>	
Raw materials and supplies	\$ 47,537	\$ 37,521
Finished goods	156,019	83,280
LIFO Reserve	(8,139)	(6,239)
Total	\$ 195,417	\$ 114,562

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Approximately \$62.0 million and \$88.8 million of our inventory was accounted for under the LIFO method of accounting at June 30, 2006 and December 31, 2005, respectively.

**6. Intangible Assets**

Changes in the carrying amount of goodwill for the six months ended June 30, 2006 are as follows:

	Pickles	Powder	Soup & Infant Feeding	Other	Total
	(In thousands)				
Balance at December 31, 2005	\$ 34,031	\$ 185,785	\$	\$ 73,558	\$ 293,374
Goodwill from acquisition			108,669		108,669
Balance at June 30, 2006	\$ 34,031	\$ 185,785	\$ 108,669	\$ 73,558	\$ 402,043

The gross carrying amount and accumulated amortization of our intangible assets other than goodwill as of June 30, 2006 and December 31, 2005 are as follows:

	June 30, 2006			December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Net Accumulated Amortization	Carrying Amount
	(In thousands)					
Intangible assets with indefinite lives:						
Trademarks	\$ 30,800	\$	\$ 30,800	\$ 22,800	\$	\$ 22,800
Intangible assets with finite lives:						
Customer-related	44,722	(6,845)	37,877	11,846	(5,658)	6,188
Total	\$ 75,522	\$ (6,845)	\$ 68,677	\$ 34,646	\$ (5,658)	\$ 28,988

Intangible assets acquired in the six months ended June 30, 2006 are customer related intangibles acquired in the pickle segment in February 2006 and the trademarks, customer lists and transition services agreement with Del Monte Foods Company resulting from the acquisition of the soup and infant feeding business in April 2006. The trademarks are deemed to have indefinite useful lives because they are expected to generate cash flows indefinitely. Customer related intangibles are estimated to have a useful life of fifteen years and are being amortized over a fifteen year period on a straight line basis. Other intangibles relate to favorable terms on the transition services agreement with Del Monte Foods Company, which is being amortized on a straight line basis over the nine month term of the agreement. The company is in the process of finalizing the fair value and useful lives of these assets and as a result the amortization expense is subject to revision.

Amortization expense on intangible assets for the three months ended June 30, 2006 and 2005 was \$845,000 and \$414,000, respectively and \$1.3 million and \$828,000 in the six months ended June 30, 2006 and 2005 respectively. Estimated aggregate intangible asset amortization expense for the next five years is as follows:

2007	\$3.8 million
2008	\$3.7 million
2009	\$3.5 million
2010	\$3.5 million
2011	\$2.2 million

**7. Long-Term Debt**

	<b>June 30, 2006 Amount Outstanding</b>	<b>December 31, 2005 Amount Outstanding</b>
	<b>(In thousands)</b>	
Revolving credit facility	\$ 248,300	\$
Capital lease obligations and other	9,660	6,465
	257,960	6,465
Less current portion	248,797	321
Total	\$ 9,163	\$ 6,144

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*Revolving Credit Facility* Effective June 27, 2005 we entered into a five-year unsecured revolving credit agreement with a group of participating financial institutions under which we can borrow up to \$400 million. This agreement also includes a \$75 million letter of credit sublimit, against which a \$1.4 million letter of credit has been issued, but undrawn. We may request to increase the commitments under the credit facility up to an aggregate of \$500 million upon the satisfaction of certain conditions. Proceeds from the credit facility may be used for working capital and general corporate purposes, including acquisition financing. The credit facility contains various financial and other restrictive covenants and requires that we maintain certain financial ratios, including a leverage and interest coverage ratio. We are in compliance with all applicable covenants as of June 30, 2006. We believe that, given our current cash position, our cash flow from operating activities and our available credit capacity, we can comply with the current terms of the credit facility and meet foreseeable financial requirements.

Interest is payable quarterly or at the end of the applicable interest period in arrears on any outstanding borrowings at a customary Eurodollar rate plus the applicable margin or at a customary base rate. The underlying rate is defined as either the rate offered in the inter-bank Eurodollar market or the higher of the prime lending rate of the administrative agent or federal funds rate plus 0.5%. The applicable margin for Eurodollar loans is based on our consolidated leverage ratio and ranges from 0.50% to 0.80%. In addition, a facility fee based on our consolidated leverage ratio and ranging from 0.125% to 0.20% is due quarterly on all commitments under the credit facility. Our average interest rate on debt outstanding at June 30, 2006 was 5.87%.

The credit facility contains limitations on liens, investments, the incurrence of subsidiary indebtedness, mergers, dispositions of assets, acquisitions, material lines of business and transactions with affiliates. The credit facility restricts certain payments, including dividends, and prohibits certain agreements restricting the ability of our subsidiaries to make certain payments or to guarantee our obligations under the credit facility. The credit facility contains standard default triggers, including without limitation:

failure to pay principal, interest or other amounts due and payable under the credit facility and related loan documents;

failure to maintain compliance with the financial and other covenants contained in the credit agreement;

incorrect or misleading representations or warranties;

default on certain of our other debt;

the existence of bankruptcy or insolvency proceedings;

insolvency;

existence of certain material judgments;

failure to maintain compliance with ERISA;

the invalidity of certain provisions in any loan document; and

a change of control.

*Capital Lease Obligations and Other* Capital lease obligations include various promissory notes for the purchase of property, plant and equipment and capital lease obligations. The various promissory notes payable provide for interest at varying rates and are payable in monthly installments of principal and interest until maturity, when the remaining principal balances are due. Capital lease obligations represent machinery and equipment financing obligations, which are payable in monthly installments of principal and interest and are collateralized by the related assets financed.



*Receivables-Backed Facility* Prior to the Distribution, we participated in Dean Foods' receivables-backed facility. We sold our accounts receivable to a wholly-owned special purpose entity controlled by Dean Foods that is intended to be bankruptcy-remote. The special purpose entity transferred the receivables to third-party asset-backed commercial paper conduits sponsored by major financial institutions. Dean Foods treats the securitization as a borrowing for accounting purposes, and the assets and liabilities of the special purpose entity are fully reflected in our December 31, 2004 Consolidated Balance Sheet. The Dean Foods receivables-backed facility bears interest at a variable rate based on the commercial paper yield, as defined in the agreement. Dean Foods did not allocate interest related to the receivables-backed facility to its segments. Therefore, no interest costs related to this facility have been reflected in our Consolidated Income Statements. Effective April 1, 2005, we ceased to participate in Dean Foods' receivables-backed facility.

**Table of Contents****8. Stockholders Equity and Earnings per Share**

*Common stock distribution and issuance* Our common stock was distributed to Dean Foods stockholders on June 27, 2005 in the ratio of one share of TreeHouse common stock for every five shares of Dean Foods outstanding as of the record date of June 20, 2005. As a result, Dean Foods distributed 30,287,925 shares of TreeHouse common stock to its shareholders. In conjunction with entering into employment agreements, TreeHouse management purchased approximately 1.67% of TreeHouse common stock directly from Dean Foods in January 2005. These shares are equivalent to 513,353 shares on a post-Distribution basis. As of June 30, 2006, there were 31,202,473 shares issued and outstanding. There is no treasury stock and there is no remaining stock ownership by Dean Foods.

*Earnings per share* Basic earnings per share is computed by dividing net income by the number of weighted average common shares outstanding during the reporting period. For all periods prior to June 30, 2005, basic earnings per share are computed using our shares outstanding as of the date of the completion of the Distribution. Diluted earnings per share incorporate the incremental shares issueable upon the assumed exercise of stock options. Certain of the Company's stock options were excluded from the calculation of diluted earnings per share because they were anti-dilutive, but these options could be dilutive in the future. The restricted stock and restricted stock unit awards are subject to market conditions for vesting which were not met as of June 30, 2006, so these awards are also excluded from the diluted earnings per share calculation.

Prior to completion of the Distribution, Dean Foods converted options on Dean Foods stock held by Dean's chairman and chief executive officer. These were converted on a pro-rata basis between options for Dean Foods and TreeHouse shares. As a result, there are 344,805 options outstanding as of June 30, 2006, which are exercisable at various prices. The new awards maintained both the pre-conversion aggregate intrinsic value of each award and the ratio of the exercise price per share to the market value per share. The net dilutive effect of these options are included in the diluted earnings per share calculation for all periods presented. During the quarter ended June 30, 2006, 114,700 options held by Dean's chairman and chief executive officer were exercised at a total price of \$1.5 million.

The following table summarizes the effect of the share-based compensation awards on the weighted average number of shares outstanding used in calculating diluted earnings per share:

	<b>Three Months Ended June 30</b>		<b>Six Months Ended June 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Weighted average shares outstanding	31,145,123	30,801,278	31,120,544	30,801,278
Assumed exercise of stock options (1)	86,092	259,133	103,547	259,133
 Weighted average diluted common shares outstanding	 31,231,215	 31,060,411	 31,224,091	 31,060,411

(1) The assumed exercise of stock options excludes 1,705,802 options outstanding, which were anti-dilutive for the three and six months ended June 30, 2006 and 1,509,080

options  
outstanding,  
which were  
anti-dilutive for  
the three and six  
months ended  
June 30, 2005.

### 9. Stock-based Compensation

The following table summarizes stock option activity during the six months ended June 30, 2006. Options were granted under our long-term incentive plan and in certain cases pursuant to employment agreements. All options granted have three year terms which vest one-third on each of the first three anniversaries of the grant date.

	<b>Employee Options</b>	<b>Director Options</b>	<b>Weighted Average Exercise Price</b>
Outstanding, December 31, 2005	1,499,806	500,299	\$ 26.27
Granted	360,740	45,000	\$ 23.16
Forfeited	(117,498)		\$ 29.30
Exercised		(114,700)	\$ 12.92
Outstanding, June 30, 2006	1,743,048	430,599	\$ 26.22
Exercisable at June 30, 2006	459,756	358,403	\$ 24.15

During the six months ended June 30, 2006, the total intrinsic value of stock options exercised was approximately \$1.5 million. No stock options were exercised in the first six months of 2005. The aggregate intrinsic value of outstanding and exercisable options was \$3.4 million and \$2.8 million, respectively, at June 30, 2006 and \$11.8 million and \$11.8 million, respectively, at June 30, 2005. The tax benefit recognized from stock option exercises in both the three and six month periods ended June 30, 2006 was \$.6 million. Compensation cost related to unvested options totaled \$11.4 million at June 30, 2006 and will be recognized over the remaining vesting period of the grants, which averages 2.1 years. The average grant date fair value of options granted in 2006 was \$9.65.

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In addition to stock options, in 2005 certain key management employees were granted restricted stock and restricted stock units pursuant to the terms of their employment agreements. TreeHouse issued 630,942 shares of restricted stock and 616,802 restricted stock units in the second quarter of 2005, of which 583,622 and 584,339, respectively, are outstanding as of June 30, 2006. Restricted stock generally vests one-third on each of January 27, 2006, 2007 and 2008. It is subject to a market condition that requires that the total shareholder return of TreeHouse exceed the median of a peer group of 22 companies for the applicable vesting period. In addition, there is a cumulative test at January 27, 2007 through 2010 that allows for vesting of previously unvested grants if the total shareholder return test is met on a cumulative basis. Restricted stock units have the same vesting dates as restricted stock, but they are subject to the condition that the price of TreeHouse stock exceeds \$29.65 on each vesting date. The cumulative test extends for the two anniversary dates beyond the last vesting date of January 27, 2008. No restricted stock units or restricted shares were outstanding at June 30, 2006. Future compensation cost related to outstanding restricted stock units and shares of restricted stock totaled approximately \$2.0 million and will be recognized over the next 2.75 years.

As stated in Note 2, for the quarter beginning July 1, 2005, we adopted the requirements of SFAS 123(R) Share Based Payments. The company elected to use the modified prospective application of SFAS 123(R) for these awards issued prior to July 1, 2005. Income from continuing operations before tax for the quarter and six months ended June 30, 2006 included share-based compensation expense for employee and director stock options, restricted stock and restricted stock units of \$4.4 million and \$9.2 million, respectively.

**10. Employee Retirement and Postretirement Benefits**

*Pension, Profit Sharing and Postretirement Benefits* Our employees and retirees participate in various pension, profit sharing and other postretirement benefit plans previously sponsored by Dean Foods. At the time of the Distribution, the obligations related to such plans were transferred to TreeHouse. Employee benefit plan obligations and expenses included in our Condensed Consolidated Financial Statements are determined based on plan assumptions, employee demographic data, claims and payments. In addition, as part of the acquisition of the soup and infant feeding business, we provide healthcare benefits to certain retirees who are covered under specific contracts. The net period benefit cost for the group was approximately \$.7 million in the three months ended June 30, 2006.

*Defined Benefit Plans* The benefits under our defined benefit plans are based on years of service and employee compensation.

	Three Months Ended June 30		Six Months Ended June 30	
	2006	2005	2006	2005
	(In thousands)			
Components of net period cost:				
Service cost	\$ 90	\$ 80	\$ 180	\$ 160
Interest cost	360	399	720	798
Expected return on plan assets	(255)	(312)	(510)	(624)
Amortization of prior service costs	20	21	40	42
Amortization of unrecognized net loss	35	40	70	80
Effect of settlement		37		74
Net period benefit cost	\$ 250	\$ 265	\$ 500	\$ 530

We expect to contribute \$3.2 million to the pension plans during 2006, of which \$1.3 million has been paid as of June 30, 2006.

*Postretirement Benefits* We provide healthcare benefits to certain retirees who are covered under specific group contracts.

Three Months Ended June 30	Six Months Ended June 30
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	2006	2005	2006	2005
		(In thousands)		
Components of net period cost:				
Service and interest cost	\$ 80	\$ 73	\$ 160	\$ 146
Amortization of unrecognized net loss	25	16	50	32
Net period benefit cost	\$ 105	\$ 89	\$ 210	\$ 178

We expect to contribute \$425,000 to the postretirement health plans during 2006, of which approximately \$210,000 has been paid as of June 30, 2006.

**Table of Contents****11. Acquisition**

On April 24, 2006, we completed the acquisition of certain real estate, equipment, machinery, inventory, raw materials, intellectual property and other assets that are related to the Del Monte Foods Company (1) private label soup business, (2) infant feeding business conducted under the brand name Nature's Goodness®, and (3) the food service soup business (hereinafter collectively referred to as the Soup and Infant Feeding Business), and assumed certain liabilities to the extent related thereto. Immediately following the completion of the acquisition, the Soup and Infant Feeding Business became a division of our operating subsidiary, Bay Valley Foods, LLC. The acquisition of the soup and infant feeding business expands our offerings, primarily in the private label market allowing us to provide a broader line of goods to our customers. The value we expect to realize as a company is believed to exceed the amount paid to acquire the business.

The purchase price (subject to finalization of an adjustment for working capital) paid for the soup and infant feeding business by TreeHouse was \$284.1, which includes acquisition related costs of \$5.2 million. In addition TreeHouse assumed postretirement, vacation pay and lease, and other liabilities of \$41.4 million. The acquisition was financed through \$250 million of borrowings under our existing \$400 million credit facility and available cash balances.

The acquisition is being accounted for under the purchase method of accounting and the results of operations are included in our financial statements from the date of acquisition. The purchase price was allocated to the net assets acquired based upon estimated fair market values at the date of acquisition. The purchase price allocations are preliminary because we have not finalized our estimate of the fair value of long-lived assets or intangible assets acquired. We have made a preliminary allocation to the net tangible and intangible assets acquired and liabilities assumed as follows:

	(In thousands)
Inventory	\$ 70,667
Property Plant and Equipment	102,402
Trade Name Natures Goodness	8,000
Customer Relationships	28,100
Transition Services Agreement	1,100
Goodwill	108,669
Other Assets	6,476
 Total Assets Purchased	 325,414
Assumed Liabilities	(41,360)
 Total Purchase Price	 \$ 284,054

We have hired a third party valuation firm to establish the fair value of the soup and infant feeding business inventory, real estate, machinery and equipment and the fair value of identifiable intangible assets. As a result of information obtained as we operate the business, values assigned to these assets could change. We are also assessing certain liabilities assumed in the transaction.

We have recorded intangible assets of \$144.8 million during the three month period ended June 30, 2006, including \$108.7 million of goodwill, \$8.0 million of trademark indefinite lived intangibles and \$28.1 million of customer and contract related definite lived intangibles. The weighted average useful life of the definite lived intangibles is fifteen years and \$28.1 million of the intangible asset value is expected to be deductible for income tax purposes.

The Company has entered into a transition services agreement with Del Monte Foods Company whereby Del Monte will continue to provide various administrative and information technology support services until the soup and infant feeding business can be fully integrated into TreeHouse.

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The following pro forma summary presents the effect of the soup and infant feeding business acquired during the second quarter of 2006 as though the business had been acquired as of January 1, 2005 and is based upon unaudited financial information of the acquired entity (in thousands, except per share data):

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	<b>Three Months Ended June 30</b>		<b>Six Months Ended June 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>			
Revenue as reported	\$ 232,118	\$ 185,008	\$ 404,842	\$ 351,383
Revenue of purchased businesses for the period prior to acquisition	22,227	58,558	95,199	140,679
Pro forma revenue	\$ 254,345	\$ 243,566	\$ 500,041	\$ 492,062
Net income as reported	\$ 6,594	\$ 1,281	\$ 13,993	\$ 12,324
Net income of purchased businesses for the period prior to acquisition	5,120	1,895	10,903	11,209
Pro forma net income	\$ 11,714	\$ 3,176	\$ 24,896	\$ 23,533
Earnings per share - basic				
As reported	\$ 0.21	\$ 0.04	\$ 0.45	\$ 0.40
Effect of purchased businesses for the period prior to acquisition	0.16	0.06	0.35	0.36
Pro forma earnings per share-basic	\$ 0.37	\$ 0.10	\$ 0.80	\$ 0.76
Earnings per share-diluted				
As reported	\$ 0.21	\$ 0.04	\$ 0.45	\$ 0.40
Effect of purchased businesses for the period prior to acquisition	0.16	0.06	0.35	0.36
Pro forma earnings per share-diluted	\$ 0.37	\$ 0.10	\$ 0.80	\$ 0.76

**12. Commitments and Contingencies**

*Indemnification of Dean Foods* We have an agreement with Dean Foods under which we have agreed to assume all contingent and undisclosed liabilities relating to our businesses or operations of our assets, including those incurred prior to the Distribution, and to indemnify Dean Foods for liabilities, other than certain tax liabilities, incurred by Dean Foods relating to the businesses or operations of our assets. In addition, under the tax sharing agreement, we will, with limited exceptions, be liable for all taxes attributable to our business that are required to be paid after the Distribution. We have agreed to indemnify Dean Foods for claims arising under the distribution agreement and the tax sharing agreement.

*Tax Sharing Agreement* We entered into a tax sharing agreement with Dean Foods which generally governs Dean Foods' and our respective rights, responsibilities and obligations after the Distribution with respect to taxes attributable to our business.

Under the tax sharing agreement, we are also liable for taxes that may be incurred by Dean Foods that arise from the failure of the Distribution to qualify as a tax-free transaction under Section 355 of the Code (including as a result of Section 355(e) of the Code) if the failure to so qualify is attributable to actions, events, or transactions relating to the stock, assets, or business of us or any of our affiliates, or a breach of the relevant representations or covenants made by us in the tax sharing agreement or the Distribution agreement or to Wilmer Cutler Pickering Hale and Dorr LLP in connection with rendering its opinion. If the failure of the Distribution to qualify under Section 355 of the



Code is attributable to a breach of certain representations made by both us and Dean Foods or a change in law or change in the interpretation or application of any existing law after the execution of the tax sharing agreement, we will be liable for 50% of the taxes arising from the failure to so qualify.

*Litigation, Investigations and Audits* We are party from time to time to certain claims, litigation, audits and investigations. We believe that we have established adequate reserves to satisfy any probable liability we may have under all such claims, litigations, audits and investigations that are currently pending. In our opinion, the settlement of any such currently pending or threatened matter is not expected to have a material adverse impact on our financial position, annual results of operations or cash flows.

### **13. Supplemental Cash Flow Information**

Cash payments for interest were \$3.8 million and \$.9 million for the six months ended June 30, 2006 and 2005, respectively. Cash payments for income taxes were \$10.7 million and \$0 for the six months ended June 30, 2006 and 2005, respectively.

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### **14. Related Party Transactions**

*Management Fee Paid to Dean Foods* Prior to the Distribution, Dean Foods provided us with certain administrative services such as tax, treasury, human resources, risk management, legal, information technology, internal audit, accounting and reporting in return for a management fee. The management fee was based on budgeted annual expenses for Dean Foods' corporate headquarters and allocated among Dean Foods' segments. We paid Dean Foods a management fee of \$1.5 million and \$2.9 million in the three months and six months ended June 30, 2005, respectively. No management fees have been paid to Dean post-Distribution.

*Refrigerated Products* Effective with the Distribution, we consolidated the Refrigerated Products manufacturing activities into a leased facility in City of Industry, California. For periods prior to the Distribution, product costs were charged to the Refrigerated Products businesses based on the direct materials, direct processing costs and allocated indirect labor, benefits and other processing and facility costs applicable to our products on a shared services basis. As a result, our Consolidated Statements of Income for periods prior to the Distribution reflect the fully absorbed costs for these products, along with allocated distribution, commission and administrative costs based on the volumes of products sold, including Refrigerated Products.

*Agreements* We have entered into a trademark license agreement, co-pack agreement and transition services agreement with Dean Foods. These agreements have not had a material impact on the operations of the company.

*Sales to Dean Foods* Sales to Dean Foods were not significant for the six months ended June 30, 2005.

### **15. Business and Geographic Information and Major Customers**

Our pickles segment sells a variety of pickle, relish, sauerkraut and pepper products under customer brands and under our proprietary brands including *Farmans*®, *Nalley* s®, *Peter Piper*® and *Steinfeld* . Branded products are sold to retailers and private label products are sold to retailers, foodservice customers and in bulk to other food processors. The pickles segment also includes shrimp, seafood, tartar, horseradish, chili, sweet and sour sauces and syrups sold to retail grocers in the Eastern, Midwestern and Southeastern United States. These products are sold under the *Bennett* s®, *Hoffman House*® and *Roddenberry* s® *Northwoods*® brand names.

Our non-dairy powdered creamer segment includes private label powdered creamer and our proprietary *Cremora*® brand. The majority of our powdered products are sold under customer brands to retailers, distributors and in bulk to other food companies for use as ingredients in their products.

In addition to powdered coffee creamer, we also sell shortening powders and other high-fat powder formulas used in baking, beverage mixes, gravies and sauces.

Our soup and infant feeding business segment sells condensed and ready to serve soups, broths and gravies as well as infant baby cereals, fruits, vegetables, juices, meats, dinners and desserts. We sell our soups and gravies under private labels primarily to supermarkets and mass merchandisers. Infant feeding products are sold under the *Nature* s *Goodness*® brand and offer a complete product line focused on the four steps of a baby's development. The infant feeding products are sold to customers in grocery, and foodservice channels.

Our aseptic products and other refrigerated products do not qualify as a reportable segment and are included under other food products. Aseptic products are sterilized using a process which allows storage for prolonged periods without refrigeration. We manufacture aseptic cheese sauces and puddings. Our cheese sauces and puddings are sold primarily under private labels to distributors. Our refrigerated products include *Mocha Mix*®, a non-dairy liquid creamer, *Second Nature*®, a liquid egg substitute, and salad dressings sold in foodservice channels.

We have designated our reportable segments based on how management views our business and on differences in manufacturing processes between product categories. We do not segregate assets between segments for internal reporting. Therefore, asset-related information has been presented in total.

We evaluate the performance of our segments based on sales dollars, gross profit and adjusted gross margin (gross profit less freight out and commissions). The amounts in the following tables are obtained from reports used by our senior management team and do not include any allocated income taxes. There are no significant non-cash items reported in segment profit or loss other than depreciation and amortization. The accounting policies of our segments are the same as those described in the summary of significant accounting policies set forth in Note 2 to our 2005 Consolidated Financial Statements contained in our Annual Report on Form 10-K.



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	<b>Three Months Ended June 30</b>		<b>Six Months Ended June 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>			
Net sales to external customers:				
Pickles	\$ 98,291	\$ 94,798	\$ 172,432	\$ 168,001
Non-Dairy Powdered Creamer	60,775	61,289	127,613	125,838
Soup and Infant Feeding	42,659		42,659	
Other	30,393	28,921	62,138	57,544
<b>Total</b>	<b>232,118</b>	<b>185,008</b>	<b>404,842</b>	<b>351,383</b>
Operating income:				
Pickles	12,877	13,354	24,710	23,621
Non-Dairy Powdered Creamer	11,226	9,614	24,385	20,816
Soup and Infant Feeding	4,355		4,355	
Other	6,561	7,420	12,455	12,936
<b>Segment adjusted gross margin</b>	<b>35,019</b>	<b>30,388</b>	<b>65,905</b>	<b>57,373</b>
Other operating expenses	20,985	21,280	39,764	30,131
<b>Operating income</b>	<b>\$ 14,034</b>	<b>\$ 9,108</b>	<b>\$ 26,141</b>	<b>\$ 27,242</b>

*Geographic Information* During the six months ended June 30, 2006 and 2005, we had foreign sales of approximately 2.5% and 1% of consolidated net sales, respectively. We primarily export to South America and Canada.

*Major Customers* Our non-dairy powdered creamer segment and soup and infant feeding segment had one customer that represented greater than 10% of consolidated net sales during the first six months of 2006 and 2005. Approximately 14.4% and 11.5% of our consolidated net sales were to that customer. Our other food products segment had two customers that represented greater than 10% of our sales for the six months ended June 30, 2006 and 2005. Approximately 11.4% and 12.2% of our consolidated net sales were to those customers for 2006 and 2005, respectively.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Business Overview**

We believe we are the largest manufacturer of pickles and non-dairy powdered creamer in the United States based upon total sales volumes. We believe we are also the leading retail supplier of private label pickles, non-dairy powdered creamer and soup in the United States. We have three reportable segments of which the soup and infant feeding segment was added in the second quarter of 2006. We discuss the following segments in this Management's Discussion and Analysis of Financial Condition and Results of Operations: pickles, soup and infant feeding and non-dairy powdered creamer. We have designated our reportable segments based on how management views our business and on differences in manufacturing processes between product categories. The key performance indicators of our segments are sales dollars, gross profit and adjusted gross margin, which is gross profit less the cost of transporting products to customer locations (referred to in the tables below as "freight out") and commissions paid to independent brokers.

Our current operations consist of the following:

Our pickles segment sells pickles, peppers, relishes and related products. We supply private label pickles to supermarkets and mass merchandisers across the United States. We also sell pickle products to foodservice customers, including relish and hamburger pickle slices. In addition, we sell pickle products under our own

brands, including *Farmans*®, *Nalley* s®, *Peter Piper*® and *Steinfeld* that have a regional following in certain areas of the country. Our pickles segment also sells sauces and syrups to retail grocers in the Eastern, Midwestern and Southeastern United States under our proprietary *Bennett* s®, *Hoffman House*® and *Roddenberry* s® *Northwoods*® brand names

Our soup and infant feeding business segment sells condensed and ready to serve soups, broths and gravies as well as infant baby cereals, fruits, vegetables, juices, meats, dinners and desserts. We sell our soups and gravies under private labels primarily to supermarkets and mass merchandisers. Infant feeding products are sold under the *Nature* s *Goodness*® brand and offer a complete product line focused on the four steps of a baby s development. The infant feeding products are sold to customers in grocery, mass and foodservice channels.

Our non-dairy powdered creamer segment sells non-dairy powdered creamer under private labels and under our proprietary *Cremora*® brand. Product offerings in this segment include private label products packaged for retailers, such as supermarkets and mass merchandisers, foodservice products for use in coffee service and other industrial applications, including for repackaging in portion control packages and for use as an ingredient by other food manufacturers.

We also sell a variety of aseptic and refrigerated products. Aseptic products are processed under heat and pressure in a sterile production and packaging environment, creating a product that does not require refrigeration prior to use. We manufacture aseptic cheese sauces and puddings for sale primarily in the foodservice market. Our refrigerated products include *Mocha Mix*®, a non-dairy liquid creamer, *Second Nature*®, a liquid egg substitute, and salad dressings sold in foodservice channels.

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Prior to 2005, we manufactured and sold aseptic nutritional beverages under co-pack arrangements and private labels. We exited the nutritional beverages business in the fourth quarter of 2004 due to significant declines in volume, which we believed could not be replaced without significant investments in capital and research and development. Our financial statements reflect the operations and assets related to the nutritional beverages business as discontinued operations.

We sell our products primarily to the retail grocery and foodservice markets.

**Spin-Off from Dean Foods** TreeHouse Foods, Inc. ( TreeHouse ) was formed on January 25, 2005 by Dean Foods Company ( Dean Foods ) in order to accomplish a spin-off to its shareholders of certain specialty businesses. Dean Foods transferred the assets and liabilities of its former Specialty Foods Group segment, in addition to the *Mocha Mix*<sup>®</sup>, *Second Nature*<sup>®</sup> and foodservice salad dressings businesses conducted by other businesses owned by Dean Foods to TreeHouse. TreeHouse common stock held by Dean Foods was distributed to Dean Foods stockholders on a distribution ratio of one share of TreeHouse common stock for every five shares of Dean Foods common stock outstanding. The transfer of assets and liabilities and the distribution of shares (the Distribution ) were completed on June 27, 2005 and TreeHouse commenced operations as an independent public company. Dean Foods has no continuing stock ownership in us.

**New York Stock Exchange Listing** In conjunction with the Distribution, TreeHouse began regular trading on the New York Stock Exchange on June 28, 2005 under the symbol THS.

**Recent Developments**

**Acquisition** On March 1, 2006 the Company entered into an Asset Purchase Agreement with the Del Monte Foods Company to acquire the assets of its soup and infant feeding businesses for \$284.1 million including an adjustment for working capital. The transaction closed on April 24, 2006. The acquisition was funded by drawing down approximately \$250 million under the Company's \$400 million unsecured revolving credit agreement and available cash. Management has performed a preliminary allocation of the purchase price, with \$179.6 million allocated to tangible assets, \$144.8 million allocated to intangible assets including goodwill, other assets of \$1.1 million, and assumed liabilities of \$41.4 million.

For the 12 months ended April 30, 2006, the private label soup and infant feeding businesses together generated approximately \$295 million of net sales. Soup and infant feeding products are manufactured at facilities in Pittsburgh, PA and Mendota, IL. TreeHouse acquired the Pittsburgh, PA manufacturing facility and distribution center and entered into a long-term lease agreement at Del Monte's Mendota, IL manufacturing facility. The businesses headquarters will remain in Pittsburgh, PA.

The Company has entered into a Transition Services Agreement with Del Monte whereby Del Monte will continue to provide various administrative and information technology support services until the soup and infant feeding businesses can be fully integrated into TreeHouse.

**Results of Operations**

The following table presents certain information concerning our financial results, including information presented as a percentage of net sales.

	Three Months Ended June 30				Six Months Ended June 30			
	2006		2005		2006		2005	
	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars	Percent
	(Dollars in thousands)							
Net sales	\$ 232,118	100.0%	\$ 185,008	100.0%	\$ 404,842	100.0%	\$ 351,383	100.0%
Cost of sales	183,595	79.1	144,544	78.1	315,929	78.0	273,075	77.7
Gross profit	48,523	20.9	40,464	21.9	88,913	22.0	78,308	22.3
Operating expenses:								
Selling and distribution	18,847	8.1	16,675	9.0	32,897	8.1	30,780	8.8
General and administrative	14,797	6.4	5,662	3.1	28,566	7.1	9,239	2.6
			1,470	.8			2,940	.8

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Management fee paid to Dean Foods								
Other operating expense, net			7,135	3.9			7,279	2.1
Amortization expense	845	.4	414	.2	1,309	.3	828	.2
Total operating expenses	34,489	14.9	31,356	17.0	62,772	15.5	51,066	14.5
Total operating income	\$ 14,034	6.0%	\$ 9,108	4.9%	\$ 26,141	6.5%	\$ 27,242	7.8%

**Table of Contents*****Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005***

**Net Sales** Second quarter net sales increased approximately 25.5% to \$232.1 million in 2006, compared to \$185.0 million in the second quarter of 2005. Net sales by segment are shown in the table below.

	Net Sales			
			\$	%
	2006	2005	Increase/ (Decrease)	Increase/ (Decrease)
	(Dollars in thousands)			
Pickles	\$ 98,291	\$ 94,798	\$ 3,493	3.7%
Non-dairy powdered creamer	60,775	61,289	(514)	(.8)%
Soup and infant feeding	42,659		42,659	
Other	30,393	28,921	1,472	5.1%
Total	\$ 232,118	\$ 185,008	\$ 47,110	25.5%

The increase in sales is largely due to the acquisition of the soup and infant feeding business in the second quarter. The increase in sales of the pickles segment in the second quarter of 2006 was mainly the result of the acquisition of the Oxford Foods pickle book of business in the first quarter of 2006 as well as price increases taken during the first quarter of 2006. Sales prices were raised in response to increases in the cost of raw materials, commodities, packaging and natural gas. Pickle sales in the second quarter increased 3.7% to \$98.3 million in 2006 versus \$94.8 million in 2005. Increases in foodservice pickles, due to the Oxford Foods acquisition, were partially offset by declines in retail private label and branded pickle sales. Non-dairy powdered creamer sales decreased slightly to \$60.8 million in the second quarter compared to \$61.3 million in 2005, as price increases taken in the first quarter of 2006 were offset by unit volumes declines in retail private label sales. Net sales of other products increased 5.1% to \$30.4 million in the second quarter of 2006 from \$28.9 million in the second quarter of the prior year primarily due to increased sales of refrigerated dips.

**Cost of Sales** All expenses incurred to bring a product to completion are included in cost of sales, such as raw material, ingredient and packaging costs; labor costs; facility and equipment costs, including costs to operate and maintain our warehouses; and costs associated with transporting our finished products from our manufacturing facilities to our own distribution centers. Cost of sales as a percentage of consolidated net sales increased to 79.1% in the second quarter of 2006 from 78.1% in the second quarter of 2005, primarily due to the acquisition of the soup and infant feeding business. Excluding the soup and infant feeding business cost of sales decreased from 78.1% in the second quarter of 2005 to 77.9% in the second quarter of 2006. Price increases taken in the first quarter of 2006 as well as cost reduction initiatives offset rising raw material costs, packaging and natural gas. We continue to experience increases in commodity costs such as corn syrup and sucrose compared to the second quarter of 2005. Our packaging costs increased in the second quarter due to higher energy costs which increased the cost of plastic containers and glass. See Results by Segment .

**Operating Expenses** Our operating expenses increased \$3.1 million to \$34.5 million during the second quarter of 2006, compared to \$31.4 million for the second quarter of 2005. Selling and distribution expenses increased \$2.2 million or 13.0% in the second quarter of 2006 compared to the second quarter of 2005 due mainly to the acquisition of the soup and infant feeding business. Excluding the soup and infant feeding expenses our selling and distribution expenses decreased \$.7 million or 4.3% to \$16.0 million. Despite higher fuel prices, which we estimate added approximately \$.9 million to distribution costs in the second quarter of 2006 compared to the prior year's quarter, we were able to offset those increases with lower marketing expenditures and strategic initiatives that increased operating efficiencies and lowered our overall outbound freight costs. General and administrative expenses increased \$9.1 million in the second quarter of 2006, primarily for the following reasons: (1) the adoption of SFAS 123(R), Share Based Payments, which increased operating expenses in the current quarter by \$4.4 million, (2) hiring the TreeHouse management team and costs associated with becoming a publicly held company, which increased



operating expense by \$4.4 million from the prior year's quarter, (3) costs associated with closing the Lajunta, Colorado facility totaled \$1.0 million in the quarter. In the second quarter of 2005, a \$1.4 million management fee was paid to Dean Foods. No management fees were paid to Dean Foods in the current year's second quarter. Other operating expenses in the second quarter of 2005 recognized \$2.3 million of income from the sale of our Cairo Georgia facility and the settlement of a high fructose corn syrup class action litigation, which were offset by \$9.5 million of transaction expenses associated with the spin off of TreeHouse from Dean Foods.

*Operating Income* Operating income during the second quarter of 2006 was \$14.0 million, an increase of \$4.9 million, or 54.1%, from operating income of \$9.1 million in the second quarter of 2005. Our operating margin was 6.0% in the second quarter of 2006 as compared to 4.9% in the prior year's quarter.

*Income Taxes* Income tax expense was recorded at an effective rate of 38.8% in the second quarter of 2006 compared to 82.8% in the prior year's quarter. The higher rate in 2005 was due to \$9.5 million of Distribution expenses that were not deductible for income tax purposes. The effective tax rate in 2005 excluding this item was 38%. The higher effective rate in 2006 is primarily due to changes in the apportionment of income for state income tax purposes compared to previous estimates.

**Table of Contents****Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005 Results by Segment**  
*Pickles*

	Three Months Ended June 30 2006		2005	
	Dollars	Percent (Dollars in thousands)	Dollars	Percent
Net sales	\$ 98,291	100.0%	\$ 94,798	100.0%
Cost of sales	78,802	80.2	75,146	79.3
Gross profit	19,489	19.8	19,652	20.7
Freight out and commissions	6,612	6.7	6,298	6.6
Adjusted gross margin	\$ 12,877	13.1%	\$ 13,354	14.1%

Net sales in the pickles segment increased by \$3.5 million, or 3.7%, in the second quarter of 2006 compared to the second quarter of 2005. The change in net sales from the second quarter of 2005 to 2006 was due to the following:

	Dollars (Dollars in thousands)	Percent
2005 Net sales	\$ 94,798	
Volume	(6,690)	(7.0)%
Acquisitions	6,777	7.1
Pricing	3,406	3.6
2006 Net sales	\$ 98,291	3.7%

The increase in net sales from 2005 to 2006 resulted primarily from the acquisition of the Oxford Foods foodservice business in the second quarter of 2006. Price increases were taken in all distribution channels during the first quarter of 2006 due to rising raw materials, packaging and natural gas. Sales volumes before the acquisition declined 7.0% in the quarter compared to a year ago primarily in the retail and foodservice (excluding Oxford) pickle category. According to Information Resources, Inc., sales volumes of pickles by retail grocers were down 4.0% compared to the second quarter of the prior year.

Cost of sales as a percentage of net sales increased from 79.3% in 2005 to 80.2% in 2006 primarily as a result of the increases in raw materials, packaging and natural gas during the quarter and the higher cost of inventory acquired with the Oxford book of business. We have implemented several cost reduction initiatives in an attempt to offset these increases. Significant cost increases in the quarter include (1) a 3% increase in glass packaging costs due in part to rising natural gas prices; (2) a 5% increase in plastic container costs due to rising resin costs; (3) a 27% increase in sweeteners, and (4) a 7% increase in natural gas.

Freight out and commissions paid to independent brokers increased \$.3 million or 5.0%, to \$6.6 million in the second quarter of 2006 compared to \$6.3 million in 2005 primarily as a result of increased fuel surcharges on outbound freight to our customers. We have initiated cost reduction programs in an attempt to offset the freight expense.

*Soup and infant feeding*

Three Months Ended June 30 2006	
Dollars	Percent

	<b>(Dollars in thousands)</b>	
Net sales	\$ 42,659	100.0%
Cost of sales	35,920	84.2
Gross profit	6,739	15.8
Freight out and commissions	2,384	5.6
Adjusted gross margin	\$ 4,355	10.2%

Net sales in the quarter for soup and infant feeding includes the period from April 24, 2006, the date of acquisition, through June 30, 2006. Revenues in 2006 grew 13.5% primarily due to additional revenues under co-pack arrangements. Excluding co-pack, revenues rose \$.9 million or 2.4% in 2006 from 2005. The increase was due to strong infant feeding sales.

Adjusted gross margins in the current quarter decreased by 3.8% from last year due to the sales generated from very low margin co-pack arrangements. Excluding co-pack sales margins would have been 18.7%, with lower margins in 2006 attributable to higher freight costs.

**Table of Contents***Non-dairy powdered creamer*

	Three Months Ended June 30			
	2006		2005	
	Dollars	Percent (Dollars in thousands)	Dollars	Percent
Net sales	\$ 60,775	100.0%	\$ 61,289	100.0%
Cost of sales	46,463	76.5	48,795	79.6
Gross profit	14,312	23.5	12,494	20.4
Freight out and commissions	3,086	5.0	2,880	4.7
Adjusted gross margin	\$ 11,226	18.5%	\$ 9,614	15.7%

Net sales in the non-dairy powdered creamer segment decreased by \$.5 million, or .8%, in the second quarter of 2006 compared to the prior year. The change in net sales from 2005 to 2006 was due to the following:

	Dollars (Dollars in thousands)	Percent
2005 Net sales	\$ 61,289	
Volume	(3,379)	(5.5)%
Pricing	2,865	4.7
2006 Net sales	\$ 60,775	(0.8)%

Sales volumes were down during the second quarter of 2006 due to increased retail branded promotional spending from our competitors as well as soft industrial/bulk sales. According to Information Resources, Inc. retail sales of shelf stable creamer decreased 4.3% in the quarter versus the second quarter of the prior year.

Cost of sales as a percentage of net sales decreased from 79.6% in the second quarter of 2005 to 76.5% in 2006, as sales price increases taken in the quarter offset increases in raw material, packaging and natural gas costs. Increases in raw material costs included a 20% increase in corn syrup and sweeteners, partially offset by a 4% decrease in soybean oil and a 8% decrease in casein in the second quarter of 2006 compared to the second quarter of 2005. Packaging cost increases include an 4% increase on plastic offset somewhat by a 10% decrease in PET containers. Natural gas increased 7% in the second quarter of 2006 compared to the prior year's quarter.

Freight out and commissions paid to independent brokers increased to \$3.1 million in 2006 compared to \$2.9 million in 2005 primarily as a result of increased fuel surcharges on outbound distribution to our customers. We have implemented strategic initiatives in an attempt to offset those in fuel costs.

***First Six Months of 2006 Compared to First Six Months of 2005***

*Net Sales* Net sales increased approximately 15.2% to \$404.8 million in the first six months of 2006, compared to \$351.4 million in the first six months of 2005. Net sales by segment are shown in the table below.

	Net Sales			
	2006	2005	\$ Increase/ (Decrease) (Dollars in thousands)	% Increase (Decrease)
Pickles	\$ 172,432	\$ 168,001	\$ 4,431	2.6%
Non-dairy powder creamer	127,613	125,838	1,775	1.4%
Soup and infant feeding	42,659		42,659	

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Other	62,138	57,544	4,594	8.0%
Total	\$ 404,842	\$ 351,383	\$ 53,459	15.2%

Sales increased in the first six months of 2006 largely due to the acquisition of the soup and infant feeding business. Net sales in the pickles segment increased 2.6% to \$172.4 million in the first six months of 2006 from \$168.0 million in the first six months of the prior year primarily due to the acquisition of Oxford Foods in the first quarter of 2006. Sales in the non-dairy powdered creamer segment increased 1.4% as a result of increased prices in response to rising input costs and increased volumes in our retail and industrial channels. Net sales of other products increased 8.0% to \$62.1 million in the first six months of 2006 from \$57.5 million in the first six months of the prior year primarily due to increased sales of refrigerated dips.

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**Cost of Sales** All expenses incurred to bring a product to completion are included in cost of sales, such as raw material, ingredient and packaging costs; labor costs; facility and equipment costs, including costs to operate and maintain our warehouses; and costs associated with transporting our finished products from our manufacturing facilities to our own distribution centers. Cost of sales as a percentage of consolidated net sales increased to 78.0% in the first six months of 2006 from 77.7% in the first six months of 2005, primarily due to the acquisition of the soup and infant feeding business. Excluding the soup and infant feeding business cost of sales decreased from 77.7% in the first six months of 2005 to 77.3% in the first six months of 2006. Price increases taken in the first quarter of 2006 as well as cost reduction initiatives offset rising raw material costs, packaging and natural gas. Higher fuel and energy costs also negatively impacted cost of sales. We continue to experience increases in commodity costs such as corn syrup and sucrose compared to the first six months of 2005. See **Results by Segment**.

**Operating Expenses** Our operating expenses increased to \$62.8 million during the first six months of 2006 compared to \$51.1 million in 2005. Selling and distribution expenses increased \$2.1 million or 6.9% in the first six months of 2006 compared to the first six months of 2005 due mainly to the acquisition of the soup and infant feeding business. Excluding the soup and infant feeding expenses our selling and distribution expenses decreased \$0.9 million to \$29.9 million. Despite higher fuel prices, which we estimate added approximately \$1.7 million to distribution costs in the first six months of 2006 compared to the prior year's period, we were able to offset those increases with strategic initiatives that increased operating efficiencies and lowered our overall outbound freight costs. General and administrative expenses increased \$19.3 million in the first six months of 2006, primarily for the following reasons: (1) the adoption of SFAS 123(R), Share Based Payments, which increased operating expenses in the first six months by \$9.2 million, (2) hiring the TreeHouse management team and costs associated with becoming a publicly held company, which increased operating expense by \$5.7 million from the prior year's period, and (3) \$2.0 million of costs associated with closing our LaJunta, Colorado facilities. In the first six months of 2005, a \$2.9 million management fee was paid to Dean Foods. No management fees were paid to Dean Foods in the first six months of 2006. Other operating expenses in the first six months of 2005 recognized \$2.3 million of income from the sale of our Cairo Georgia facility and the settlement of a high fructose corn syrup class action litigation, which were offset by \$9.5 million of transaction expenses associated with the spin off of TreeHouse from Dean Foods.

**Operating Income** Operating income during the first six months of 2006 was \$26.1 million, a decrease of \$1.1 million, or 4.0% from operating income of \$27.2 million in the first six months of 2005 as a result of the increased general and administrative expenses. Our operating margin was 6.5% in the first six months of 2006 as compared to 7.8% in the prior year.

**Income Taxes** Income tax expense was recorded at an effective rate of 38.4% for the first six months of 2006 compared to 52.1% in the prior year. The non-deductibility of the Distribution expenses for tax purposes in 2005 caused the large increase in effective tax rate compared to 2006. Our effective tax rate varies based on the relative earnings of our business units.

**Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005    Results by Segment**  
**Pickles**

	Six Months Ended June 30			
	2006		2005	
	Dollars	Percent	Dollars	Percent
	(Dollars in thousands)			
Net sales	\$ 172,432	100.0%	\$ 168,001	100.0%
Cost of sales	136,404	79.1	133,259	79.3
Gross profit	36,028	20.9	34,742	20.7
Freight out and commissions	11,318	6.6	11,121	6.6
Adjusted gross margin	\$ 24,710	14.3%	\$ 23,621	14.1%

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Net sales in the pickles segment increased by \$4.4 million, or 2.6% in the first six months of 2006 compared to 2005. The change in net sales from the first six months of 2005 to 2006 was due to the following:

	<b>Dollars</b> <b>(Dollars in thousands)</b>	<b>Percent</b>
2005 Net sales	\$ 168,001	
Volume	(11,142)	(6.6)%
Acquisitions	9,717	5.7
Pricing	5,856	3.5
2006 Net sales	\$ 172,432	2.6%

The increase in net sales from 2005 to 2006 resulted primarily from the acquisition of the Oxford Foods foodservice business in the first quarter of 2006. Price increases were taken in all distribution channels during the first quarter of 2006 due to rising raw materials, packaging and natural gas. Sales volumes before the acquisition declined 6.6% in the first six months of 2006 compared to a year ago primarily in the retail and foodservice (excluding Oxford) pickle category. According to Information Resources, Inc., sales volumes of pickles by retail grocers were down 7.2% compared to the first six months of the prior year.

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Cost of sales as a percentage of net sales decreased from 79.3% in 2005 to 79.1% in 2006 primarily as a result of sales price increases, which offset increases in raw materials, packaging and natural gas during the first six months. We have implemented several cost reduction initiatives in a effort to offset these increase increases. Significant cost increases in the first six months include (1) a 4% increase in glass packaging costs due in part to rising natural gas prices; (2) a 13% increase in plastic container costs due to rising resin costs; (3) a 21% increase in corn syrup and sweeteners, and (4) a 25% increase in natural gas.

Freight out and commissions paid to independent brokers increased \$.2 million or 1.8%, to \$11.3 million in the first six months of 2006 compared to \$11.1 million in 2005 primarily as a result of increased fuel surcharges on outbound freight to our customers. We initiated several cost reduction programs, which have helped offset the freight expense.

*Non-dairy powdered creamer*

	Six Months Ended June 30			
	2006		2005	
	Dollars	Percent (Dollars in thousands)	Dollars	Percent
Net sales	\$ 127,613	100.0%	\$ 125,838	100.0%
Cost of sales	96,888	75.9	98,934	78.6
Gross profit	30,725	24.1	26,904	21.4
Freight out and commissions	6,340	5.0	6,088	4.9
Adjusted gross margin	\$ 24,385	19.1%	\$ 20,816	16.5%

Net sales in the non-dairy powdered creamer segment increased by \$1.8 million, or 1.4%, in the first six months of 2006 compared to the prior year. The change in net sales from 2005 to 2006 was due to the following:

	Dollars (Dollars in thousands)	Percent
2005 Net sales	\$ 125,838	
Volume	(3,607)	(2.9)%
Pricing	5,382	4.3
2006 Net sales	\$ 127,613	1.4%

Sales volumes were down during the first six months of 2006 due to increased retail branded promotional spending from our competitors. According to Information Resources, Inc. retail sales of shelf stable creamer decreased 7.0% in the first six months of 2006 versus the prior year.

Cost of sales as a percentage of net sales decreased from 78.6% in the first six months of 2005 to 75.9% in 2006, as sales price increases taken in the first six months offset increases in raw material, packaging and natural gas costs. Increases in raw material costs included a 4% increase in casein, and a 17% increase in corn syrup and sweeteners, partially offset by a 6% decrease in soybean oil in the first six months of 2006 compared to the first six months of 2005. Packaging cost increases include an 8% increase on plastic and PET containers. Natural gas increased 25% in the first six months of 2006 compared to the prior year's six months.

Freight out and commissions paid to independent brokers increased to \$6.3 million in 2006 compared to \$6.1 million in 2005 primarily as a result of increased fuel surcharges on outbound distribution to our customers. We have implemented strategic initiatives in an attempt to offset those in fuel costs.

**Liquidity and Capital Resources***Historical Cash Flow*



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We have generated and expect to continue to generate positive cash flow from operations.

When we were part of Dean Foods, our cash was swept regularly by Dean Foods. Dean Foods also funded our operating and investing activities as needed. Dean Foods did not allocate the interest expense related to segments. Therefore, the interest expense reflected in our Consolidated Financial Statements, for the periods prior to the Distribution, relates only to our capital leases. Subsequent to the Distribution, interest expense relates to capital leases and our new line of credit.

	<b>Six Months Ended</b>	
	<b>June 30</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>	
Cash provided by operating activities	\$40,681	\$43,836
Capital spending	\$ 4,387	\$ 7,736

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Net cash provided by operating activities decreased by \$3.2 million for the first six months of 2006 compared to 2005, due to:

An increase in net income excluding non-cash items such as depreciation, amortization and stock-based compensation increased cash by \$10.8 million.

An increase in net working capital decreased cash provided from operating activities by \$11.6 million. An increase in accounts receivable and inventories was offset by an increase in accounts payable.

A decrease in cash provided by discontinued operations of \$2.4 million.

Net cash used in investing activities was \$299.0 million in the first six months of 2006 compared to \$7.7 million in the first six months of 2005, an increase of \$291.3 million primarily due to the acquisition of the Oxford Foods pickle book of business for \$11.0 million in February 2006 and the acquisition of the soup and infant feeding business for \$284.1 million.

***Current Debt Obligations***

At June 30, 2006 we had \$248.3 million in borrowings under our revolving credit facility and \$6.4 million of capital leases. In addition, at June 30, 2006 there were \$1.4 million in letters of credit under the revolver that were issued but undrawn.

Our short-term financing needs primarily are for financing of working capital during the year. Due to the seasonality of pickle production driven by the cucumber harvest cycle, which occurs primarily during the spring and summer, pickle inventories generally are at a low point in late spring and at a high point during the fall increasing our working capital requirement. Our long-term financing needs will depend largely on potential acquisition activity. We are currently in compliance with all covenants contained in our credit agreement. Our credit agreement, plus cash flow from operations, is expected to be adequate to provide liquidity for our planned growth strategy.

See Note 7 to our Condensed Consolidated Financial Statements.

**Table of Contents*****Long-Term Liabilities***

Prior to the Distribution, our employees participated in Dean Foods retirement plans. At the date of Distribution we assumed the liabilities and plan assets related to our employees. These plans offer pension benefits through various defined benefit pension plans and also offer health care and life insurance benefits to certain eligible employees and their eligible dependents upon the retirement of such employees. Reported costs of providing non-contributory defined pension benefits and other postretirement benefits are dependent upon numerous factors, assumptions and estimates.

For example, these costs are impacted by actual employee demographics (including age, compensation levels and employment periods), the level of contributions made to the plan and earnings on plan assets. Our pension plan assets are primarily made up of equity and fixed income investments. Changes made to the provisions of the plan may impact current and future pension costs. Fluctuations in actual equity market returns, as well as changes in general interest rates may result in increased or decreased pension costs in future periods. Pension costs may be significantly affected by changes in key actuarial assumptions, including anticipated rates of return on plan assets and the discount rates used in determining the projected benefit obligation and pension costs.

We expect to contribute approximately \$3.2 million to the pension plans and approximately \$425,000 to the postretirement health plans in 2006, of which approximately \$1.5 million was paid in the six month period ended June 30, 2006.

***Other Commitments and Contingencies***

We also have the following commitments and contingent liabilities, in addition to contingent liabilities related to ordinary course litigation, investigations and audits:

certain indemnification obligations in favor of Dean Foods related to tax liabilities related to the Distribution;

certain lease obligations, and

selected levels of property and casualty risks, primarily related to employee health care, workers' compensation claims and other casualty losses.

See Note 11 to our Condensed Consolidated Financial Statements for more information about our commitments and contingent obligations.

***Future Capital Requirements***

During 2006, we intend to invest a total of approximately \$22.0 million in capital expenditures primarily for our existing manufacturing facilities and distribution capabilities. We intend to fund these expenditures using cash flow from operations. We intend to spend this amount as follows:

<b>Operating Division</b>	<b>Amount (In thousands)</b>
Pickles	\$ 7,500
Non-Dairy Powdered Creamer	5,000
Soup and Infant Feeding	6,000
Other	3,500
Total	\$ 22,000

In 2006, we expect cash interest to be approximately \$11.8 million based on anticipated debt levels including the acquisition of the Del Monte Food Company's soup and infant feeding business, which closed on April 24, 2006. Cash taxes are expected to be approximately \$19.6 million. As of August 8, 2006, \$150 million was available for future borrowings under our line of credit.

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**Known Trends and Uncertainties**

***Prices of Raw Materials***

We were adversely affected by rising input costs during 2005 and the first six months of 2006, and we expect our financial results to continue to be adversely affected by high input costs throughout 2006.

Many of the raw materials that we use in our products rose to unusually high levels during 2005 and continued at high levels in the first half of 2006, including soybean oil, casein, corn syrup and packaging materials. High fuel costs are also having a negative impact on our results. Prices for many of these raw materials and packaging materials are expected to remain high and in some cases may increase during the remainder of 2006. For competitive reasons, we may not be able to pass along increases in raw materials and other input costs as we incur them. Therefore, the current raw materials environment may continue to adversely affect our financial results in 2006.

***Competitive Environment***

There has been significant consolidation in the retail grocery and foodservice industries in recent years, and mass merchandisers are gaining market share. As our customer base continues to consolidate, we expect competition to intensify as we compete for the business of fewer customers. There can be no assurance that we will be able to keep our existing customers, or gain new customers. As the consolidation of the retail grocery and foodservice industries continues, we could lose sales if any one or more of our existing customers were to be sold.

Both the difficult economic environment and the increased competitive environment at the retail and foodservice levels have caused competition to become increasingly intense in our business. We expect this trend to continue for the foreseeable future.

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### **Forward Looking Statements**

From time to time, we and our representatives may provide information, whether orally or in writing, including certain statements in this Quarterly Report on Form 10-Q, which are deemed to be forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995 (the Litigation Reform Act). These forward-looking statements and other information are based on our beliefs as well as assumptions made by us using information currently available.

The words anticipate, believe, estimate, expect, intend, should and similar expressions, as they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended. We do not intend to update these forward-looking statements.

In accordance with the provisions of the Litigation Reform Act, we are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors that could cause actual results to differ materially from those contemplated by the forward-looking statements contained in this Quarterly Report on Form 10-Q and other public statements we make. Such factors include, but are not limited to: the outcome of litigation and regulatory proceedings to which we may be a party; actions of competitors; changes and developments affecting our industry; quarterly or cyclical variations in financial results; development of new products and services; interest rates and cost of borrowing; our ability to maintain and improve cost efficiency of operations; changes in foreign currency exchange rates; changes in economic conditions, political conditions, reliance on third parties for manufacturing of products and provision of services; and other risks that are set forth in the Risk Factors section, the Legal Proceedings section, the Management's Discussion and Analysis of Financial Condition and Results of Operations section and other sections of this Quarterly Report on Form 10-Q, as well as in our Current Reports on Form 8-K.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

#### **Fuel Cost**

Fuel costs, which represent the most important factor affecting utility costs at our production facilities and our transportation costs, are currently at very high levels. Forward purchase contracts for approximately one half of our expected requirements for the year are used to minimize our exposure to fuel costs at our plants.

#### **Interest Rate Fluctuations**

We do not utilize financial instruments for trading purposes or hold derivative financial instruments, which could expose us to significant market risk. In addition, all of our foreign sales are transacted in U.S. dollars. Our exposure to market risk for changes in interest rates relates primarily to the increase in the amount of interest expense we expect to pay with respect to our revolving credit facility entered into in connection with the Distribution, which is tied to variable market rates. Based on our outstanding debt balance as of June 30, 2006, each 1% rise in our interest rate would increase our interest expense by approximately \$2.5 million annually.

### **Item 4. Controls and Procedures**

#### **Disclosure Controls and Procedures**

Evaluations were carried out under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon those evaluations, the Chief Executive Officer and Chief Financial Officer concluded that as of June 30, 2006, these disclosure controls and procedures were effective.

#### **Internal Control Over Financial Reporting**

In the second quarter of 2006, we acquired the soup and infant feeding business from the Del Monte Food Company. In connection with a transition services agreement entered into in connection with the purchase, certain administrative services are being provided by Del Monte, however, we believe the services involved are being provided in a manner, which will not have a material effect on our internal control, or is reasonably likely to materially affect, our internal control over financial reporting.



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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
TreeHouse Foods, Inc.  
Westchester, Illinois

We have reviewed the accompanying condensed consolidated balance sheet of TreeHouse Foods, Inc. and subsidiaries (the Company) as of June 30, 2006, and the related condensed consolidated statements of income for the three and six month periods ended June 30, 2006 and 2005 and of cash flows for the six-month periods ended June 30, 2006 and 2005. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of TreeHouse Foods, Inc. and subsidiaries as of December 31, 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated March 29, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2005 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

DELOITTE & TOUCHE LLP  
Chicago, Illinois  
August 14, 2006

**Table of Contents****Part II Other Information****Item 1. Legal Proceedings**

We are not party to, nor are our properties the subject of, any material pending legal proceedings. However, we are parties from time to time to certain claims, litigation, audits and investigations. We believe that we have established adequate reserves to satisfy any potential liability we may have under all such claims, litigations, audits and investigations that are currently pending. In our opinion, the settlement of any such currently pending or threatened matter is not expected to have a material adverse impact on our financial position, results of operations or cash flows.

**Item 1A. Risk Factors**

Information regarding risk factors appears in Management's Discussion and Analysis of Financial Condition and Results of Operations Information Related to Forward-Looking Statements, in Part I Item 2 of this Form 10-Q and in Part I Item 1A of the TreeHouse Foods, Inc. Annual Report on Form 10-K for the year ended December 31, 2005. There have been no material changes from the risk factors previously disclosed in the TreeHouse Foods, Inc. Annual Report on Form 10-K.

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

None

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

The following matters were submitted to a vote of security holders at TreeHouse Foods' Annual Meeting of Shareholders held on April 21, 2006.

**Election of Directors**

Nominee	For	Withheld
Frank J. O'Connell	26,394,808	1,434,244
Terdema L. Ussery,	26,394,554	1,434,498

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The two directors listed above were elected to a three-year term expiring in 2009.

**Description of Proposals**

Ratification of the appointment of Deloitte & Touche LLP as independent auditors of the Company to serve for the fiscal year 2006.

	For	Against	Abstain
Votes	27,810,043	11,857	7,152

**Item 6. Exhibits**

- 10.18 Awareness Letter from Deloitte & Touche LLP regarding unaudited financial information
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002



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**SIGNATURES**

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

TREEHOUSE FOODS, INC.

/s/ Dennis F. Riordan

Dennis F. Riordan  
Senior Vice President and Chief Financial  
Officer  
August 14, 2006

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n;">progress of our product candidates through the regulatory process and our ability to successfully commercialize any such products that receive regulatory approval;

results of clinical trials, announcements of technological innovations or new products by us or our competitors;

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# Management's Discussion and Analysis of Financial Condition and Results of Operations – (Continued)

results relating to our lawsuits against Par and DRL to protect our patents relating to Kuvan tablets and powder and generic competition to Kuvan relating to our settlement with DRL related to Kuvan tablets;  
 government regulatory action affecting our product candidates, our products or our competitors' product candidates and products in both the U.S. and non-U.S. countries;  
 developments or disputes concerning patent or proprietary rights;  
 general market conditions and fluctuations for the emerging growth and pharmaceutical market sectors;  
 economic conditions in the U.S. or abroad;  
 negative publicity about our company or the pharmaceutical industry;  
 broad market fluctuations in the U.S., the EU or in other parts of the world;  
 actual or anticipated fluctuations in our operating results, including due to timing of large order for our products, in particular in Latin America, where governments place large periodic orders for Naglazyme and Vimizim;  
 changes in company assessments or financial estimates by securities analysts;  
 acquisitions of products, businesses, or other assets; and  
 sales of our shares of stock by us, our significant shareholders, or members of our management or Board of Directors.

## Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that are currently material or reasonably likely to be material to our consolidated financial position or results of operations.

## Contractual and Commercial Obligations

We have contractual and commercial obligations under our debt, operating leases and other obligations related to R&D activities, purchase commitments, licenses and sales royalties with annual minimums. Our contractual obligations as of December 31, 2016 are presented in the table below (in millions).

	Payments Due within				Total
	1 Year or Less	>1 -3 Years	> 3 - 5 Years	More Than 5 Years	
2017 Notes and related interest	\$22.7	\$—	\$—	\$ —	\$22.7
2018 Notes and related interest	2.8	377.8	—	—	380.6
2020 Notes and related interest	5.6	11.3	380.6	—	397.5
Operating leases	9.1	12.6	6.1	6.6	34.4
R&D and purchase commitments	41.5	4.3	—	—	45.8
Total	\$81.7	\$406.0	\$386.7	\$ 6.6	\$881.0

We are also subject to contingent payments related to certain development and regulatory activities and commercial sales and licensing milestones totaling approximately \$576.5 million as of December 31, 2016, which are due upon achievement of certain development and commercial milestones, if they occur before certain dates in the future. Of this amount, \$194.3 million (USD equivalent of €185 million translated at 1.05 USD per Euro in effect on December 31, 2016) relates to the Merck PKU Business acquisition and \$50.8 million relates to programs that are no longer

being developed.

Any outstanding amounts due under the Revolving Credit Facility will be due in full in November 2018 with related interest due on a quarterly basis. As of December 31, 2016, there is no outstanding balance.

## Item 7A. Quantitative and Qualitative Disclosure About Market Risk

We are exposed to market risks that may result from changes in foreign currency exchange rates, interest rates and credit risks. To reduce certain of these risks, we enter into foreign currency derivative hedging transactions, follow investment guidelines and monitor outstanding trade receivables as part of our risk management program.

### Foreign Currency Exchange Rate Risk

Our operations include manufacturing and sales activities in the U.S. as well as sales activities in regions outside the U.S., including Europe, Latin America and Asia Pacific. As a result our financial results can be significantly affected by factors such as changes in foreign currency exchange rates or weak economic conditions in the foreign markets in which we sell our products. Our operating results are exposed to changes in foreign currency exchange rates between the U.S. dollar and various foreign currencies, primarily the Euro. When the U.S. dollar strengthens against these currencies, the relative value of the sales made in the respective foreign currency decreases. Conversely, when the U.S. dollar weakens against these currencies, the relative value of such sales increases. Overall, we are a net receiver of foreign currencies and, therefore, benefit from a weaker U.S. dollar and are adversely affected by a stronger U.S. dollar relative to those foreign currencies in which we transact significant business.

During 2016, approximately 42% of our net product sales were denominated in foreign currencies and 18% of our operating expenses were denominated foreign currencies. To partially mitigate the impact of changes in currency exchange rates on net cash flows from our foreign currency denominated sales and operating expenses, we may enter into forward foreign currency contracts. We also hedge certain monetary assets and liabilities denominated in Euros and British pounds using forward foreign currency exchange contracts, which reduces but does not eliminate our exposure to currency fluctuations between the date the transaction is recorded and the date the cash is collected or paid. Generally, the market risks of these contracts are offset by the corresponding gains and losses on the transactions being hedged.

We do not use derivative financial instruments for speculative trading purposes, nor do we hedge foreign currency exchange rate exposure in a manner that entirely offsets the effects of changes in foreign currency exchange rates. The counterparties to these forward foreign currency exchange contracts are creditworthy multinational commercial banks, which minimizes the risk of counterparty nonperformance. We regularly review our hedging program and may, as part of this review, make changes to the program.

As of December 31, 2016 and 2015, we had open forward foreign currency exchange contracts with notional amounts of \$223.5 million and \$260.9 million, respectively. A hypothetical 10% strengthening in foreign currency exchange rates compared with the U.S. dollar relative to exchange rates at December 31, 2016 would have resulted in a reduction in the value received over the remaining life of these contracts of approximately \$21.0 million on this date and, if realized, would negatively affect earnings during the remaining life of the contracts. The same hypothetical movement in foreign currency exchange rates with the U.S. dollar relative to exchange rates at December 31, 2015, would have resulted in a reduction of the value received over the remaining life of the contracts by approximately \$25.5 million on this date and, if realized, would have negatively affect earnings during the remaining life of these contracts. This analysis does not consider the impact of the hypothetical changes in foreign currency rates would have on the forecasted transactions that these foreign currency sensitive instruments were designated to offset.

Based on our overall foreign currency exchange rate exposures at December 31, 2016, we believe that a near-term 10% fluctuation of the U.S. dollar exchange rate could result in a potential change in the fair value of our foreign currency sensitive assets, excluding our investments and open forward foreign currency contracts by approximately \$3.7 million. We expect to enter into new transactions based in foreign currencies that could be impacted by changes in exchange rates.

### Interest Rate Market Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. By policy, we place our investments with highly rated credit issuers and limit the amount of credit exposure to any one

issuer. As stated in our investment policy, we seek to improve the safety and likelihood of preservation of our invested funds by limiting default risk and market risk.

We mitigate default risk by investing in high credit quality securities and by positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. The portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity.

We have outstanding \$22.5 million of the 2017 Notes, \$375.0 million of the 2018 Notes and \$375.0 million of the 2020 Notes. The interest rates on these notes are fixed and therefore they do not expose us to risk related to rising interest rates. At December 31, 2016 the fair value of our convertible debt was \$956.9 million.

In connection with the October 2013 offering of the 2018 Notes and the 2020 Notes, we paid \$29.8 million to purchase a capped call covering 3,982,988 shares of our common stock. If the per share price of our common stock remains below \$94.15, these capped call transactions would be not applicable and, therefore, would provide us no benefit in offsetting potential dilution from the 2018 Notes and the 2020 Notes. If the per share price of our common stock exceeds \$121.05, then, to the extent of the excess, these capped call transactions would result in additional dilution from conversion of the 2018 Notes and the 2020 Notes.

As of December 31, 2016, our investment portfolio did not include any investments with significant exposure to the subprime mortgage market issues or the European debt crisis. Based on our investment portfolio and interest rates at December 31, 2016, we believe that a 100 basis point increase in interest rates could result in a potential loss in fair value of our investment portfolio of approximately \$11.4 million. Changes in interest rates may affect the fair value of our investment portfolio. However, we will not recognize such gains or losses in our Consolidated Statement of Operations unless the investments are sold or we determine that the decline in the investment's value is other-than-temporary.

The table below summarizes the expected maturities and average interest rates of our interest-generating investments at December 31, 2016 (in millions):

	Expected Maturity						Total
	2017	2018	2019	2020	2021	Thereafter	
Available-for-sale securities	\$381.3	\$323.3	\$243.3	\$6.0	\$ —	\$ 0.2	\$954.1
Average interest rate	1.0 %	1.4 %	1.8 %	2.1 %	—	7.6 %	1.3 %

#### Counterparty credit risks

Our financial instruments, including derivatives, are subject to counterparty credit risk that we consider as part of the overall fair value measurement. Our financial risk management policy limits derivative transactions by requiring transactions to be with institutions with minimum credit ratings of A or equivalent by Standards & Poor's, Moody's or Fitch. In addition, we have an investment policy that limits investments to certain types of debt and money market instruments issued by institutions primarily with investment grade credit ratings and places restriction on maturities and concentrations by asset class and issuer.

Item 8. Financial Statements and Supplementary Data

The information required to be filed in this item appears on pages F-1 to F-51 of this report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

## Item 9A. Controls and Procedures

### Evaluation of Disclosure Controls and Procedures

An evaluation was carried out, under the supervision of and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on the evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of December 31, 2016.

### Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting. Under the supervision of and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, our management has assessed the effectiveness of our internal control over financial reporting as defined in Rule 13a-15(f) under the Exchange Act as of December 31, 2016. Our management's assessment was based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), Internal Control-Integrated Framework (2013).

Based on the COSO criteria, our management has concluded that our internal control over financial reporting as of December 31, 2016 was effective.

Our independent registered public accounting firm, KPMG LLP, has audited the financial statements included in this Annual Report on Form 10-K and has issued a report on the effectiveness of our internal control over financial reporting. The report of KPMG LLP is incorporated by reference to Item 8 of this Annual Report on Form 10-K.

### Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during our most recently completed quarter that have materially affected or are reasonably likely to materially affect our internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act.

### Scope of the Effectiveness of Controls

Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Our internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and our board of directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.



Item 9B. Other Information

None

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### Part III

#### Item 10. Directors, Executive Officers and Corporate Governance

The information required by this Item regarding our directors, executive officers and corporate governance is incorporated into this section by reference to the sections captioned “Election of Directors” and “Executive Officers” in the proxy statement for our 2017 annual meeting of stockholders.

#### Item 11. Executive Compensation

The information required by this Item regarding executive compensation is incorporated into this section by reference to the section captioned “Executive Compensation” in the proxy statement for our 2017 annual meeting of stockholders.

#### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item regarding security ownership of our beneficial owners, management and related stockholder matters is incorporated into this section by reference to the section captioned “Security Ownership of Certain Beneficial Owners” in the proxy statement for our 2017 annual meeting of stockholders. The information required by this Item regarding the securities authorized for issuance under our equity compensation plans is incorporated into this section by reference to the section captioned “Equity Compensation Plan Information” in the proxy statement for our 2017 annual meeting of stockholders.

#### Item 13. Certain Relationships and Related Transactions and Director Independence

The information required by this Item regarding certain relationships, related transactions and director independence is incorporated into this section by reference to the section captioned “Transactions with Related Persons, Promoters and Certain Control Persons” in the proxy statement for our 2017 annual meeting of stockholders.

#### Item 14. Principal Accounting Fees and Services

The information required by this Item regarding our principal accountant fees and services is incorporated into this section by reference to the section captioned “Independent Registered Public Accounting Firm” in the proxy statement for our 2017 annual meeting of stockholders.

Part IV

Item 15. Exhibits, Financial Statement Schedules

Financial Statements

<u>Reports of Independent Registered Public Accounting Firm</u>	Page F-2
Consolidated Financial Statements as of December 31, 2016 and 2015 and for the three years ended December 31, 2016:	
<u>Consolidated Balance Sheets</u>	F-4
<u>Consolidated Statements of Operations</u>	F-5
<u>Consolidated Statements of Comprehensive Loss</u>	F-6
<u>Consolidated Statements of Changes in Stockholders' Equity</u>	F-7
<u>Consolidated Statements of Cash Flows</u>	F-8
<u>Notes to Consolidated Financial Statements</u>	F-9

Exhibit Index

- 2.1 Purchase Agreement, dated as of November 23, 2014, among BioMarin Falcons B.V., BioMarin Pharmaceutical Inc. and Prosensa Holding N.V., previously filed with the SEC on November 26, 2014 as Exhibit 2.01 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated by reference herein.
- 2.2 Asset Purchase Agreement between BioMarin Pharmaceutical Inc. and Medivation, Inc., dated August 21, 2015, previously filed with the SEC on October 7, 2015 as Exhibit 2.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference. The SEC has granted confidential treatment with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.
- 2.3 Amended and Restated Termination and Transition Agreement, dated as of December 23, 2015, between BioMarin Pharmaceutical Inc. and Ares Trading S.A., previously filed with the SEC on January 7, 2016 as Exhibit 2.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference. Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a request for confidential treatment. Omitted portions have been filed separately with the SEC.
- 2.4 Termination Agreement, dated as of October 1, 2015, between BioMarin Pharmaceutical Inc. and Ares Trading S.A., previously filed with the SEC on January 7, 2016 as Exhibit 2.2 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference. Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a request for confidential treatment. Omitted portions have been filed separately with the SEC.
- 2.5 Termination and Transition Agreement, dated as of October 1, 2015, between BioMarin Pharmaceutical Inc. and Ares Trading S.A., previously filed with the SEC on January 7, 2016 as Exhibit 2.3 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference. Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a request for confidential treatment. Omitted portions have been filed separately with the SEC.
- 2.6\* First Amendment, dated as of December, 12, 2016, to the Amended and Restated Termination and Transition Agreement, dated as of December 23, 2015 and effective as of October 1, 2015, between BioMarin Pharmaceutical Inc. and Ares Trading S.A. Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a request for confidential treatment. Omitted portions have been filed separately with the SEC.
- 3.1 Amended and Restated Certificate of Incorporation of BioMarin Pharmaceutical Inc., as amended June 12, 2003, previously filed with the SEC on June 23, 2003 as Exhibit 3.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 3.2 Certificate of Correction to Certificate of Amendment to the Amended and Restated Certificate of Incorporation of BioMarin Pharmaceutical Inc., dated April 4, 2005, previously filed with the SEC on April 5, 2005 as Exhibit 3.2 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 3.3 Certificate of Amendment to the Amended and Restated Certificate of Incorporation of BioMarin Pharmaceutical Inc. as filed with the Delaware Secretary of State on October 12, 2007, previously filed with the SEC on February 22, 2012 as Exhibit 3.3 to the Company's Annual Report on Form 10-K (File No. 000-26727), which is incorporated herein by reference.

- 3.4 Amended and Restated Bylaws of BioMarin Pharmaceutical Inc., previously filed with the SEC on June 15, 2015 as Exhibit 3.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 4.1 Indenture dated as of March 29, 2006, between BioMarin Pharmaceutical Inc. and Wilmington Trust Company, previously filed with the SEC on March 29, 2006 as Exhibit 4.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.

- 4.2 Second Supplemental Indenture, dated as of April 23, 2007, between BioMarin Pharmaceutical Inc. and Wilmington Trust Company, previously filed with the SEC on April 23, 2007 as Exhibit 4.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 4.3 Form of 1.875% Senior Subordinated Convertible Notes due 2017, previously filed with the SEC on April 23, 2007 as Exhibit 4.2 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 4.4 Indenture, dated as of October 15, 2013, between BioMarin Pharmaceutical Inc. and Wilmington Trust, National Association, previously filed with the SEC on October 15, 2013 as Exhibit 4.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 4.5 First Supplemental Indenture, dated as of October 15, 2013, between BioMarin Pharmaceutical Inc. and Wilmington Trust, National Association, previously filed with the SEC on October 15, 2013 as Exhibit 4.2 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 4.6 Second Supplemental Indenture, dated as of October 15, 2013, between BioMarin Pharmaceutical Inc. and Wilmington Trust, National Association, previously filed with the SEC on October 15, 2013 as Exhibit 4.3 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 4.7 Form of 0.75% Senior Subordinated Convertible Notes due 2018, previously filed with the SEC on October 15, 2013 as included in Exhibit 4.2 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 4.8 Form of 1.50% Senior Subordinated Convertible Notes due 2020, previously filed with the SEC on October 15, 2013 as included in Exhibit 4.3 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.1†Form of Indemnification Agreement for Directors and Officers, previously filed with the SEC on October 19, 2010 as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.2†Form of Indemnification Agreement for Directors and Officers, previously filed with the SEC on December 19, 2016 as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.3†Amended and Restated Severance Plan and Summary Plan Description as originally adopted on January 27, 2004 and amended and restated on May 12, 2009 and further amended and restated on July 29, 2013 and October 7, 2014, previously filed with the SEC on October 14, 2014 as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated by reference herein.
- 10.4†Amendment to BioMarin Pharmaceutical Inc. 1997 Stock Plan, as amended, as adopted March 20, 2002, previously filed with the SEC on March 21, 2002 as Exhibit 99.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.5†Amendment No. 2 to BioMarin Pharmaceutical Inc. 1997 Stock Plan, as amended, as adopted May 5, 2004, previously filed with the SEC on August 9, 2004 as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q (File No. 000-26727), which is incorporated herein by reference.

10.6†BioMarin Pharmaceutical Inc. 1998 Director Option Plan and forms of agreements thereunder, previously filed with the SEC on May 4, 1999 as Exhibit 10.3 to the Company's Registration Statement on Form S-1 (File No. 333-77701), which is incorporated herein by reference.

10.7†Amendment No. 1 to BioMarin Pharmaceutical Inc. 1998 Director Plan as adopted March 26, 2003 previously filed with the SEC on May 15, 2003 as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q (File No. 000-26727), which is incorporated herein by reference.

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- 10.8† Amendment No. 2 to BioMarin Pharmaceutical Inc. 1998 Director Option Plan, effective as of June 12, 2003 and July 21, 2003, previously filed with the SEC on August 12, 2003 as Exhibit 10.1 to the Company's Quarterly report on Form 10-Q (File No. 000-26727), which is incorporated herein by reference.
- 10.9† Amendment No. 3 to BioMarin Pharmaceutical Inc. 1998 Director Option Plan, as amended, as adopted May 5, 2004, previously filed with the SEC on August 9, 2004 as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q (File No. 000-26727), which is incorporated herein by reference.
- 10.10†BioMarin Pharmaceutical Inc. Amended and Restated 2006 Employee Stock Purchase Plan, as adopted on June 21, 2006 and amended on March 5, 2014, previously filed with the SEC on June 10, 2014 as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.11†BioMarin Pharmaceutical Inc. Amended and Restated 2006 Share Incentive Plan, as adopted on May 2, 2006 and as amended and restated on April 16, 2015, previously filed with the SEC on June 15, 2015 as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference..
- 10.12†Form of Agreement Regarding Restricted Share Units for the BioMarin Pharmaceutical Inc. 2006 Share Incentive Plan, previously filed with the SEC on May 16, 2013 as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.13†Form of Amendment to Agreement Regarding Restricted Share Units for the BioMarin Pharmaceutical Inc. 2006 Share Incentive Plan, previously filed with the SEC on December 9, 2016 as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.14†Amended and Restated BioMarin Pharmaceutical Inc. Nonqualified Deferred Compensation Plan, as adopted on December 1, 2005 and as amended and restated on January 1, 2009 and further amended and restated on December 19, 2013 and October 7, 2014, previously filed with the SEC on October 14, 2014 as Exhibit 10.2 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.15†Summary of Bonus Plan, previously filed with the SEC on February 27, 2009 as Exhibit 10.33 to the Company's Annual Report on Form 10-K (File No. 000-26727), which is incorporated herein by reference.
- 10.16†Amended and Restated Employment Agreement with Jean-Jacques Bienaimé effective December 13, 2016 previously filed with the SEC on December 23, 2008 as Exhibit 10.2 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.17 Grant Terms and Conditions Agreement between BioMarin Pharmaceutical Inc. and Harbor-UCLA Research and Education Institute dated April 1, 1997, as amended, previously filed with the SEC on July 21, 1999 as Exhibit 10.17 to the Company's Amendment No. 3 to Registration Statement on Form S-1 (File No. 333-77701), which is incorporated herein by reference. The SEC has granted confidential treatment with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.
- 10.18 License Agreement dated July 30, 2004, between BioMarin Pharmaceutical Inc. and Daiichi Suntory Pharma Co., Ltd., as amended by Amendment No. 1 to License Agreement dated November 19, 2004, previously filed with the SEC on March 16, 2005 as Exhibit 10.25 to the Company's Annual Report on Form 10-K (File No. 000-26727), which is incorporated herein by reference. The SEC has granted confidential treatment with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.



- 10.19 Operating Agreement with Genzyme Corporation, previously filed with the SEC on July 6, 1999 as Exhibit 10.30 to the Company's Amendment No. 2 to Registration Statement on Form S-1 (File No. 333-77701), which is incorporated herein by reference.
- 10.20 Manufacturing, Marketing and Sales Agreement dated as of January 1, 2008, by and among BioMarin Pharmaceutical Inc., Genzyme Corporation and BioMarin/Genzyme LLC previously filed with the SEC on February 28, 2008 as Exhibit 10.30 to the Company's Annual Report on Form 10-K (File No. 000-26727), which is incorporated herein by reference. The SEC has granted confidential treatment with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.
- 10.21 Amended and Restated Collaboration Agreement dated as of January 1, 2008, by and among BioMarin Pharmaceutical Inc., Genzyme Corporation and BioMarin/Genzyme LLC previously filed with the SEC on February 28, 2008 as Exhibit 10.31 to the Company's Annual Report on Form 10-K (File No. 000-26727), which is incorporated herein by reference. The SEC has granted confidential treatment with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.
- 10.22 Members Agreement dated as of January 1, 2008 by and among BioMarin Pharmaceutical Inc., Genzyme Corporation, BioMarin Genetics Inc., and BioMarin/Genzyme LLC previously filed with the SEC on February 28, 2008 as Exhibit 10.32 to the Company's Annual Report on Form 10-K (File No. 000-26727), which is incorporated herein by reference. The SEC has granted confidential treatment with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.
- 10.23†BioMarin Pharmaceutical Inc. 2012 Inducement Plan, adopted May 8, 2012, previously filed with the SEC on May 9, 2012 as Exhibit 10.2 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.24†Form of Stock Options Agreement for the BioMarin Pharmaceutical Inc. 2006 Share Incentive Plan. (as Amended and Restated 2010), previously filed with the SEC on August 2, 2012 as Exhibit 10.11 to the Company's Quarterly Report on Form 10-Q (File No. 000-26727), which is incorporated herein by reference.
- 10.25†Form of Stock Options Agreement for the BioMarin Pharmaceutical Inc. 2012 Inducement Plan, previously filed with the SEC on August 2, 2012 as Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q (File No. 000-26727), which is incorporated herein by reference.
- 10.26†Form of Agreement Regarding Restricted Stock Units for the BioMarin Pharmaceutical Inc. 2012 Inducement Plan, previously filed with the SEC on August 2, 2012 as Exhibit 10.14 to the Company's Quarterly Report on Form 10-Q (File No. 000-26727), which is incorporated herein by reference.
- 10.27 Capped Call Confirmation for the 2018 Notes, dated October 8, 2013, between BioMarin Pharmaceutical Inc. and Bank of America, N.A., previously filed with the SEC on October 11, 2013 as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.28 Capped Call Confirmation for the 2020 Notes, dated October 8, 2013, between BioMarin Pharmaceutical Inc. and Bank of America, N.A., previously filed with the SEC on October 11, 2013 as Exhibit 10.2 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.29 Capped Call Confirmation for the 2018 Notes, dated October 8, 2013, between BioMarin Pharmaceutical Inc. and Morgan Stanley & Co. LLC, previously filed with the SEC on October 11, 2013 as Exhibit 10.3 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.



- 10.30 Capped Call Confirmation for the 2020 Notes, dated October 8, 2013, between BioMarin Pharmaceutical Inc. and Morgan Stanley & Co. LLC, previously filed with the SEC on October 11, 2013 as Exhibit 10.4 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.31 Capped Call Confirmation for the 2018 Notes, dated October 8, 2013, between BioMarin Pharmaceutical Inc. and Barclays Bank PLC, previously filed with the SEC on October 11, 2013 as Exhibit 10.5 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.32 Capped Call Confirmation for the 2020 Notes, dated October 8, 2013, between BioMarin Pharmaceutical Inc. and Barclays Bank PLC, previously filed with the SEC on October 11, 2013 as Exhibit 10.6 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.33 Additional Capped Call Confirmation for the 2018 Notes, dated October 9, 2013, between BioMarin Pharmaceutical Inc. and Bank of America, N.A., previously filed with the SEC on October 11, 2013 as Exhibit 10.7 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.34 Additional Capped Call Confirmation for the 2020 Notes, dated October 9, 2013, between BioMarin Pharmaceutical Inc. and Bank of America, N.A., previously filed with the SEC on October 11, 2013 as Exhibit 10.8 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.35 Additional Capped Call Confirmation for the 2018 Notes, dated October 9, 2013, between BioMarin Pharmaceutical Inc. and Morgan Stanley & Co. LLC, previously filed with the SEC on October 11, 2013 as Exhibit 10.9 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.36 Additional Capped Call Confirmation for the 2020 Notes, dated October 9, 2013, between BioMarin Pharmaceutical Inc. and Morgan Stanley & Co. LLC, previously filed with the SEC on October 11, 2013 as Exhibit 10.10 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.37 Additional Capped Call Confirmation for the 2018 Notes, dated October 9, 2013, between BioMarin Pharmaceutical Inc. and Barclays Bank PLC, previously filed with the SEC on October 11, 2013 as Exhibit 10.11 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.38 Additional Capped Call Confirmation for the 2020 Notes, dated October 9, 2013, between BioMarin Pharmaceutical Inc. and Barclays Bank PLC, previously filed with the SEC on October 11, 2013 as Exhibit 10.12 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.39 Contract of Purchase and Sale and Joint Escrow Instructions, dated December 17, 2013, for the San Rafael Corporate Center, by and among BioMarin Pharmaceutical Inc., through its wholly-owned subsidiary, California Corporate Center Acquisition, LLC, SR Corporate Center Phase One, LLC, and SR Corporate Center Phase Two, previously filed with the SEC on February 26, 2014 as Exhibit 10.68 to the Company's Annual Report on Form 10-K (File No. 000-26727), which is incorporated herein by reference.

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Asset Purchase Agreement, between BioMarin Pharmaceutical Inc., BioMarin GALNS Ltd. and Regeneron Ireland dated July 29, 2014, previously filed with the SEC on October 28, 2014 as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q (File No. 000-26727), which is incorporated herein by reference.

- 10.41 Form of Tender and Support Agreement by and among BioMarin Pharmaceutical Inc., BioMarin Falcons B.V. and shareholders of Prosensa Holding N.V., previously filed with the SEC on November 26, 2014 as Exhibit 10.2 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.42 Convertible Promissory Note, dated as of November 26, 2014, between Prosensa Holding N.V. and BioMarin Falcons B.V., previously filed as Exhibit 10.3 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.43† BioMarin Pharmaceutical Inc. 2014 Inducement Plan, adopted December 17, 2014, previously filed with the SEC on December 23, 2014 as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.44 Form of Contingent Value Rights Agreement, dated as of January 14, 2015, by and between BioMarin Pharmaceutical Inc., BioMarin Falcons B.V. and American Stock Transfer & Trust Company, LLC, previously filed with the SEC on January 16, 2015 as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated by reference herein.
- 10.45† Form of Stock Options Agreement for the BioMarin Pharmaceutical Inc. 2014 Inducement Plan, previously filed with the SEC on March 2, 2015 as Exhibit 10.60 to the Company's Annual Report on Form 10-K (File No. 000-26727), which is incorporated herein by reference.
- 10.46† Form of Agreement Regarding Restricted Share Units for the BioMarin Pharmaceutical Inc. 2014 Inducement Plan, previously filed with the SEC on March 2, 2015 as Exhibit 10.61 to the Company's Annual Report on Form 10-K (File No. 000-26727), which is incorporated herein by reference.
- 10.47† Form of Amended and Restated Employment Agreement for the Company's Executive Officers (other than the Company's Chief Executive Officer) previously filed with the SEC on June 15, 2015 as Exhibit 10.2 to the Company's Current Report on Form 8-K (File No. 000-26727), which is incorporated herein by reference.
- 10.48 Settlement and License Agreement among BioMarin Pharmaceutical Inc., Merck & Cie, Dr. Reddy's Laboratories, Inc. and Dr. Reddy's Laboratories, Ltd., dated September 14, 2015, previously filed with the SEC on November 2, 2015 as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q (File No. 000-26727), which is incorporated herein by reference. The SEC has granted confidential treatment with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.
- 10.49\* Credit Agreement by and among BioMarin Pharmaceutical Inc., as the Borrower, Bank of America, N.A., as Administrative Agent, Swing Line Lender, L/C Issuer and a Lender, and the Lenders party thereto, dated as of November 29, 2016.
- 10.50\*† Form of Agreement Regarding Performance Compensation Award in the Form of Restricted Stock Units for the BioMarin Pharmaceutical Inc. 2006 Share Incentive Plan.
- 21.1\* Subsidiaries of BioMarin Pharmaceutical Inc.
- 23.1\* Consent of KPMG LLP, Independent Registered Public Accounting Firm for BioMarin Pharmaceutical Inc.
- 24.1\* Power of Attorney (Included in Signature Page to this Report)

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- 31.1\* Certification of Chief Executive Officer pursuant to Rules 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended.
- 31.2\* Certification of Chief Financial Officer pursuant to Rules 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended.
- 32.1\* Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. This Certification accompanies this report and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed for purposes of §18 of the Securities Exchange Act of 1934, as amended.



101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Document

101.DEF XBRL Taxonomy Extension Definition Linkbase

101.LAB XBRL Taxonomy Extension Labels Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Link Document

\* Filed herewith

Management contract or compensatory plan or arrangement

Item 16. Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BIOMARIN PHARMACEUTICAL INC.

Dated: February 27, 2017 By: /S/ DANIEL SPIEGELMAN  
Daniel Spiegelman  
Executive Vice President and Chief Financial Officer

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Jean-Jacques Bienaimé and Daniel Spiegelman, his or her attorney-in-fact, with the power of substitution, for him or her in any and all capacities, to sign any amendments to the Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/S/ JEAN-JACQUES BIENAIMÉ Jean-Jacques Bienaimé	Chairman and Chief Executive Officer (Principal Executive Officer)	February 27, 2017
/S/ DANIEL SPIEGELMAN Daniel Spiegelman	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	February 27, 2017
/S/ BRIAN R. MUELLER Brian R. Mueller	Senior Vice President, Corporate Controller and Chief Accounting Officer (Principal Accounting Officer)	February 27, 2017
/S/ WILLARD H. DERE, M.D. Willard H. Dere, M.D.	Director	February 27, 2017
/S/ KATHRYN E. FALBERG Kathryn E. Falberg	Director	February 27, 2017
/S/ MICHAEL G. GREY Michael G. Grey	Director	February 27, 2017
/S/ ELAINE HERON Elaine Heron	Director	February 27, 2017
/S/ V. BRYAN LAWLIS V. Bryan Lawlis	Director	February 27, 2017
/S/ ALAN J. LEWIS Alan J. Lewis	Director	February 27, 2017
/S/ RICHARD A. MEIER Richard A. Meier	Lead Independent Director	February 27, 2017

/S/ DAVID PYOTT      Director  
David Pyott

February 27, 2017

/S/ DENNIS J. SLAMON      Director  
Dennis J. Slamon

February 27, 2017

BIOMARIN PHARMACEUTICAL INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

BioMarin Pharmaceutical Inc.:

We have audited the accompanying consolidated balance sheets of BioMarin Pharmaceutical Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BioMarin Pharmaceutical Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), BioMarin Pharmaceutical Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 27, 2017 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

As discussed in Note 4 to the consolidated financial statements, the company has changed its method of accounting for share-based compensation due to the adoption of the amendments to the FASB Accounting Standards Codification Topic 718- "Compensation – Stock compensation", effective January 1, 2016.

/s/ KPMG LLP

San Francisco, California  
February 27, 2017



Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

BioMarin Pharmaceutical Inc.:

We have audited BioMarin Pharmaceutical Inc. and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting in Item 9a. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of BioMarin Pharmaceutical Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016, and our report dated February 27, 2017 expressed an unqualified opinion on those consolidated financial statements.



/s/ KPMG LLP

San Francisco, California  
February 27, 2017

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## BIOMARIN PHARMACEUTICAL INC.

## CONSOLIDATED BALANCE SHEETS

December 31, 2016 and 2015

(In thousands of U.S. dollars, except per share amounts)

	December 31, 2016	December 31, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 408,330	\$ 397,040
Short-term investments	381,347	195,579
Accounts receivable, net (allowance for doubtful accounts: \$73 and \$93, at December 31, 2016 and 2015, respectively)	215,280	164,959
Inventory	355,126	271,683
Other current assets	61,708	60,378
Total current assets	1,421,791	1,089,639
Noncurrent assets:		
Long-term investments	572,711	425,652
Property, plant and equipment, net	798,768	704,207
Intangible assets, net	553,780	683,996
Goodwill	197,039	197,039
Deferred tax assets	446,786	220,191
Other assets	32,815	408,644
Total assets	\$ 4,023,690	\$ 3,729,368
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 370,505	\$ 392,511
Short-term convertible debt, net	22,478	—
Short-term contingent acquisition consideration payable	46,327	52,946
Total current liabilities	439,310	445,457
Noncurrent liabilities:		
Long-term convertible debt, net	660,761	662,286
Long-term contingent acquisition consideration payable	115,310	32,663
Deferred tax liabilities	—	143,527
Other long-term liabilities	42,034	44,588
Total liabilities	1,257,415	1,328,521
Stockholders' equity:		
Common stock, \$0.001 par value: 250,000,000 shares authorized at December 31, 2016 and 2015: 172,647,588 and 161,526,044 shares	173	162

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issued and outstanding at December 31, 2016 and 2015, respectively.		
Additional paid-in capital	4,288,113	3,414,837
Company common stock held by Nonqualified Deferred Compensation		
Plan (the NQDC)	(14,321 )	(13,616 )
Accumulated other comprehensive income	12,816	21,033
Accumulated deficit	(1,520,506 )	(1,021,569)
Total stockholders' equity	2,766,275	2,400,847
Total liabilities and stockholders' equity	\$ 4,023,690	\$ 3,729,368

The accompanying notes are an integral part of these Consolidated Financial Statements.

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## BIOMARIN PHARMACEUTICAL INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended December 31, 2016, 2015 and 2014

(In thousands of U.S. dollars, except per share amounts)

	2016	2015	2014
<b>REVENUES:</b>			
Net product revenues	\$ 1,110,381	\$ 884,522	\$ 738,416
Royalty and other revenues	6,473	5,373	10,868
Total revenues	1,116,854	889,895	749,284
<b>OPERATING EXPENSES:</b>			
Cost of sales (excludes amortization of intangible assets)	209,620	152,008	122,267
Research and development	661,905	634,806	461,543
Selling, general and administrative	476,593	402,271	302,156
Intangible asset amortization and contingent consideration	(26,953 )	(17,690 )	23,709
Impairment of intangible asset	599,118	198,700	—
Gain on sale of intangible asset	—	(369,498 )	(67,500 )
Total operating expenses	1,920,283	1,000,597	842,175
<b>LOSS FROM OPERATIONS</b>	<b>(803,429 )</b>	<b>(110,702 )</b>	<b>(92,891 )</b>
Equity in the loss of BioMarin/Genzyme LLC	(538 )	(817 )	(877 )
Interest income	7,487	4,501	5,937
Interest expense	(39,499 )	(38,244 )	(36,642 )
Other income (expense)	4,929	(9,462 )	(395 )
<b>LOSS BEFORE INCOME TAXES</b>	<b>(831,050 )</b>	<b>(154,724 )</b>	<b>(124,868 )</b>
Provision for (benefit from) income taxes	(200,840 )	17,075	9,101
<b>NET LOSS</b>	<b>\$(630,210 )</b>	<b>\$(171,799 )</b>	<b>\$(133,969 )</b>
<b>NET LOSS PER SHARE, BASIC</b>	<b>\$(3.80 )</b>	<b>\$(1.07 )</b>	<b>\$(0.92 )</b>
<b>NET LOSS PER SHARE, DILUTED</b>	<b>\$(3.81 )</b>	<b>\$(1.07 )</b>	<b>\$(0.92 )</b>
Weighted average common shares outstanding, basic	165,985	160,025	146,349
Weighted average common shares outstanding, diluted	166,219	160,025	146,349

The accompanying notes are an integral part of these Consolidated Financial Statements.

## BIOMARIN PHARMACEUTICAL INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

Years Ended December 31, 2016, 2015 and 2014

(In thousands of U.S. dollars, except per share amounts)

	2016	2015	2014
NET LOSS	\$(630,210)	\$(171,799)	\$(133,969)
OTHER COMPREHENSIVE INCOME (LOSS):			
Net foreign currency gain (loss)	(2 )	(59 )	(75 )
Available-for-sale securities:			
Unrealized holding gain (loss) arising during the period, net of tax impact of \$4,412, \$1,581 and \$(2,931) for the years ended December 31, 2016, 2015 and 2014, respectively.	(7,692 )	(2,878 )	5,088
Less reclassifications to net loss, net of tax impact of \$42, \$(681) and \$0 for the years ended December 31, 2016, 2015 and 2014, respectively.	(73 )	1,192	—
Net change in unrealized holding gains, net of tax	(7,619 )	(4,070 )	5,088
Cash flow hedges:			
Unrealized holding gain arising during the period, net of tax impact of \$0, \$0 and \$(1,214) for the years ended December 31, 2016, 2015 and 2014, respectively.	9,677	17,300	18,078
Less reclassifications to net loss, net of tax impact of \$0, \$0 and \$(365) for the years ended December 31, 2016, 2015 and 2014, respectively.	10,273	19,604	643
Net change in unrealized holding gains (loss), net of tax	(596 )	(2,304 )	17,435
OTHER COMPREHENSIVE INCOME (LOSS),			
NET OF TAX	(8,217 )	(6,433 )	22,448
COMPREHENSIVE LOSS	\$(638,427)	\$(178,232)	\$(111,521)

The accompanying notes are an integral part of these Consolidated Financial Statements.

## BIOMARIN PHARMACEUTICAL INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended December 31, 2016, 2015 and 2014

(In thousands of U.S. dollars and share amounts in thousands)

	Common stock		Additional	Company	Accumulated		Total
	Shares	Amount	Paid-in	Stock	Other	Accumulated	Stockholders'
			Capital	Held by	Comprehensive	Deficit	Equity
				NQDC	Income		
					(Loss)		
Balance at December 31, 2013	143,464	\$ 144	\$2,059,101	\$(7,421 )	\$ 5,018	\$(715,801 )	\$ 1,341,041
Net loss						(133,969 )	(133,969 )
Other comprehensive income					22,448		22,448
Issuance of common stock, net of offering costs	1,500	1	117,463				117,464
Issuance of common stock under ESPP	258		8,714				8,714
Issuances under equity incentive plans, net of tax	2,817	3	63,419				63,422
Conversion of convertible notes, net	1,055	1	21,323				21,324
Company stock held by NQDC				(2,274 )			(2,274 )
Excess tax benefit from stock option exercises			1,491				1,491
Stock-based compensation			88,233				88,233
Balance at December 31, 2014	149,094	\$ 149	\$2,359,744	\$(9,695 )	\$ 27,466	\$(849,770 )	\$ 1,527,894
Net loss						(171,799 )	(171,799 )
Other comprehensive loss					(6,433 )		(6,433 )
Issuance of common stock, net of offering costs	9,775	10	888,247				888,257
Issuance of common stock under ESPP	185		9,957				9,957
Issuances under equity incentive plans, net of tax	2,023	2	30,097				30,099
Conversion of convertible notes, net	449	1	9,111				9,112
Company stock held by NQDC				(3,921 )			(3,921 )
Excess tax benefit from stock option exercises			2,190				2,190

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Stock-based compensation							115,491	115,491
Balance at December 31, 2015	161,526	\$ 162	\$3,414,837	\$(13,616)	\$ 21,033	\$(1,021,569)	\$ 2,400,847	
Net loss						(630,210)	(630,210)	
Cumulative-effect adjustment of new share-based compensation guidance						131,273	131,273	
Other comprehensive loss					(8,217)		(8,217)	
Issuance of common stock, net of offering costs	7,500	8	712,930				712,938	
Issuance of common stock under ESPP	197		11,998				11,998	
Issuances under equity incentive plans, net of tax	2,987	3	2,757				2,760	
Conversion of convertible notes, net	438		8,928				8,928	
Company stock held by NQDC					(705)		(705)	
Stock-based compensation			136,663				136,663	
Balance at December 31, 2016	172,648	\$ 173	\$4,288,113	\$(14,321)	\$ 12,816	\$(1,520,506)	\$ 2,766,275	

The accompanying notes are an integral part of these Consolidated Financial Statements.

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## BIOMARIN PHARMACEUTICAL INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2016, 2015 and 2014

(In thousands of U.S. dollars)

	2016	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net loss	\$(630,210)	\$(171,799 )	\$(133,969)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization expense	96,912	47,187	45,871
Non-cash interest expense	29,930	28,493	27,225
Accretion of discount on investments	1,300	2,177	7,211
Stock-based compensation expense	134,641	111,525	86,410
Gain on sale of intangible asset	—	(369,498 )	(67,500 )
Gain on termination of leases	—	—	(10,092 )
(Gain) loss on sale of equity investment	108	(3,022 )	—
Impairment of assets	599,118	211,502	—
Deferred income taxes	(228,054)	(76,827 )	(25,617 )
Unrealized foreign exchange gain on forward contracts	(14,481 )	(19,575 )	(832 )
Non-cash changes in the fair value of contingent acquisition consideration payable	(57,161 )	(28,457 )	11,567
Other	336	2,463	5,188
Changes in operating assets and liabilities:			
Accounts receivable, net	(51,483 )	(16,367 )	(25,951 )
Inventory	(64,512 )	(50,989 )	(22,339 )
Other current assets	19,316	25,800	(2,211 )
Other assets	(4,979 )	(3,157 )	(6,516 )
Accounts payable and accrued liabilities	(53,205 )	90,298	38,040
Other long-term liabilities	(5,413 )	747	3,093
Net cash used in operating activities	(227,837)	(219,499 )	(70,422 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of property, plant and equipment	(148,380)	(227,653 )	(117,062)
Deposit on purchase of PKU rights	—	(371,756 )	—
Maturities and sales of investments	367,569	424,713	808,313
Purchase of available-for-sale investments	(699,749)	(873,184 )	(507,036)
Proceeds from sale of intangible asset	—	410,000	67,500
Business acquisitions, net of cash acquired	(2,789 )	(538,392 )	—
Investment in convertible promissory note	—	(3,326 )	(52,288 )
Other	(698 )	—	(3,100 )
Net cash provided by (used in) investing activities	(484,047)	(1,179,598)	196,327
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from exercises of stock options and the ESPP	74,227	63,045	79,904
Taxes paid related to net share settlement of equity awards	(59,469 )	(22,989 )	(7,768 )
Proceeds from public offering of common stock, net	712,938	888,257	117,464



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Payment of contingent acquisition consideration payable	—	—	(4,691 )
Other	(588 )	(2,590 )	(711 )
Net cash provided by financing activities	727,108	925,723	184,198
Effect of exchange rate changes on cash	(3,934 )	(5,072 )	(3,398 )
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	11,290	(478,446 )	306,705
Cash and cash equivalents:			
Beginning of period	397,040	\$875,486	568,781
End of period	408,330	\$397,040	\$875,486
SUPPLEMENTAL CASH FLOW DISCLOSURES:			
Cash paid for interest, net of interest capitalized into fixed assets	8,643	9,307	9,324
Cash paid for income taxes	95,857	16,084	34,986
Stock-based compensation capitalized into inventory	11,449	11,140	8,166
Depreciation capitalized into inventory	17,375	14,627	10,952
SUPPLEMENTAL CASH FLOW DISCLOSURES FOR NON-CASH			
INVESTING AND FINANCING ACTIVITIES:			
Increase (decrease) in accounts payable and accrued liabilities related to fixed assets	20,158	(4,651 )	16,766
Conversion of convertible debt, net	8,928	9,112	21,324

The accompanying notes are an integral part of these Consolidated Financial Statements.

BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

(1) NATURE OF OPERATIONS AND BUSINESS RISKS

BioMarin Pharmaceutical Inc. (the Company or BioMarin) is a global biotechnology company that develops and commercializes innovative therapies for people with serious and life-threatening rare diseases and medical conditions. BioMarin selects product candidates for diseases and conditions that represent a significant unmet medical need, have well-understood biology and provide an opportunity to be first-to-market or offer a significant benefit over existing products. The Company's therapy portfolio consists of five products and multiple clinical and pre-clinical product candidates.

The Company expects to continue to finance future cash needs that exceed its operating activities primarily through its current cash, cash equivalents, short-term and long-term investments, and to the extent necessary, through proceeds from debt or equity offerings, commercial borrowing, or through collaborative agreements with corporate partners. If the Company elects to increase its spending on development programs significantly above current long-term plans or enters into potential licenses and other acquisitions of complementary technologies, products or companies, the Company may need additional capital.

The Company is subject to a number of risks, including: the financial performance of its commercial products; the potential need for additional financings; the Company's ability to successfully commercialize its approved product candidates; the uncertainty of the Company's research and development (R&D) efforts resulting in future successful commercial products; the Company's ability to successfully obtain regulatory approval for new products; significant competition from larger organizations; reliance on the proprietary technology of others; dependence on key personnel; uncertain patent protection; dependence on corporate partners and collaborators; and possible restrictions on reimbursement from governmental agencies and healthcare organizations, as well as other changes in the health care industry.

(2) BASIS OF PRESENTATION

Basis of Presentation

These Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and include the accounts of BioMarin and its wholly owned subsidiaries. All significant intercompany transactions have been eliminated. Management performed an evaluation of the Company's activities through the date of filing of this Annual Report on Form 10-K, and has concluded that there are no subsequent events.

## Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## (3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Cash and Cash Equivalents

The Company treats liquid investments with original maturities of three months or less when purchased as cash and cash equivalents.

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

Investments

The Company determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such designations at each balance sheet date. All of the Company's securities are classified as available-for-sale and reported in short-term investments, long-term investments or other assets. Available-for-sale investments are recorded at fair market value, with unrealized gains or losses included in Accumulated Other Comprehensive Income on the Company's Consolidated Balance Sheets, exclusive of other-than-temporary impairment losses, if any. Investments consist of corporate securities, commercial paper, U.S. federal government agency securities and certificates of deposit.

Inventory

The Company values inventory at the lower of cost and net realizable value and determines the cost of inventory using the average-cost method. Inventories consist of currently marketed products and may contain certain products awaiting regulatory approval.

The Company analyzes its inventory levels quarterly and writes down inventory that has become obsolete, or has a cost basis in excess of its expected net realizable value and inventory quantities in excess of expected requirements. Expired inventory is disposed of and the related costs are recognized as Cost of Sales in the Company's Consolidated Statements of Operations.

Inventories Produced in Preparation for Product Launches

The Company capitalizes inventories produced in preparation for product launches based upon the probability of regulatory approval and earning future revenues. Typically, capitalization of such inventory begins when positive results have been obtained for the clinical trials that the Company believes are necessary to support regulatory approval, uncertainties regarding ultimate regulatory approval have been significantly reduced and the Company has determined it is probable that these capitalized costs will provide some future economic benefit in excess of capitalized costs. The material factors considered by the Company in evaluating these uncertainties include the receipt and analysis of positive pivotal clinical trial results for the underlying product candidate, results from meetings with the relevant regulatory authorities prior to the filing of regulatory applications, and the compilation of the regulatory application. The Company closely monitors the status of each respective product within the regulatory approval process, including all relevant communication with regulatory authorities. The Company also considers its historical experience with manufacturing and commercializing similar products and the relevant product candidate. If the Company is aware of any specific material risks or contingencies other than the normal regulatory review and approval process, or if there are any specific issues identified relating to safety, efficacy, manufacturing, marketing or labeling, the related inventory would generally not be capitalized.

For inventories that are capitalized in preparation of product launch, anticipated future sales, expected approval date and shelf lives are evaluated in assessing realizability. The shelf life of a product is determined as part of the regulatory approval process; however, in evaluating whether to capitalize pre-launch inventory production costs, the Company considers the product stability data of all of the pre-approval production to date to determine whether there is adequate expected shelf life for the capitalized pre-launch production costs. In applying the lower of cost or net

realizable value to pre-launch inventory, the Company estimates a range of likely commercial prices based on its comparable commercial products.

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

Property, Plant and Equipment

Property, plant and equipment are stated at cost net of accumulated depreciation. Depreciation is computed using the straight-line method over the related estimated useful lives as presented in the table below. Significant additions and improvements are capitalized, while repairs and maintenance are charged to expense as incurred. Property and equipment purchased for specific R&D projects with no alternative uses are expensed as incurred.

Leasehold improvements	Shorter of life of asset or lease term
Building and improvements	Lesser of useful life of the asset or remaining life of the building
Manufacturing and laboratory equipment	5 to 15 years
Computer hardware and software	3 to 8 years
Office furniture and equipment	5 years
Vehicles	5 years
Land improvements	10 years
Land	Not applicable
Construction-in-progress	Not applicable

Certain of the Company's operating lease agreements include scheduled rent escalations over the lease term, as well as tenant improvement allowances. Scheduled increases in rent expense are recognized on a straight-line basis over the lease term. The difference between rent expense and rent paid is recorded as deferred rent and included in other liabilities in the accompanying Consolidated Balance Sheets. The tenant improvement allowances and free rent periods are recognized as a reduction of rent expense over the lease term on a straight-line basis.

Impairment of Long-Lived Assets

The Company records goodwill in a business combination when the total consideration exceeds the fair value of the net tangible and identifiable intangible assets acquired. Goodwill and intangible assets with indefinite lives are not amortized but subject to an annual impairment analysis. Intangible assets with finite lives are amortized over their estimated useful lives on a straight-line basis.

The Company performs its annual impairment review of goodwill and indefinite lived intangibles during the fourth quarter and whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. If it is determined that the full carrying amount of an asset is not recoverable, an impairment loss is recorded in the amount by which the carrying amount of the asset exceeds its fair value.

During the fourth quarter of 2016, the Company performed its annual impairment review and determined no impairments of goodwill existed and, other than the impairments recognized in the second quarter of 2016, there were no additional impairments of intangible assets at December 31, 2016. See Note 7 to these Consolidated Financial Statements for further details on impairments to intangible assets.

The Company tests finite-lived intangible assets for impairment when facts or circumstances suggest that the carrying value of the asset may not be recoverable. If the carrying value exceeds the projected undiscounted pre-tax cash flows of the intangible asset, an impairment loss equal to the excess of the carrying value over the estimated fair value (discounted after-tax cash flows) is recognized.

The recoverability of the carrying value of the Company's buildings, leasehold improvements for its facilities and equipment depends on the successful execution of the Company's business initiatives and its ability to earn sufficient returns on approved products and product candidates. The Company continually monitors events and changes in circumstances that could indicate carrying amounts of its fixed assets may not be recoverable. When such events or changes in circumstances occur, the Company assesses recoverability by determining whether the carrying value of such assets will be recovered through the undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, the Company recognizes an impairment loss based on the excess of the carrying amount over the fair value of the assets.

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable and collection from the customer is reasonably assured.

**Net Product Revenues**—The Company recognizes revenues from product sales when title and risk of loss have passed to the customer, which typically occurs upon delivery. Product sales transactions are evidenced by customer purchase orders, customer contracts, invoices and/or the related shipping documents. Amounts collected from customers and remitted to governmental authorities, which primarily consists of value-added taxes related to product sales in foreign jurisdictions, are presented on a net basis in the Company's Consolidated Statements of Operations, in that taxes billed to customers are not included as a component of net product revenues.

In the U.S., the Company's commercial products are generally sold to specialty pharmacies or end-users, such as hospitals, which act as retailers. Through December 31, 2015, the Company also sold Kuvan to Ares Trading S.A. (Merck Serono) at a price near its manufacturing cost, and Merck Serono resold the product to end users outside the U.S., Canada and Japan. The royalty earned from Kuvan product sold by Merck Serono in the EU was included as a component of net product revenues in the period earned. Outside the U.S., the Company's commercial products were sold to its authorized distributors or directly to government purchasers or hospitals, which act as the end-users.

The Company receives a payment ranging from 39.5% to 50% on worldwide net Aldurazyme sales by Genzyme Corporation (Genzyme) depending on sales volume, which is included in Net Product Revenues in the Company's Consolidated Statements of Operations. The Company recognizes a portion of this amount as product transfer revenue when the product is released to Genzyme because all of the Company's performance obligations are fulfilled at that point and title to, and risk of loss for, the product has transferred to Genzyme. The product transfer revenue represents the fixed amount per unit of Aldurazyme that Genzyme is required to pay the Company if the product is unsold by Genzyme. The amount of product transfer revenue will eventually be deducted from the calculated royalty recognized when the product is sold by Genzyme. The company records the Aldurazyme revenues based on net sales information provided by Genzyme and record product transfer revenue based on the fulfillment of Genzyme purchase orders in accordance with the terms of the related agreements with Genzyme and when the title and risk of loss for the product is transferred to Genzyme. Although described as royalties in the Company's agreements with Genzyme, the revenues that the Company receives for Aldurazyme and, for the periods through 2015, for Kuvan are similar to direct product sales because the Company manufactures the product and the revenue is highly dependent on substantial operational activities performed by the Company, including responsibility for global regulatory compliance. These responsibilities, and the operational risk that could reduce or eliminate the Company's receipt of these percentage of net sales amounts, are similar to many of the responsibilities and risks associated with the Company's direct sales of other commercial products. Due to the significant role the Company plays in the operations of Aldurazyme and, through 2015, Kuvan as well as the rights and responsibilities to deliver the products to Genzyme and previously to Merck Serono, respectively, the Company includes Aldurazyme revenues as a component of Net Product Revenues in the Company's Consolidated Statements of Operations.

The Company records reserves for rebates payable under Medicaid and other government programs as a reduction of revenue at the time product revenues are recorded. The Company's reserve calculations require estimates, including estimates of customer mix, to determine which sales will be subject to rebates and the amount of such rebates. The



Company updates its estimates and assumptions on a quarterly basis and records any necessary adjustments to its reserves. The Company records fees paid to distributors and cash discounts as a reduction of revenue.

The Company records allowances for product returns, if appropriate, as a reduction of revenue at the time product sales are recorded. Several factors are considered in determining whether an allowance for product returns is required, including market exclusivity of the products based on their orphan drug status, the patient population, the customers' limited return rights and the Company's experience with returns. Because of the pricing of the Company's commercial products, the limited number of patients and the customers' limited return rights, most customers and retailers carry a limited inventory.

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

However, certain international customers, usually government entities, tend to purchase larger quantities of product less frequently. Although such buying patterns may result in revenue fluctuations from quarter to quarter, the Company has not experienced any increased product returns or risk of product returns. The Company relies on historical return rates to estimate returns. Genzyme's contractual return rights for Aldurazyme are limited to defective product. Based on these factors and the fact that the Company has not experienced significant product returns to date, management has concluded that product returns will be minimal. In the future, if any of these factors and/or the history of product returns change, an allowance for product returns may be required.

**Royalty and Other Revenues**—Royalty and other revenues includes royalties on net sales of products with which the Company has no direct involvement, collaborative agreement revenues and rental income.

Royalty revenue is recognized as earned in accordance with the contract terms at the time the royalty amount is fixed or determinable based on information received from the licensees and sublicensees and at the time collectibility is reasonably assured.

Collaborative agreement revenues includes both license revenue and contract research revenue. Activities under collaborative agreements are evaluated to determine if they represent a multiple element revenue arrangement. The Company allocates the arrangement consideration to those units of accounting. The amount of allocable arrangement consideration is limited to amounts that are fixed or determinable. Arrangement consideration is allocated at the inception of the arrangement to the identified units of accounting based on their relative estimated selling price. Revenue is recognized for each unit of accounting when the appropriate revenue recognition criteria are met.

Rental income associated with the tenants in the San Rafael Corporate Center (SRCC) is recognized on a straight-line basis over the term of the respective lease.

Revenue from non-refundable up-front license fees and milestone payments, such as under a development collaboration or an obligation to supply product, is recognized as performance occurs and the Company's obligations are completed. In accordance with the specific terms of the Company's obligations under these arrangements, revenue is recognized as the obligation is fulfilled or ratably over the development or manufacturing period. Revenue associated with substantive at-risk milestones is recognized based upon the achievement of the milestones set forth in the respective agreements. Advance payments received in excess of amounts earned are classified as deferred revenue on the Company's Consolidated Balance Sheets.

**Research and Development**

R&D expenses include expenses associated with contract R&D provided by third-parties, most product manufacturing prior to regulatory approval, clinical and regulatory costs, and internal R&D costs. In instances where the Company enters into agreements with third-parties for R&D activities, costs are expensed upon the earlier of when non-refundable amounts are due or as services are performed unless there is an alternative future use of the funds in other R&D projects. Amounts due under such arrangements may be either fixed fee or fee for service and may include upfront payments, monthly payments and payments upon the completion of milestones or receipt of deliverables. The Company accrues costs for clinical trial activities based upon the services received and estimates of related expenses incurred that have yet to be invoiced by the vendors that perform the activities.

## Convertible Debt Transactions

The Company separately accounts for the liability and equity components of convertible debt instruments that can be settled in cash by allocating the proceeds from issuance between the liability component and the embedded conversion option, or equity component, in accordance with accounting for convertible debt instruments that may be settled in cash (including partial cash settlement) upon conversion. The value of the equity component is calculated by first measuring the fair value of the liability component, using the interest rate of a similar liability that does not have a conversion feature, as of the issuance date. The difference between the proceeds from the convertible debt issuance and the amount measured as the liability component is recorded as the equity component with a

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

corresponding discount recorded on the debt. The Company recognizes the accretion of the resulting discount using the effective interest method as part of Interest Expense in its Consolidated Statements of Operations.

Net Loss Per Common Share

Basic net loss per share is calculated by dividing net loss by the weighted average shares of common stock outstanding during the period. Diluted net loss per share reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock; however, potential common equivalent shares are excluded if their effect is anti-dilutive. See Note 14 to these Consolidated Financial Statements for further details.

Stock-Based Compensation

The Company uses the Black-Scholes option-pricing model to determine the fair value of stock options and the Company's ESPP awards. The determination of the fair value of stock-based payment awards using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. Stock-based compensation expense is recognized on a straight-line basis over the requisite service period for each award.

The Company uses a lattice model with a Monte Carlo simulation to value restricted stock unit awards with performance and market conditions. This valuation methodology utilizes the closing price of the Company's common stock on grant date and several key assumptions, including expected volatility of the Company's stock price, risk-free rates of return, expected dividend yield and estimated total shareholder return.

In the fourth quarter of 2016, the Company elected to early adopt Accounting Standards Update No. 2016-09, Compensation-Stock Compensation (Topic 718): Improvement to Employee Share-based Payment Accounting issued by the Financial Accounting Standards Board (FASB), which among other items, provides an accounting policy election to account for forfeitures as they occur, rather than to account for them based on an estimate of expected forfeitures. The Company elected to account for forfeitures as they occur. See Note 4 to these Consolidated Financial Statements for further information on the impact of adoption.

If factors change and different assumptions are employed in determining the fair value of stock-based awards, the stock-based compensation expense recorded in future periods may differ significantly from what was recorded in the current period. See Note 17 to these Consolidated Financial Statements for further information.

Nonqualified Deferred Compensation Plan

The Company's NQDC Plan allows eligible employees, including members of the Company's Board of Directors (the Board), management and certain highly-compensated employees as designated by the NQDC Plan's administrative committee, to make voluntary deferrals of compensation to specified dates, retirement or death. Participants are permitted to defer portions of their salary, annual cash bonus and restricted stock. The Company is not allowed to make additional direct contributions to the NQDC Plan on behalf of the participants without further action by the Board.

All of the investments held in the NQDC Plan are classified as trading securities and recorded at fair value with changes in the investments' fair values recognized as earnings in the period they occur. Company stock issued and held by the NQDC Plan is accounted for similarly to treasury stock in that the value of the employer stock is determined on the date the restricted stock vests and the shares are issued into the NQDC Plan. The restricted stock issued into the NQDC Plan is recorded as stockholders' equity and changes in the fair value of the corresponding liability are recognized in earnings as incurred. The corresponding liabilities for the NQDC Plan are included in Accounts Payable and Accrued Liabilities and Other Long-Term Liabilities in the Company's Consolidated Balance Sheets. The corresponding assets for the NQDC Plan are included in Other Current Assets and Other Assets in the Company's Consolidated Balance Sheets.

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

Income Taxes

The Company calculates and provides for income taxes in each of the tax jurisdictions in which it operates. Deferred tax assets and liabilities, measured using enacted tax rates, are recognized for the future tax consequences of temporary differences between the tax and financial statement basis of assets and liabilities. A valuation allowance reduces the deferred tax assets to the amount that is more likely than not to be realized. The Company establishes liabilities or reduces assets for uncertain tax positions when the Company believes certain tax positions are not more likely than not of being sustained if challenged. Each quarter, the Company evaluates these uncertain tax positions and adjusts the related tax assets and liabilities in light of changing facts and circumstances.

The Company uses financial projections to support its net deferred tax assets, which contain significant assumptions and estimates of future operations. If such assumptions were to differ significantly, it may have a material impact on the Company's ability to realize its deferred tax assets. At the end of each period, the Company will reassess the ability to realize its deferred tax benefits. If it is more likely than not that the Company would not realize the deferred tax benefits, a valuation allowance may need to be established against all or a portion of the deferred tax assets, which will result in a charge to tax expense.

Foreign Currency and Other Hedging Instruments

The Company engages in transactions denominated in foreign currencies and, as a result, is exposed to changes in foreign currency exchange rates. To manage the volatility resulting from fluctuating foreign currency exchange rates, the Company nets a portion of its exposures to take advantage of natural offsets and enters into forward foreign currency exchange contracts for a portion of the remaining exposures.

The Company accounts for its derivative instruments as either assets or liabilities on the balance sheet and measures them at fair value. Derivatives that are not defined as hedging instruments are adjusted to fair value through earnings. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting.

The Company assesses, both at inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting the changes in cash flows of the hedged items. The Company also assesses hedge ineffectiveness on a monthly basis and records the gain or loss related to the ineffective portion to current earnings. If the Company determines that a forecasted transaction is no longer probable of occurring, it discontinues hedge accounting for the affected portion of the hedge instrument, and if the forecasted transaction becomes unlikely to occur, any related unrealized gain or loss on the contract is recognized in current earnings.

See Note 11 to these Consolidated Financial Statements for further information.

Fair Value of Financial Instruments

The Company discloses the fair value of financial instruments for assets and liabilities for which the value is practicable to estimate. The carrying amounts of all cash equivalents, short-term and long-term investments and forward exchange contracts approximate fair value based upon quoted market prices. The fair values of trade accounts

receivables, accounts payable and other financial instruments approximate carrying value due to their short-term nature, and would be considered level 2 items in the fair value hierarchy.

#### Segment Information

The Company currently operates in one business segment focused on the development and commercialization of innovative therapies for people with serious and life threatening rare diseases and medical conditions. The Company is not organized by market and is managed and operated as one business. A single management team reports to the chief operating decision maker who comprehensively manages the entire business. The Company does not operate any separate lines of business or separate business entities with respect to its products. Accordingly, the Company does not accumulate discrete financial information with respect to separate products, other than revenues, and does not have separately reportable segments.

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

Business Combinations

The Company allocates the purchase price of acquired businesses to the tangible and intangible assets acquired and liabilities assumed based upon their estimated fair values on the acquisition date. The purchase price allocation process requires management to make significant estimates and assumptions, especially at the acquisition date with respect to intangible assets and in-process research and development (IPR&D). In connection with the purchase price allocations for acquisitions, the Company estimates the fair value of contingent payments utilizing a probability-based income approach inclusive of an estimated discount rate.

Contingent Acquisition Consideration Payable

The Company determines the fair value of contingent acquisition consideration payable on the acquisition date using a probability-based income approach utilizing an appropriate discount rate. Each reporting period thereafter, the Company revalues these obligations and records increases or decreases in their fair value as adjustments to Intangible Asset Amortization and Contingent Consideration in the Company's Consolidated Statements of Operations. Changes in the fair value of the contingent acquisition consideration payable can result from adjustments to the estimated probability and assumed timing of achieving the underlying milestones, as well as from changes to the discount period and rates.

Comprehensive Income (Loss) and Accumulated Other Comprehensive Income

Comprehensive income (loss) includes net income (loss) and certain changes in stockholders' equity that are excluded from net income (loss), such as changes in unrealized gains and losses on the Company's available-for-sale securities, unrealized gains (losses) on foreign currency hedges and changes in the Company's cumulative foreign currency translation account.

(4) RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Pronouncements Not Yet Adopted

In January 2017, the FASB issued Accounting Standards Update (ASU) No. 2017-04, Goodwill and Other - Simplifying the Test for Goodwill Impairment (ASU 2017-04), which eliminates the requirement to determine the fair value of individual assets and liabilities of a reporting unit to measure goodwill impairment. Under the amendments in the new ASU, goodwill impairment testing will be performed by comparing the fair value of the reporting unit with its carrying amount and recognizing an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The new standard is effective for annual and interim goodwill impairment tests in fiscal years beginning after December 15, 2019, and should be applied on a prospective basis. Early adoption is permitted for annual or interim goodwill impairment testing performed after January 1, 2017, therefore an early election to adopt as of December 31, 2016 is not applicable. The Company will evaluate the potential impact the adoption of ASU



2017-04 will have on its consolidated financial statements when it becomes necessary.

In January 2017, the FASB issued ASU No. 2017-01, Clarifying the Definition of a Business (ASU 2017-01), which is intended to clarify the definition of a business. ASU 2017-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. ASU 2017-01 will be effective for the Company's fiscal year beginning January 1, 2018 unless it elects early adoption. The Company will evaluate the potential impact the adoption of ASU 2017-01 will have on its consolidated financial statements when it becomes necessary. As of December 31, 2016, the Company has not elected to early adopt the amendments of ASU 2017-01.

In February 2016, the FASB issued ASU No. 2016-02, Leases (ASU 2016-02). The amended guidance requires balance sheet recognition of lease assets and liabilities by lessees for leases classified as operating leases, with an option to not recognize lease assets and lease liabilities for leases with a term of 12 months or less. The amendments also require new disclosures providing additional qualitative and quantitative information about the amounts recorded in the financial statements. Lessor accounting is largely unchanged. ASU 2016-02 is effective for

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted, but the Company has not made the election to do so. ASU 2016-02 will be effective for the Company's fiscal year beginning January 1, 2019 unless it elects early adoption. The amendments require a modified retrospective approach with optional practical expedients. The Company is currently evaluating the potential impact the adoption of ASU 2016-02 may have on its consolidated financial statements, however, recognition of additional assets and corresponding liabilities related to operating leases on the Company's Consolidated Balance Sheets is required. See Note 23 to these Consolidated Financial Statements for further details on the Company's operating leases.

In May 2014, the FASB issued ASU No. 2014-09 (ASU 2014-09) regarding Accounting Standards Codification (ASC) Topic 606, Revenue from Contracts with Customers. ASU 2014-09 provides principles for recognizing revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU No. 2015-14 to defer the effective date by one year with early adoption permitted as of the original effective date. ASU 2014-09 will be effective for the Company's fiscal year beginning January 1, 2018. In 2016, the FASB issued several ASUs to help provide interpretive clarifications on the new guidance for ASC Topic 606.

As of December 31, 2016, the Company has not elected early adoption and has not concluded on an adoption method. The Company has formed a task force that is in the process of analyzing the Company's customer contracts and the potential impacts the standard may have on previously reported revenues and future revenues. After completing the analysis of the accounting for the Company's customer contracts under the new revenue standard, the Company will assess the required changes to its accounting policies, systems and internal control over financial reporting. Based on its preliminary analysis of its material contracts with customers, the Company does not anticipate that ASU 2014-09 will have a material impact on its net product revenues for products that are marketed by the Company (e.g., Kuvan, Naglazyme, and Vimizim). The Company is still assessing the application of ASU 2014-09 to its Aldurazyme revenues from Genzyme, which are currently recognized in two components upon delivery and upon sale of the product by Genzyme to third parties. ASU 2014-09 may have an impact on the timing of Aldurazyme revenue recognition, however the Company is in the early stages of its analysis and has not yet concluded on the impact of the new revenue standard on its Aldurazyme revenue recognition.

#### Accounting Pronouncements Adopted

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting (ASU 2016-09), which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early application is permitted and the Company adopted the amendments in ASU 2016-09 during the fourth quarter of fiscal 2016, which required the Company to reflect any adjustments as of January 1, 2016, the beginning of the annual period that includes the interim period of adoption.

The impact of adopting ASU 2016-09 resulted in the following:

• The Company recorded \$15.1 million of tax benefits within income tax expense for the year ended December 31, 2016 related to employee equity award activity. Prior to adoption the excess tax benefit had not been realized through

a reduction in taxes payable. In a small number of states, there had been a benefit to taxes payable and for these states the benefit was recorded as additional paid-in capital. This change could create future volatility in the Company's effective tax rate depending upon the amount of exercise or vesting activity from stock-based awards.

•The Company recorded a \$131.3 million cumulative-effect adjustment to accumulated deficit as of January 1, 2016 related to historical excess tax benefits.

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

•The Company elected to recognize forfeitures as they occur. The cumulative effect adjustment as a result of the adoption of this amendment on a modified retrospective basis was insignificant.

•The Company elected to apply the change in classification of cash flows resulting from excess tax benefits or deficiencies on a retrospective basis. Accordingly, \$2.2 million and \$1.5 million of excess tax benefits previously reported as a cash flow provided by financing activities during the years ended December 31, 2015 and 2014, respectively, have been reclassified to be included in cash flows from operating activities. The reclassification of excess tax benefits on the Consolidated Statements of Cash Flows is not material.

There were no other material impacts to our consolidated financial statements as a result of adopting this updated standard.

## (5) ACQUISITIONS

### The Merck PKU Business

On October 1, 2015, the Company entered into a Termination and Transition Agreement with Ares Trading S.A. (Merck Serono), as amended and restated on December 23, 2015 (the A&R Kuvan Agreement), to terminate the Development, License and Commercialization Agreement, dated May 13, 2005, as amended (the License Agreement), between the Company and Merck Serono, including the license to Kuvan the Company had granted to Merck Serono under the License Agreement. Also on October 1, 2015, the Company and Merck Serono entered into a Termination Agreement (the Pegvaliase Agreement) to terminate the license to pegvaliase the Company had granted to Merck Serono under the License Agreement. On January 1, 2016, pursuant to the A&R Kuvan Agreement and the Pegvaliase Agreement, the Company completed the acquisition from Merck Serono and its affiliates of certain rights and other assets with respect to Kuvan and pegvaliase (the Merck PKU Business). As a result, the Company acquired all global rights to Kuvan and pegvaliase from Merck Serono, with the exception of Kuvan in Japan. Previously, the Company had exclusive rights to Kuvan in the United States (U.S.) and Canada and pegvaliase in the U.S. and Japan. In connection with the acquisition of the Merck PKU Business, the Company recognized transaction costs of \$0.6 million, of which \$0.3 million was recognized in each of the years ended December 31, 2016 and 2015.

Pursuant to the A&R Kuvan Agreement, the Company paid Merck Serono \$374.5 million, in cash and is obligated to pay Merck Serono up to a maximum of €60.0 million, in cash, if future sales milestones are met. Pursuant to the Pegvaliase Agreement, the Company is obligated to pay Merck Serono up to a maximum of €125.0 million, in cash, if future development milestones are met. Merck Serono transferred certain inventory, regulatory materials and approvals, and intellectual property rights to the Company and will perform certain transition services for the Company. As of December 31, 2016, the inventory acquired from Merck Serono has been sold through to customers.

The Company and Merck Serono have no further rights or obligations under the License Agreement with respect to pegvaliase. As of December 31, 2016, the License Agreement, as amended in December 2016, will continue in effect in order for Merck Serono to provide critical transition services for the sales and distribution of Kuvan in four remaining countries until marketing authorizations can be transferred in such countries.

Prior to the consummation of the transactions described above, the Company sold Kuvan to Merck Serono at a price near its manufacturing costs, and Merck Serono resold the product to end users outside the U.S., Canada and Japan. The royalty earned by the Company from Kuvan product sold by Merck Serono was included as a component of Net Product Revenues in the period earned.

Kuvan is a commercialized product for the treatment of patients with phenylketonuria (PKU) and/or for primary BH4 deficiency in certain countries. Pegvaliase is currently in pivotal studies as a potential therapeutic option for adult patients with PKU. In March 2016, the Company announced that its pivotal Phase 3 PRISM-2 study of pegvaliase met the primary endpoint of change in blood Phe compared with placebo ( $p < 0.0001$ ); and the

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

Company also announced its plans to submit a marketing application in the U.S. Kuvan has Orphan Drug exclusivity in the European Union (EU) until 2020, and pegvaliase has Orphan Drug designation in the U.S. and the EU.

The acquisition date fair value of the contingent acquisition consideration payments, Kuvan global marketing rights, with the exception of Japan, and pegvaliase IPR&D acquired was estimated by applying a probability-based income approach utilizing an appropriate discount rate. This estimation was based on significant inputs that are not observable in the market, referred to as level 3 inputs. Key assumptions include a discount rate and various probability factors. The range of outcomes and assumptions used to develop these estimates has been updated to estimate the fair value of the contingent acquisition consideration payable at December 31, 2016. See Note 12 to these Consolidated Financial Statements for additional discussion regarding fair value measurements of the contingent acquisition consideration payable included on the Company's Consolidated Balance Sheet.

The following table presents the final allocation of the purchase consideration for the Merck PKU Business acquisition, including the contingent acquisition consideration payable based on the acquisition date fair value. The allocation of the purchase price below reflects an inventory adjustment in the second quarter of 2016.

Cash payments	\$374,545
Estimated fair value of contingent acquisition consideration payable	138,974
<b>Total consideration</b>	<b>\$513,519</b>

Kuvan intangible assets	\$172,961
Pegvaliase IPR&D	326,359
Inventory	14,199
<b>Total identifiable assets acquired</b>	<b>\$513,519</b>

The amount allocated to the Kuvan intangible assets is considered to be finite-lived and will be amortized on a straight-line basis over its estimated useful life through 2024.

The amount allocated to acquired pegvaliase IPR&D is considered to be indefinite-lived until the completion or abandonment of the associated R&D efforts. During the period the assets are considered indefinite-lived, they will not be amortized but will be tested for impairment on an annual basis and between annual tests if the Company becomes aware of any events occurring or changes in circumstances that would indicate the reduction in the fair value of the IPR&D assets below their respective carrying amounts. When development is complete, which generally occurs if and when regulatory approval to market a product is obtained, the associated assets would be deemed finite-lived and would then be amortized based on their respective estimated useful lives at that point. See Note 7 to these Consolidated Financial Statements for further discussion of the indefinite-lived intangible asset.

## Pro Forma Financial Information

The following unaudited pro forma financial information presents the combined results of operations of the Company and the Merck PKU Business as if the acquisition occurred on January 1, 2015. This unaudited pro forma financial

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information is presented for informational purposes only and is not necessarily indicative of the results of future operations that would have been achieved had the acquisitions taken place at the beginning of 2015.

	2015
Total revenues	\$962,853
Net loss	\$(143,506)
Net loss per share, basic and dilutive	\$(0.90 )
Weighted average common shares outstanding, basic and diluted	160,025

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

## Prosensa Holding N.V.

On January 29, 2015, the Company completed the acquisition of Prosensa Holding N.V. (Prosensa), a public limited liability company organized under the laws of the Netherlands, for a total purchase price of \$751.5 million. Prosensa was an innovative biotechnology company engaged in the discovery and development of ribonucleic acid (RNA)-modulating therapeutics for the treatment of genetic disorders. Prosensa's primary focus was on rare neuromuscular and neurodegenerative disorders with a large unmet medical need, including subsets of patients with Duchenne muscular dystrophy (DMD), myotonic dystrophy and Huntington's disease.

In connection with its acquisition of Prosensa, the Company made cash payments totaling \$680.1 million, which consisted of \$620.7 million for approximately 96.8% of Prosensa's ordinary shares (the Prosensa Shares), \$38.6 million for the options that vested pursuant to the Company's tender offer for the Prosensa Shares and \$20.8 million to the remaining Prosensa shareholders that did not tender their shares under the tender offer. The fair value of non-transferable contingent value rights and acquired in-process research and development (IPR&D) on the acquisition date was \$71.4 million and \$772.8 million, respectively. In connection with the acquisition of Prosensa, the Company recognized transaction costs of \$9.7 million, of which \$7.0 million and \$2.7 million, was recognized in the years ended December 31, 2015 and 2014, respectively.

The following table presents the allocation of the purchase consideration for the Prosensa acquisition based on fair value.

Cash and cash equivalents	\$141,669
Trade accounts receivable	3,086
Other current assets	1,537
Property, plant and equipment	2,683
Intangible assets	497
Other assets	104
Acquired IPR&D	772,808
Total identifiable assets acquired	922,384
Accounts payable and accrued expenses	(68,799 )
Debt assumed	(57,053 )
Deferred tax liability	(193,202)
Total liabilities assumed	(319,054)
Net identifiable assets acquired	603,330
Goodwill	148,134
Net assets acquired	\$751,464

See Note 7 to these Consolidated Financial Statements for further discussion of the indefinite-lived intangible assets.

The deferred tax liability relates to the tax impact of future amortization or possible impairments associated with the identified intangible assets acquired, which are not deductible for tax purposes.



Prosensa's results of operations prior to and since the acquisition date are insignificant to the Company's Consolidated Financial Statements.

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

## (6) INVESTMENTS

All investments were classified as available-for-sale at December 31, 2016 and 2015. The amortized cost, gross unrealized holding gains or losses, and fair value of the Company's available-for-sale securities by major security type at December 31, 2016 and 2015 are summarized in the tables below:

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Aggregate Fair Value at December 31, 2016
Certificates of deposit	\$2,800	\$ —	\$ —	\$ 2,800
Corporate debt securities	633,072	329	(2,277 )	631,124
Commercial paper	16,075	—	—	16,075
U.S. government agency securities	304,635	37	(747 )	303,925
Greek government-issued bonds	48	86	—	134
Total	\$956,630	\$ 452	\$ (3,024 )	\$ 954,058

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Aggregate Fair Value at December 31, 2015
Certificates of deposit	\$63,919	\$ 1	\$ —	\$ 63,920
Corporate debt securities	358,625	20	(732 )	357,913
Commercial paper	12,733	—	—	12,733
U.S. government agency securities	186,882	—	(344 )	186,538
Greek government-issued bonds	48	79	—	127
Total	\$622,207	\$ 100	\$ (1,076 )	\$ 621,231

As of December 31, 2016, the Company had one investment in marketable equity securities measured using quoted prices in its active market that is considered a strategic investment. During 2016, shares of strategic investments were sold for net realized losses of \$0.1 million. As of December 31, 2016, the fair value of the Company's strategic investment of \$4.1 million included an unrealized gain of \$2.3 million. As of December 31, 2015, the fair value of the Company's strategic investments of \$18.1 million included an unrealized gain of \$12.7 million. Strategic investments are recorded in Other Assets in the Company's Consolidated Balance Sheets.

The fair values of available-for-sale securities by contractual maturity were as follows:

	December 31,	
	2016	2015
Maturing in one year or less	\$381,347	\$195,579
Maturing after one year through five years	572,711	425,652
Total	\$954,058	\$621,231

Impairment assessments are made at the individual security level each reporting period. When the fair value of an investment is less than its cost at the balance sheet date, a determination is made as to whether the impairment is other-than-temporary and, if it is other-than-temporary, an impairment loss is recognized in earnings equal to the difference between the investment's amortized cost and fair value at such date. As of December 31, 2016, some of the Company's investments were in an unrealized loss position. However, the Company has the ability and intent to hold all investments that have been in a continuous loss position until maturity or recovery, thus no other-than-temporary impairment is deemed to have occurred.

See Note 12 to these Consolidated Financial Statements for additional discussion regarding the fair value of the Company's available-for-sale securities.

## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

## (7) INTANGIBLE ASSETS

Intangible assets consisted of the following:

	December 31,	
	2016	2015
Intangible assets:		
Finite-lived intangible assets	\$305,122	\$129,572
Indefinite-lived intangible assets	332,199	607,548
Gross intangible assets:	637,321	737,120
Less: Accumulated amortization	(83,541 )	(53,124 )
Net carrying value	\$553,780	\$683,996

## Finite-Lived Intangible Assets

The following table summarizes the net-book-value and estimated remaining life of the Company's finite-lived intangible assets as of December 31, 2016:

	Net Balance at December 31,	
	2016	Average Remaining Life
Repurchased royalty rights	\$ 46,688	6.9 years
Acquired intellectual property	172,256	8.1 years
License payments for marketing approvals	1,869	4.9 years
SRCC in-place and above market tenant leases	768	Remaining lease terms
Total	\$ 221,581	

As of December 31, 2016, the estimated future amortization expense associated with the Company's finite-lived intangible assets for each of the five succeeding fiscal years is as follows:

Fiscal Year	Amount
2017	\$30,430
2018	30,400

2019	30,086
2020	27,605
2021	26,681
Thereafter	76,379
	\$221,581

## Indefinite-Lived Intangible Assets

Indefinite-lived intangible assets consisted of the following:

	December 31,	
	2016	2015
In-Process Research and Development:		
Pegvaliase	\$326,359	\$—
Kyndrisa	—	533,064
Other exons acquired with Prosensa	—	41,044
Reveglucosidase alfa	—	25,010
Other acquired pre-clinical compounds	5,840	8,430
Net carrying value	\$332,199	\$607,548

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

Intangible assets related to IPR&D assets are considered to be indefinite-lived until the completion or abandonment of the associated R&D efforts. During the period the assets are considered indefinite-lived, they will not be amortized but will be tested for impairment on an annual basis and between annual tests if the Company becomes aware of any events occurring or changes in circumstances that would indicate a reduction in the fair value of the IPR&D assets below their respective carrying amounts. If and when development is complete, which generally occurs if and when regulatory approval to market a product is obtained, the associated assets would be deemed finite-lived and would then be amortized based on their respective estimated useful lives at that point in time.

Related to the Kyndrisa and other exon IPR&D assets, the Company recorded impairment charges of \$198.7 million in the fourth quarter of 2015 and impairment charges of \$574.1 million in the second quarter of 2016 based on the status of development efforts. These impairments reduced the remaining book value to zero due to the termination of the programs. The Company also recognized an impairment charge of \$25.0 million in the second quarter of 2016 related to the reveglucosidase alfa IPR&D assets due to the decision to terminate that development program.

In 2015, the Company completed the sale of talazoparib to Medivation Inc. (Medivation). Pursuant to the Asset Purchase Agreement, Medivation paid the Company an upfront payment of \$410.0 million upon the closing of the transaction. In addition, contingent upon the successful development and commercialization of talazoparib, Medivation will pay the Company milestone payments of up to \$160.0 million and mid-single digit percentage royalties on net sales of talazoparib. During the fourth quarter of 2015, the Company recognized a net gain of \$369.5 million related to the sale of the talazoparib intangible assets.

## (8) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, net consisted of the following:

	December 31,	
	2016	2015
Building and improvements	\$510,805	\$442,100
Manufacturing and laboratory equipment	242,899	145,313
Computer hardware and software	129,506	113,442
Leasehold improvements	44,184	44,247
Furniture and equipment	27,229	22,817
Land improvements	4,881	4,881
Land	55,412	45,727
Construction-in-progress	126,446	164,283

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	1,141,362	982,810
Less: Accumulated depreciation	(342,594 )	(278,603 )
Total property, plant and equipment, net	\$798,768	\$704,207

The construction-in-process balance primarily includes costs related to the Company's significant in-process projects at its facilities in Marin County, California, and its manufacturing facility in Shanbally, Cork, Ireland.

Depreciation for the years ended December 31, 2016, 2015 and 2014 was \$73.2 million, \$50.1 million and \$44.3 million, respectively, of which \$17.4 million, \$14.6 million and \$11.0 million was capitalized into inventory, respectively.

Capitalized interest related to the Company's property, plant and equipment purchases for each of the three years ended December 31, 2016 was insignificant.

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

## (9) INVENTORY

Inventory consisted of the following:

	December 31,	
	2016	2015
Raw materials	\$51,250	\$46,115
Work-in-process	167,788	150,289
Finished goods	136,088	75,279
Total inventory	\$355,126	\$271,683

In the first quarter of 2016, process qualification production activities commenced in the Company's Shanbally facility related to Vimizim production. As of December 31, 2016, the value of the qualification campaign was \$30.0 million, which was capitalized as inventory because the product is expected to be sold commercially. While the Company believes it is unlikely that the manufacturing process will not be approved for Vimizim production, should that occur, the value of the inventory would be expensed at that time.

Inventory as of December 31, 2016 included \$39.1 million of pre-launch Brineura (formerly referred to as cerliponase alfa) inventory for production that commenced in the second quarter of 2016. Brineura is an investigational therapy to treat children with CLN2 disease, or late infantile neuronal ceroid lipofuscinosis, a lysosomal storage disorder primarily affecting the brain. The Company must receive marketing approval from the applicable regulators before the Brineura inventory can be sold commercially. Although regulatory approval cannot be assured, the Company expects to receive regulatory approval and realize the costs of the inventory through future sales. The Company believes that all material uncertainties related to the ultimate regulatory approval of Brineura for commercial sale have been significantly reduced based on positive data from Phase I/II clinical trial results and the filings of Biologics License Application (BLA) with the Food and Drug Administration (FDA) and the MAA with the European Medicines Agency (EMA) during the second quarter of 2016. In its evaluation, the Company also considered its historical experience with developing and commercially producing similar products for rare genetic disorders.

## (10) SUPPLEMENTAL BALANCE SHEET INFORMATION

Other assets consisted of the following:



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	December 31,	
	2016	2015
Deposit for business acquisition	\$—	\$371,756
Deposits	10,722	8,606
Strategic investments	4,064	18,056
Long-term forward foreign currency exchange		
contract assets	8,194	3,533
Other	9,835	6,693
Total other assets	\$32,815	\$408,644

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

Accounts payable and accrued liabilities consisted of the following:

	December 31,	
	2016	2015
Accounts payable and accrued operating expenses	\$ 191,353	\$ 179,294
Accrued compensation expense	109,038	95,345
Accrued rebates payable	34,737	32,553
Accrued royalties payable	15,151	10,412
Value added taxes payable	7,848	6,377
Accrued income taxes	—	59,572
Other	12,378	8,958
Total accounts payable and accrued liabilities	\$ 370,505	\$ 392,511

The roll forward of significant estimated accrued rebates, reserve for cash discounts and allowance for doubtful accounts for the years ended December 31, 2016, 2015 and 2014 were as follows:

	Balance at	Provision	Provision/	Actual Charges	Actual Charges	Balance at
	Beginning	for Current	(Reversals)	Related to	Related to	End of
	of Period	Period Sales	for Prior	Current	Prior Period	Period
	of Period	Period Sales	Period Sales	Period Sales	Sales	Period
Year ended December 31, 2016:						
Accrued rebates	\$ 32,553	\$ 44,347	\$ (5,205 )	\$ (23,879 )	\$ (13,079 )	\$ 34,737
Reserve for cash discounts	831	8,889	(22 )	(8,160 )	(650 )	888
Sales return reserve	40	—	(40 )	—	—	—
Allowance for doubtful accounts	93	—	(20 )	—	—	73
Year ended December 31, 2015:						
Accrued rebates	\$ 14,859	\$ 45,356	\$ (1,245 )	\$ (18,421 )	\$ (7,996 )	\$ 32,553
Reserve for cash discounts	688	7,402	—	(6,722 )	(537 )	831
Sales return reserve	—	40	—	—	—	40
Allowance for doubtful accounts	490	—	(397 )	—	—	93
Year ended December 31, 2014:						
Accrued rebates	\$ 10,429	\$ 24,431	\$ (1,159 )	\$ (12,768 )	\$ (6,074 )	\$ 14,859
Reserve for cash discounts	388	6,435	—	(5,747 )	(388 )	688

Sales return reserve	907	—	(907	)	—	—	—
Allowance for doubtful accounts	529	410	(319	)	—	(130	) 490

## (11) DERIVATIVE INSTRUMENTS AND HEDGING STRATEGIES

## Foreign Currency Exchange Rate Exposure

The Company uses forward foreign currency exchange contracts to hedge certain operational exposures resulting from potential changes in foreign currency exchange rates. Such exposures result from portions of the Company's forecasted revenues and operating expenses being denominated in currencies other than the U.S. dollar, primarily the Euro.

The Company designates certain of these forward foreign currency exchange contracts as hedging instruments and enters into some forward foreign currency exchange contracts that are considered to be economic hedges that are not designated as hedging instruments. Whether designated or undesignated, these forward foreign currency exchange contracts protect against the reduction in value of forecasted foreign currency cash flows resulting from product revenues, royalty revenues, operating expenses and asset or liability positions designated in currencies other than the U.S. dollar. The fair values of forward foreign currency exchange contracts are estimated using current

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

exchange rates and interest rates, and take into consideration the current creditworthiness of the counterparties or the Company, as applicable. Information regarding the specific instruments used by the Company to hedge its exposure to foreign currency exchange rate fluctuations is provided below. See Note 12 to these Consolidated Financial Statements for additional discussion regarding the fair value of forward foreign currency exchange contracts.

The Company enters into forward foreign currency exchange contracts in order to protect against the fluctuations in revenue and operating expenses associated with foreign currency-denominated cash flows. The Company has formally designated these forward foreign currency exchange contracts as cash flow hedges and expects them to be highly effective in offsetting fluctuations in operating expenses denominated in Euros and revenues denominated in currencies other than the U.S. dollar related to changes in foreign currency exchange rates.

The following table summarizes the Company's designated forward foreign currency exchange contracts outstanding as of December 31, 2016 (notional amounts in millions):

	Number of Contracts	Aggregate Notional Amount in Foreign Currency	Maturity
Foreign Exchange Contracts			
Euros - Purchase	82	104.2	Jan. 2017 - Dec. 2019
Euros - Sell	311	340.2	Jan. 2017 - Dec. 2019
Canadian Dollars - Sell	24	23.3	Jan. 2017 - Dec. 2017
Colombian Pesos - Sell	12	62,304.0	Jan. 2017 - Dec. 2017
Brazilian Reais - Sell	3	64.5	May 2017
Total	432		

The maximum length of time over which the Company is hedging its exposure to the reduction in value of forecasted foreign currency revenues through forward foreign currency exchange contracts is through December 2019. Over the next twelve months, the Company expects to reclassify \$7.1 million from Accumulated Other Comprehensive Income to earnings as the forecasted revenue and operating expense transactions occur.

The Company also enters into forward foreign currency exchange contracts that are not designated as hedges for accounting purposes. The changes in fair value of these forward foreign currency exchange contracts are included as a part of selling, general and administrative (SG&A) expense in the Company's Consolidated Statements of Comprehensive Loss.

The following table summarizes the Company's non-designated forward foreign currency exchange contracts outstanding as of December 31, 2016 (notional amounts in millions):

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		Aggregate Notional Amount in	
Foreign Exchange Contracts	Number of Contracts	Foreign Currency	Maturity
Euros - Purchase	1	94.9	January 2017
British Pounds - Sell	1	2.7	January 2017
Total	2		

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

The fair value carrying amounts of the Company's derivative instruments were as follows:

	Asset Derivatives December 31, 2016 Balance Sheet Location	Fair Value	Liability Derivatives December 31, 2016 Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:				
Forward foreign currency exchange contracts	Other current assets	\$ 13,048	Accounts payable & accrued liabilities	\$ 5,176
Forward foreign currency exchange contracts				
	Other assets	8,194	Other long- term liabilities	2,342
Total		\$ 21,242		\$ 7,518
Derivatives not designated as hedging instruments:				
Forward foreign currency exchange contracts	Other current assets	\$ 964	Accounts payable & accrued liabilities	\$ 25
Total		964		25
Total value of derivative contracts		\$ 22,206		\$ 7,543

	Asset Derivatives December 31, 2015 Balance Sheet Location	Fair Value	Liability Derivatives December 31, 2015 Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:				
Forward foreign currency exchange contracts	Other current assets	\$ 10,478	Accounts payable & accrued liabilities	\$ 1,986
Forward foreign currency exchange contracts				
	Other assets	3,533	Other long- term liabilities	3,057
Total		\$ 14,011		\$ 5,043
Derivatives not designated as hedging				

instruments:				
Forward foreign currency exchange			Accounts payable &	
contracts	Other current assets	\$ —	accrued liabilities	\$ 22
Total		—		22
Total value of derivative contracts		\$ 14,011		\$ 5,065

The effect of the Company's derivative instruments on the Consolidated Financial Statements for the years ended December 31, 2016, 2015 and 2014 was as follows:

	Years Ended December 31,		
	2016	2015	2014
<b>Derivatives Designated as Hedging Instruments:</b>			
Net gain recognized in Other Comprehensive Income (OCI) <sup>(1)</sup>	\$9,677	\$17,300	\$18,078
Net gain reclassified from accumulated OCI into earnings <sup>(2)</sup>	6,529	19,604	643
Net gain (loss) recognized in net loss <sup>(3)</sup>	5,070	(727 )	(294 )
<b>Derivatives Not Designated as Hedging Instruments:</b>			
Net gain (loss) recognized in net loss <sup>(4)</sup>	\$(8,687)	\$4,493	\$8,010

(1) Net change in the fair value of the effective portion classified as OCI.

(2) Effective portion classified as Net Product Revenues and SG&A expense.

(3) Ineffective portion and amount excluded from effectiveness testing classified as SG&A expense.

(4) Classified as SG&A expense.

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

At December 31, 2016, 2015 and 2014, accumulated other comprehensive income before taxes associated with forward foreign currency exchange contracts qualifying for hedge accounting treatment was a gain of \$13.0 million, \$13.6 million and \$15.9 million, respectively.

The Company is exposed to counterparty credit risk on all of its derivative financial instruments. The Company has established and maintains strict counterparty credit guidelines and enters into hedges only with financial institutions that are investment grade or better to minimize the Company's exposure to potential defaults. The Company does not require collateral to be pledged under these agreements.

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

## (12) FAIR VALUE MEASUREMENTS

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including available-for-sale fixed income securities and foreign currency derivatives.

The tables below present the fair value of these financial assets and liabilities determined using the following input levels.

Fair Value Measurements at December 31, 2016				
Quoted Price in				
	Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Cash and cash equivalents:				
Overnight deposits	\$235,571	\$ —	\$ —	\$235,571
Money market instruments	—	172,759	—	172,759
Total cash and cash equivalents	235,571	172,759	—	408,330
Available-for-sale securities:				
Short-term:				
Certificates of deposit	—	2,800	—	2,800
Corporate debt securities	—	193,974	—	193,974
Commercial paper	—	16,075	—	16,075
U.S. government agency securities	—	168,499	—	168,499
Long-term:				
Corporate debt securities	—	437,150	—	437,150
U.S. government agency securities	—	135,426	—	135,426
Greek government-issued bonds	—	134	—	134
Total available-for-sale securities	—	954,058	—	954,058
Other Current Assets:				
Nonqualified Deferred Compensation Plan assets	—	163	—	163
Forward foreign currency exchange contract <sup>(1)</sup>	—	14,012	—	14,012
Restricted investments <sup>(2)</sup>	—	3,754	—	3,754
Total other current assets	—	17,929	—	17,929

## Other Assets:

Nonqualified Deferred Compensation Plan assets	—	9,121	—	9,121
Forward foreign currency exchange contract <sup>(1)</sup>	—	8,194	—	8,194
Strategic investment <sup>(3)</sup>	4,064	—	—	4,064
Total other assets	4,064	17,315	—	21,379
Total assets	\$239,635	\$ 1,162,061	\$ —	\$1,401,696

## Liabilities:

## Current Liabilities:

## Nonqualified Deferred Compensation Plan

liability	\$2,073	\$ 163	\$ —	\$2,236
Forward foreign currency exchange contract <sup>(1)</sup>	—	5,201	—	5,201
Contingent acquisition consideration payable	—	—	46,327	46,327
Total current liabilities	2,073	5,364	46,327	53,764

## Other long-term liabilities:

## Nonqualified Deferred Compensation Plan

liability	17,303	9,121	—	26,424
Forward foreign currency exchange contract <sup>(1)</sup>	—	2,342	—	2,342
Contingent acquisition consideration payable	—	—	115,310	115,310
Total other long-term liabilities	17,303	11,463	115,310	144,076
Total liabilities	\$19,376	\$ 16,827	\$ 161,637	\$197,840

## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

Fair Value Measurements at December 31, 2015				
Quoted Price in				
	Active Markets	Significant Other	Significant	
	For Identical	Observable	Unobservable	
	Assets	Inputs	Inputs	
	(Level 1)	(Level 2)	(Level 3)	Total
Assets:				
Cash and cash equivalents:				
Overnight deposits	\$ 290,731	\$ —	\$ —	\$ 290,731
Money market instruments	—	106,309	—	106,309
Total cash and cash equivalents	290,731	106,309	—	397,040
Available-for-sale securities:				
Short-term:				
Certificates of deposit	—	56,951	—	56,951
Corporate debt securities	—	42,673	—	42,673
Commercial paper	—	12,733	—	12,733
U.S. government agency securities	—	83,222	—	83,222
Long-term:				
Certificates of deposit	—	6,969	—	6,969
Corporate debt securities	—	315,240	—	315,240
U.S. government agency securities	—	103,316	—	103,316
Greek government-issued bonds	—	127	—	127
Total available-for-sale securities	—	621,231	—	621,231
Other Current Assets:				
Nonqualified Deferred Compensation Plan assets	—	440	—	440
Forward foreign currency exchange contract <sup>(1)</sup>	—	10,478	—	10,478
Restricted investments <sup>(2)</sup>	—	7,348	—	7,348
Total other current assets	—	18,266	—	18,266
Other Assets:				
Nonqualified Deferred Compensation Plan assets	—	6,362	—	6,362
Forward foreign currency exchange contract <sup>(1)</sup>	—	3,533	—	3,533
Strategic investment <sup>(3)</sup>	18,056	—	—	18,056
Total other assets	18,056	9,895	—	27,951
Total assets	\$ 308,787	\$ 755,701	\$ —	\$ 1,064,488
Liabilities:				
Current Liabilities:				
Nonqualified Deferred Compensation Plan	\$ 1,151	\$ 440	\$ —	\$ 1,591

liability				
Forward foreign currency exchange contract <sup>(1)</sup>	—	2,008	—	2,008
Contingent acquisition consideration payable	—	—	52,946	52,946
Total current liabilities	1,151	2,448	52,946	56,545
Other long-term liabilities:				
Nonqualified Deferred Compensation Plan				
liability	24,341	6,362	—	30,703
Forward foreign currency exchange contract <sup>(1)</sup>	—	3,057	—	3,057
Contingent acquisition consideration payable	—	—	32,663	32,663
Total other long-term liabilities	24,341	9,419	32,663	66,423
Total liabilities	\$25,492	\$ 11,867	\$ 85,609	\$122,968

- (1) See Note 11 to these Consolidated Financial Statements for further information regarding the derivative instruments.
- (2) The restricted investments at December 31, 2016 and 2015 secure the Company's irrevocable standby letter of credit obtained in connection with certain commercial agreements.
- (3) The Company has investments in marketable equity securities measured using quoted prices in an active market that are considered strategic investments. See Note 6 to these Consolidated Financial Statements for additional discussion regarding the Company's strategic investments.

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

There were no transfers between levels during the year ended December 31, 2016.

The Company's Level 2 securities are valued using third-party pricing sources. The pricing services utilize industry standard valuation models, including both income and market-based approaches, for which all significant inputs are observable, either directly or indirectly, to estimate fair value. These inputs include reported trades of and broker/dealer quotes on the same or similar securities, issuer credit spreads, benchmark securities, prepayment/default projections based on historical data and other observable inputs.

The Company validates the prices provided by its third-party pricing services by understanding the models used, obtaining market values from other pricing sources, analyzing pricing data in certain instances and confirming those securities traded in active markets. See Note 6 to these Consolidated Financial Statements for further information regarding the Company's financial instruments.

Liabilities measured at fair value using Level 3 inputs consisted of contingent acquisition consideration payable and asset retirement obligations.

The Company's contingent acquisition consideration payable is estimated using a probability-based income approach utilizing an appropriate discount rate. Key assumptions used by management to estimate the fair value of contingent acquisition consideration payable include estimated probabilities, the estimated timing of when a milestone may be attained and assumed discount periods and rates. Subsequent changes in the fair value of the contingent acquisition consideration payable, resulting from management's revision of key assumptions, will be recorded in Intangible Asset Amortization and Contingent Consideration in the Company's Consolidated Statements of Operations. The probability-based income approach used by management to estimate the fair value of the contingent acquisition consideration is most sensitive to changes in the estimated probabilities.

Contingent acquisition consideration payable at	
December 31, 2015	\$85,609
Addition of contingent acquisition consideration payable related to	
the purchase of the Merck PKU Business	138,974
Changes in the fair value of contingent acquisition	
consideration payable for continuing development programs	6,825
Reduction of fair value related to termination of Kyndrisa	
development program	(43,652 )
Reduction of fair value related to termination of	
reveglucosidase alfa development program	(20,334 )
Foreign exchange remeasurement of Euro denominated contingent	(5,785 )

acquisition consideration payable	
Contingent acquisition consideration payable at	
December 31, 2016	\$ 161,637

Under certain of the Company's lease agreements, the Company is contractually obligated to return leased space to its original condition upon termination of the lease agreement. The Company records an asset retirement obligation liability and a corresponding capital asset in an amount equal to the estimated fair value of the obligation, when estimable. In subsequent periods, for each such lease, the Company records interest expense to accrete the asset retirement obligation liability to full value and depreciates each capitalized asset retirement obligation asset, both over the term of the associated lease agreement.

Asset retirement obligations at December 31, 2015	\$4,704
Accretion expense	107
Additions	—
Settlements and reversals	(665 )
Asset retirement obligations at December 31, 2016	\$4,146

BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

The Company acquired intangible assets as a result of various business acquisitions. The estimated fair value of these long-lived assets was measured using Level 3 inputs as of the acquisition date.

(13) DEBT

2018/2020 Convertible Notes

On October 15, 2013, the Company issued \$750.0 million in aggregate principal amount of senior subordinated convertible notes consisting of \$375.0 million in aggregate principal amount of 0.75% senior subordinated convertible notes due in October 2018 (the 2018 Notes) and \$375.0 million in aggregate principal amount of 1.50% senior subordinated convertible notes due in October 2020 (the 2020 Notes and, together with the 2018 Notes, the Notes). Net proceeds from the offering were \$726.2 million.

The 2018 Notes and the 2020 Notes bear interest at a rate of 0.75% and 1.5% per year, respectively, which is payable semiannually in arrears on April 15 and October 15 of each year.

The Notes are senior unsecured obligations, and rank (i) subordinated to any of the Company's existing and future unsecured senior debt, (ii) equally to any of the Company's existing and future senior subordinated debt, (iii) senior to any of the Company's future indebtedness that is expressly subordinated to the Notes, and (iii) effectively junior to any secured indebtedness to the extent of the value of the assets securing such indebtedness. Upon the occurrence of a "fundamental change", as defined in the indenture, the holders may require the Company to repurchase all or a portion of the Notes for cash at 100% of the principal amount of the Notes being purchased, plus any accrued and unpaid interest.

The Notes are convertible into 7,965,975 shares of the Company's common stock under certain circumstances prior to maturity at a conversion rate of 10.6213 shares per \$1,000 principal amount of the Notes, which represents a conversion price of \$94.15 per share, subject to adjustment under certain conditions. Holders may convert their notes at their option at any time prior to July 15, 2018, in the case of the 2018 Notes, and July 15, 2020, in the case of the 2020 Notes, only under the following circumstances: (1) during any calendar quarter commencing after the calendar quarter ending on March 31, 2014 (and only during such calendar quarter), if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any five consecutive trading day period (the measurement period) in which the trading price per \$1,000 principal amount of the relevant notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the applicable conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events.

Upon conversion, the Company may pay cash, shares of the Company's common stock or a combination of cash and stock, as determined by the Company in its discretion.

The Company has separately accounted for the liability and equity components of the Notes by allocating the proceeds from issuance of the Notes between the liability component and the embedded conversion option, or equity component. This allocation was done by first estimating an interest rate at the time of issuance for similar notes that do not include the embedded conversion option. The Company allocated \$156.2 million to the equity component, net of offering costs of \$5.1 million. The Company recorded a discount on the notes of \$161.3 million which will be accreted and recorded as additional interest expense over the life of the Notes. Additionally, in connection with the issuance of the Notes, the Company incurred \$23.8 million of issuance costs, which are being amortized and recorded as additional interest expense over the life of the Notes. The effective interest rate on the liability component of the Notes for the years ended December 31, 2016, 2015 and 2014 was 7.5%, 7.3% and 7.5%.

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

The following table summarizes the additional interest expense recognized for the accretion of the debt discount and amortization of the deferred offering costs.

	Years Ended December 31,		
	2016	2015	2014
Convertible Notes due 2018			
Amortization of issuance costs	\$1,931	\$1,921	\$1,910
Accretion of discount on convertible notes	14,337	13,633	12,963
Convertible Notes due 2020			
Amortization of issuance costs	1,288	1,283	1,279
Accretion of discount on convertible notes	12,240	11,567	10,930
Total	\$29,796	\$28,404	\$27,082

To minimize the impact of potential dilution upon conversion of the 2018 Notes and the 2020 Notes, the Company entered into capped call transactions separate from the issuance of the Notes with certain counterparties covering 3,982,988 shares of the Company's common stock, subject to adjustment. The capped calls have a strike price of \$94.15 and a cap price of \$121.05 and are exercisable when and if the Notes are converted. If upon conversion of the Notes, the price of the Company's common stock is above the strike price of the capped calls, the counterparties will deliver shares of the Company's common stock and/or cash with an aggregate value equal to the difference between the price of the Company's common stock at the conversion date and the strike price, multiplied by the number of shares of the Company's common stock related to the capped calls being exercised. The Company paid \$29.8 million for these capped calls transactions, which was recorded as additional paid-in capital.

## 2017 Convertible Notes

In April 2007, the Company sold \$324.9 million in aggregate principal amount of senior subordinated convertible notes due in April 2017 (the 2017 Notes). The 2017 Notes were issued at face value and bear interest at the rate of 1.875% per annum, payable semi-annually in cash. The 2017 Notes are convertible, at the option of the holder, at any time prior to maturity or redemption, into shares of the Company's common stock at a conversion price of \$20.36 per share, subject to adjustment in certain circumstances. The 2017 Notes do not include a call provision and the Company is unable to unilaterally redeem the 2017 Notes prior to maturity on April 23, 2017. The Company also must repay the 2017 Notes if there is a qualifying change in control or termination of trading of its common stock. If a change of control occurs, the Company will pay a make whole premium by increasing the conversion rate applicable to the 2017 Notes.

In connection with the placement of the 2017 Notes, the Company paid \$8.5 million in offering costs, which have been deferred and are presented as a direct reduction of the outstanding 2017 Notes. The deferred offering costs are being amortized as interest expense over the life of the debt. For the year ended December 31, 2016, the Company recognized amortization expense of \$0.1 million, compared to \$0.1 million and \$0.1 million for the years ended December 31, 2015 and 2014, respectively.

During 2016, certain existing holders of the Company's senior subordinated notes due in 2017 elected to convert \$8.9 million in aggregate principal amount of the 2017 Notes into 438,462 shares of the Company's common stock. During 2015, the Company entered into separate agreements with three existing holders of its senior subordinated convertible notes due in 2017 pursuant to which such holders converted \$8.1 million in aggregate principal amount of the 2017 Notes into 399,469 share of the Company's common stock. In addition to issuing the requisite number of the Company's common stock, the Company also made varying cash payments to the holders totaling \$0.2 million in the aggregate, which was recognized as Debt Conversion Expense on the Consolidated Statement of Operations for the year ended December 31, 2015. During 2014, the Company entered into two separate agreements with an existing holder of its senior subordinated convertible notes due in 2017 pursuant to which such holder converted \$16.5 million in aggregate principal amount of the 2017 Notes into 809,351 shares of the Company's common stock. In addition to issuing the requisite number of shares of the Company's common stock, the Company also made varying cash payments to the holder totaling \$0.7 million in aggregate, of which \$0.7

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

million was recognized in total as Debt Conversion Expense on the Consolidated Statement of Operations for the year ended December 31, 2014.

The following table summarizes information regarding the Company's convertible debt at December 31:

	2016	2015
Convertible Notes due 2017	\$22,503	\$31,430
Unamortized deferred offering costs	(25 )	(110 )
Convertible Notes due 2017, net	22,478	31,320
Convertible Notes due 2018	374,980	374,980
Unamortized discount	(27,566 )	(41,904 )
Unamortized deferred offering costs	(3,484 )	(5,415 )
Convertible Notes due 2018, net	343,930	327,661
Convertible Notes due 2020	374,993	374,993
Unamortized discount	(53,239 )	(65,478 )
Unamortized deferred offering costs	(4,923 )	(6,210 )
Convertible Notes due 2020, net	316,831	303,305
Total convertible debt, net	\$683,239	\$662,286
Fair value of fixed rate convertible debt		
Convertible Notes due in 2017 <sup>(1)</sup>	\$90,977	\$162,016
Convertible Notes due in 2018 <sup>(1)</sup>	423,202	482,584
Convertible Notes due in 2020 <sup>(1)</sup>	442,754	502,701
Total	\$956,933	\$1,147,301

(1) The fair value of the Company's fixed rate convertible debt is based on open market trades and is classified as Level 1 in the fair value hierarchy.

See Note 14 to these Consolidated Financial Statements for further discussion of the effect of conversion on net loss per common share.

## Revolving Credit Facility

In November 2016, the Company entered into a credit agreement (Credit Agreement) with Bank of America, N.A., as the administrative agent, swing line lender and letter of credit issuer. The Credit Agreement provides for up to \$100.0 million (Revolving Credit Facility), a \$10.0 million letter of credit subfacility and a \$15.0 million swing line loan subfacility. The maturity date of the Revolving Credit Facility will occur on November 29, 2018. Interest on any outstanding balance of the Revolving Credit Facility is payable quarterly and draws may be voluntary prepaid at any time without penalty. In connection with entering into the Credit Agreement, \$0.6 million in financing costs was

incurred and will be amortized as Interest Expense over the term of the Credit Agreement. As of December 31, 2016, there were no outstanding amounts due under the Revolving Credit Facility.

In connection with the Revolving Credit Facility, the Company and certain of its subsidiaries are required to comply with covenants, including, among other things, restrictions on the Company's and such subsidiaries' ability to incur additional indebtedness, dispose of its assets, incur liens, make investments, and pay dividends or other distributions, in each case subject to specified exceptions. The Credit Agreement also contains customary indemnification obligations and customary events of default. If the Company's Global Liquidity, which is defined as the sum of the market value of unrestricted cash, marketable securities and other assets to the extent constituting "cash and cash equivalents," "short-term investments" or "long-term investments" as reflected in the Company's Consolidated Balance Sheet, in each case, held by the Company or certain of the Company's subsidiaries at such

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

time, regardless of where such assets are domiciled, falls below \$225.0 million at the end of any month or at the time of any borrowing or issuance of a letter of credit under the Revolving Credit Facility, then the Company's obligations under the Credit Agreement will also be secured by the assets held by the Company in the custody account. The custody account will be established in the first quarter of 2017. As of December 31, 2016, the Company and certain of its subsidiaries that serve as guarantors are in compliance with all covenants.

Interest expense on the Company's debt consisted of the following:

	Years Ended December 31,		
	2016	2015	2014
Coupon interest	\$9,555	\$9,750	\$9,417
Amortization of debt issuance costs	3,367	3,294	3,332
Accretion of discount on convertible notes	26,577	25,200	23,893
Total interest expense on convertible debt	\$39,499	\$38,244	\$36,642

## (14) NET LOSS PER COMMON SHARE

Potentially issuable shares of common stock include shares issuable upon the exercise of outstanding employee stock option awards, common stock issuable under the Company's ESPP, unvested restricted stock units (RSUs), common stock held by the NQDC and contingent issuances of common stock related to convertible debt.

The following table sets forth the computation of basic and diluted earnings per common share (in thousands of common shares):

	Years Ended December 31,		
	2016	2015	2014
Numerator:			
Net loss, basic	\$(630,210)	\$(171,799)	\$(133,969)
Gain on common stock held by the NQDC	(3,184 )	—	—
Net loss, diluted	(633,394)	(171,799)	(133,969)
Denominator:			
Weighted-average common shares outstanding, basic	165,985	160,025	146,349
Effect of dilutive securities:			
Common shares held by the NQDC	234	—	—
Weighted-average common shares outstanding, diluted	166,219	160,025	146,349
Net loss per common share, basic	\$(3.80 )	\$(1.07 )	\$(0.92 )

Net loss per common share, diluted	\$(3.81	) \$(1.07	) \$(0.92	)
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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

In addition to the equity instruments included in the table above, the table below presents potential shares of common stock that were excluded from the computation as they were anti-dilutive using the treasury stock method (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Options to purchase common stock	8,856	10,323	11,477
Common stock issuable under the 2017 Notes	1,105	1,544	1,992
Common stock issuable under the 2018 and 2020			
Notes	7,966	7,966	7,966
Unvested restricted stock units	2,618	1,743	1,244
Common stock potentially issuable for ESPP			
purchases	246	316	351
Common stock held by the NQDC	—	243	224
Total number of potentially issuable shares	20,791	22,135	23,254

The effect of the Company's 0.7% senior subordinated convertible notes due in 2018 (the 2018 Notes) and the Company's 1.50% senior subordinated convertible notes due in 2020 (the 2020 Notes, and together with the 2018 Notes, the Notes) were excluded from the diluted net loss per common share because they were antidilutive. The Company's closing stock price on December 31, 2016 and 2014 did not exceed the conversion price of \$94.15 per share for the Notes. Although the Company's stock price exceeded the conversion price \$94.15 at December 31, 2015, the potential shares issuable under the Notes were excluded from the calculation of diluted loss per share as they were anti-dilutive using the if-converted method.

## (15) INCOME TAXES

The provision for (benefit from) income taxes is based on loss before income taxes as follows:

	Years Ended December 31,		
	2016	2015	2014
U.S. Source	\$10,696	\$182,215	\$49,411

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Non-U.S. Source	(841,746)	(336,939)	(174,279)
Loss before income taxes	\$ (831,050)	\$ (154,724)	\$ (124,868)

The U.S. and foreign components of the provision for (benefit from) income taxes are as follows:

	Years Ended December 31,		
	2016	2015	2014
Provision for current income tax expense:			
Federal	\$22,239	\$84,743	\$28,093
State and local	1,418	5,323	3,011
Foreign	3,557	3,836	3,614
	27,214	93,902	34,718
Provision for (benefit from) deferred income tax			
expense:			
Federal	(78,428 )	(17,741 )	(20,367 )
State and local	(6,012 )	(8,770 )	(4,982 )
Foreign	(143,614)	(50,316)	(268 )
	(228,054)	(76,827)	(25,617)
Provision for (benefit from) income taxes	\$ (200,840)	\$ 17,075	\$ 9,101

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

For the year ended December 31, 2016, the Company's Dutch operations had a GAAP loss of \$539.2 million, which included the impairment of the Kyndrisa IPR&D assets and a resulting deferred tax benefit of \$143.5 million associated with the reversal of the deferred tax liability of such IPR&D assets.

The following is a reconciliation of the statutory federal income tax rate to the Company's effective income tax rate expressed as a percentage of loss before income taxes:

	Years Ended December 31,		
	2016	2015	2014
Federal statutory income tax rate	35.0 %	35.0 %	35.0 %
State and local taxes	0.4 %	(2.2 )%	(1.6 )%
Orphan Drug & General Business Credit	7.5 %	34.8 %	29.3 %
Stock compensation expense	4.6 %	(2.8 )%	(2.4 )%
Changes in the fair value of contingent acquisition consideration payable	0.9 %	0.2 %	(3.6 )%
Subpart F income	— %	(8.4 )%	(9.2 )%
Foreign tax rate differential	(18.6)%	(46.2)%	(51.5)%
Section 162(m) limitation	(5.4 )%	(1.3 )%	(1.7 )%
Other	0.3 %	(1.6 )%	(1.9 )%
Valuation allowance/deferred benefit	(0.5 )%	(18.5)%	0.3 %
Effective income tax rate	24.2 %	(11.0)%	(7.3 )%

The significant components of the Company's net deferred tax assets are as follows:

	December 31,	
	2016	2015
Net deferred tax assets:		
Net operating loss carryforwards	\$49,787	\$44,942
Tax credit carryforwards	352,535	143,987
Accrued expenses, reserves, and prepaids	77,904	79,029
Intangible assets	26,751	16,177
Stock-based compensation	47,713	49,322
Inventory	15,581	18,942
Impairment	5,017	5,005
Other	1,415	1,155
Valuation allowance	(73,037 )	(67,708 )
Total deferred tax assets	503,666	290,851

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Joint venture basis difference	(1,714 )	(1,888 )
Acquired intangibles	(8,773 )	(162,689)
Convertible notes discount	(24,394 )	(32,162 )
Property, plant and equipment	(22,103 )	(13,192 )
Unrealized (gains) losses	104	(4,256 )
Total deferred tax liabilities	(56,880 )	(214,187)
Net deferred tax assets	\$446,786	\$76,664

The increase to the tax credit carryforwards was primarily attributed to the adoption of ASU 2016-09 in 2016. See Note 4 to these Consolidated Financial Statements for additional discussion related to the adoption of ASU 2016-09. The decrease in the acquired intangibles was primarily attributed to the reversal of the deferred tax liability for impairment of the Kyndrisa IPR&D. See Note 7 to these Consolidated Financial Statements for additional discussion related to the impairment of the Kyndrisa IPR&D assets.

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

As of December 31, 2016, the Company had federal net operating loss carryforwards of \$18.9 million, state net operating loss carryforwards of \$174.7 million and Dutch net operating loss carryforwards of \$125.1 million. The Company also had federal R&D and orphan drug credit carryforwards of \$377.4 million and state research credit carryovers of \$71.7 million.

The federal net operating loss carryforwards will expire at various dates beginning in 2028 through 2033 if not utilized. The federal credit carryforward will expire at various dates beginning in 2024 through 2036 if not utilized. The state net operating loss carryforwards will expire at various dates beginning in 2017 through 2036 if not utilized. The Dutch net operating loss carryforwards will expire at various dates beginning in 2017 through 2025 if not utilized. Certain state research credit carryovers will begin to expire in 2019 if not utilized, with others carrying forward indefinitely.

The Company's net operating losses and credits could be subject to annual limitations due to ownership change limitations provided by Internal Revenue Code Section 382 and similar state provisions. An annual limitation could result in the expiration of net operating losses and tax credit carryforward before utilization. There are limitations on the tax attributes of acquired entities however, the Company does not believe the limitations will have a material impact on the utilization of the net operating losses or tax credits.

In 2016, the valuation allowance increased by \$5.3 million primarily due to California net operating losses that may not be realized. In 2015, the Company established deferred tax assets related to the future contingent consideration on the sale of talazoparib and the net operating loss carryforwards acquired with Prosensa. Due to the uncertainty of the Company's ability to realize the benefits from these deferred tax assets, the Company has recorded a full valuation allowance on these assets resulting in a \$59.9 million increase in the valuation allowance.

The financial statement recognition of the benefit for a tax position is dependent upon the benefit being more likely than not to be sustainable upon audit by the applicable taxing authority. If this threshold is met, the tax benefit is then measured and recognized at the largest amount that is greater than 50% likely of being realized upon ultimate settlement. A reconciliation of the beginning and ending amount of unrecognized tax benefits for the years ended December 31, 2016 is as follows:

	December 31,	
	2016	2015
Balance at beginning of period	\$86,731	\$71,663
Additions based on tax positions related to the		
current year	15,982	13,614
Additions for tax positions of prior years	497	1,454
Balance at end of period	\$103,210	\$86,731

Included in the balance of unrecognized tax benefits at December 31, 2016 are potential benefits of \$103.2 million that, if recognized, would affect the effective tax rate. The Company's policy for classifying interest and penalties associated with unrecognized income tax benefits is to include such items in the income tax expense. The total amount of accrued interest and penalties was not significant as of December 31, 2016.

The Company files income tax returns in the U.S. and various foreign jurisdictions. The U.S. and foreign jurisdictions have statute of limitations ranging from three to five years. However, carryforward tax attributes that were generated in 2013 and earlier may still be adjusted upon examination by tax authorities. Currently, the Company is under audit by the Internal Revenue Service for the years 2012 through 2014 and various states for similar periods.

U.S. income and foreign withholding taxes have not been recognized on the excess of the amount for financial reporting over the tax basis of investments in foreign subsidiaries that are essentially permanent in duration. This excess totaled approximately \$3.9 million as of December 31, 2016, which will be indefinitely reinvested; deferred income taxes have not been provided on such foreign earnings.

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

(16) EQUITY COMPENSATION PLANS

Share Incentive Plan

The 2006 Share Incentive Plan, which replaced the Company's previous stock option plans (the 1997 Stock Plan and the 1998 Directors Options Plan), provides for grants of options to employees to purchase common stock at the fair market value of such shares on the grant date, as well as other forms of equity compensation. During the year ended December 31, 2016, awards issued under the 2006 Share Incentive Plan include both stock options and RSUs. Stock option awards granted to employees generally vest over a four-year period on a cliff basis six months after the grant date and then monthly thereafter. The term of the outstanding options is generally ten years. RSUs granted to employees generally vest annually over a straight-line four-year period after the grant date. RSUs granted to directors generally vest in full one year after the grant date.

As of December 31, 2016, options to purchase approximately 8.9 million shares were outstanding under the Company's stock option plans.

As of December 31, 2016, an aggregate of approximately 41.5 million shares were authorized and 24.3 million shares were authorized for future issuance under the Share Incentive Plan.

Employee Stock Purchase Plan

Under BioMarin's ESPP, which was initially approved in June 2006, replacing the Company's previous plan, and was further amended on March 5, 2014, employees meeting specific employment qualifications are eligible to participate and can purchase shares on established dates (each purchase date) semi-annually through payroll deductions at the lower of 85% of the fair market value of the stock at the commencement of the offering period or each purchase date of the offering period. Each offering period will span up to two years. The ESPP permits eligible employees to purchase common stock through payroll deductions for up to 10% of qualified compensation, up to an annual limit of \$25,000. The ESPP is intended to qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code. During the year ended December 31, 2016, the Company issued 0.2 million shares under the ESPP.

As of December 31, 2016, there were approximately 3.5 million shares were authorized and 0.8 million shares reserved for future issuance under the ESPP.

Board of Director Grants

The Board of Directors have approved the following awards to directors under the 2006 Share Incentive Plan. Each Independent Director is automatically granted an initial equity grant valued at \$550,000, based on the Black-Scholes model valuation using a three-month trailing average closing price of the Company's common stock, with such valuation allocated 40% to RSUs and 60% to options to purchase shares of the Company's common stock on the date that such person first becomes an Independent Director. The shares of common stock subject to the initial grant vest quarterly over three years and the initial RSU grant vest annually over three years. On the date of the Company's

annual meeting of shareholders, each re-elected Independent Director is granted an additional equity grant valued at \$375,000, based on the Black-Scholes model valuation using a three-month trailing average closing price of the Company's common stock, with such valuation allocated 50% to RSUs and 50% to options. The shares of common stock subject to the annual option grant vest quarterly over one year and the additional annual RSUs vest in full on the one-year anniversary of the grant date. The additional option grant or RSU grant for a director that has served for less than a year is prorated to the nearest quarter. These options and RSUs continue to vest only while the director serves on the Board. The exercise price per share of each of these options is 100% of the fair market value of a share of the Company's common stock on the date of the grant. These options have a term of 10 years.

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

## Shares Available Under Equity Compensation Plans

At December 31, 2016, an aggregate of approximately 27.2 million unissued shares was authorized for future issuance under the Company's stock plans, which includes shares issuable under the 2006 Share Incentive Plan, the ESPP and the Company's expired plans. Under the 2006 Share Incentive Plan, awards that expire or are cancelled generally become available for future issuance under the respective plan.

## (17) STOCK-BASED COMPENSATION

The following table summarizes activity under the Company's stock option plans, including the 2012 and 2014 Inducement Plans and those suspended upon the adoption of the 2006 Share Incentive Plan, for the year ended December 31, 2016. All option grants presented in the table had exercise prices not less than the fair value of the underlying common stock on the grant date:

		Weighted Average Exercise Price	Weighted Average Remaining Years	Aggregate Intrinsic Value <sup>(1)</sup>
	Shares			
Options outstanding as of				
December 31, 2015	10,322,903	\$ 44.50	5.6	\$ 630,949
Granted	847,450	\$ 84.31		
Exercised	(2,129,090 )	\$ 29.23		
Expired and forfeited	(185,055 )	\$ 84.78		
Options outstanding as of				
December 31, 2016	8,856,208	\$ 51.13	5.4	\$ 304,356
Options expected to vest at				
December 31, 2016	1,753,013	\$ 84.38	8.3	\$ 10,707
Exercisable at December 31, 2016	7,103,016	\$ 42.92	4.6	\$ 293,646

(1)

The aggregate intrinsic value for outstanding options is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Company's common stock as of the last trading day for the respective year. The aggregate intrinsic value of options outstanding and exercisable includes options with an exercise price below \$82.84, the closing price of the Company's common stock on December 31, 2016.

The weighted-average fair value per option granted in the years ended December 31, 2016, 2015 and 2014 were \$40.70, \$56.76 and \$30.93, respectively. The total intrinsic value of options exercised during the years ended December 31, 2016, 2015 and 2014 was \$127.4 million, \$146.6 million and \$130.1 million, respectively. The aggregate intrinsic value of options exercised was determined as of the date of option exercise. Upon the exercise of the options, the Company issues new common stock from its authorized shares. There were 7.4 million options that were in-the-money at December 31, 2016.

#### Determining the Fair Value of Stock Options and Stock Purchase Rights

The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model and the assumptions noted in the tables below. The expected life of options is based on observed historical exercise patterns. Groups of employees that have similar historical exercise patterns were considered separately for valuation purposes. The Company has identified two groups with distinctly different exercise patterns. The two groups identified are executive and non-executive employees. The executive employee group has a history of holding options for longer periods than non-executive employees. The expected volatility of stock options is based upon the weighted average of the historical volatility of the Company's common stock and the implied volatility of traded options on the Company's common stock for fiscal periods in which there is sufficient trading volume in options on the Company's common stock. The risk-free interest rate is based on the implied yield on a U.S. Treasury zero-coupon issue with a remaining term equal to the expected term of the option. The dividend yield reflects that the



BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

Company has not paid any cash dividends since inception and does not intend to pay any cash dividends in the foreseeable future. Effective January 1, 2016, forfeitures were accounted for as they occurred.

The assumptions used to estimate the per share fair value of stock options granted during the periods presented were as follows:

	Years Ended December 31,		
	2016	2015	2014
	36 –		
Expected volatility	44%	36 – 45%	44 – 45%
Dividend yield	0.00%	0.00%	0.00%
	5.0 – 6.4 –		
Expected life	8.1 years	8.0 years	6.9 years
	1.1 – 1.8 –		
Risk-free interest rate	2.3%	1.5 – 2.2%	2.3%

The Company recorded \$45.5 million, \$41.5 million and \$41.1 million of compensation costs related to current period vesting of stock options for the years ended December 31, 2016, 2015 and 2014, respectively. As of December 31, 2016, the total unrecognized compensation cost related to unvested stock options was \$63.4 million. These costs are expected to be recognized over a weighted average period of 2.4 years.

The assumptions used to estimate the per share fair value of stock purchase rights granted under the ESPP were as follows:

	Years Ended December 31,		
	2016	2015	2014
	42 –		
Expected volatility	50%	36 – 38%	38 – 39%
Dividend yield	0.00%	0.00%	0.00%
	0.4 –		
Expected life	6-24 months	6-24 months	6-24 months
	0.4 –		
Risk-free interest rate	0.8%	0.1- 0.8%	0.1- 0.5%

The Company recorded \$10.1 million, \$7.1 million and \$4.8 million of compensation costs related to shares granted under the ESPP for the years ended December 31, 2016, 2015 and 2014, respectively. As of December 31, 2016, there was \$13.8 million of total unrecognized compensation cost related to unvested stock options issuable under the ESPP. These costs are expected to be recognized over a weighted average period of 1.8 years.

Restricted Stock Unit Awards with Service-Based Vesting Conditions

RSUs are generally subject to forfeiture if employment terminates prior to the release of vesting restrictions. The Company expenses the cost of the RSUs, which is determined to be the fair market value of the shares of common stock underlying the RSUs at the date of grant, ratably over the period during which the vesting restrictions lapse.

A summary of RSU activity under the plan for the year ended December 31, 2016 as follows:

		Weighted		
		Average	Weighted	
		Grant	Average	Aggregate
		Date	Remaining	Intrinsic
	Shares	Fair	Years	Value
	Value			
Non-vested units as of December 31, 2015	2,147,209	\$ 93.89	2.8	\$ 224,942
Granted	1,321,224	\$ 84.18		
Vested	(751,203 )	\$ 80.42		
Forfeited	(272,264 )	\$ 94.52		
Non-vested units as of December 31, 2016	2,444,966	\$ 92.70	1.4	\$ 202,541
Non-vested units expected to vest at				
December 31, 2016	2,444,966	\$ 92.70		\$ 202,541

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

The weighted-average grant date fair value per share of RSUs granted during the years ended December 31, 2016, 2015 and 2014, was \$84.18, \$119.86 and \$64.37, respectively. The total intrinsic value of restricted stock that vested and was released in the years ended December 31, 2016, 2015 and 2014 was \$63.5 million, \$59.5 million and \$22.9 million, respectively.

The Company recorded \$74.7 million, \$47.9 million and \$21.3 million of compensation costs related to RSUs with service-based vesting conditions for the years ended December 31, 2016, 2015 and 2014, respectively. As of December 31, 2016, there was \$168.5 million of total unrecognized compensation cost related to unvested RSUs with service-based vesting conditions. These costs are expected to be recognized over a weighted average period of 2.6 years.

Restricted Stock Unit Awards with Performance and Market-Based Vesting Conditions

During 2012 and 2011, pursuant to the approval of the Board, the Company granted 860,000 RSU awards with performance and market-based vesting conditions (the 2011/2012 Base RSUs) under the 2006 Share Incentive Plan and the 2012 Inducement Plan to certain executive officers. The 2011/2012 Base RSUs had a weighted-average grant date fair value of \$34.66 and vested on February 29, 2016, based upon the achievement of the Vimizim approval and the 2015 revenue goal. The number of Base RSUs earned was 799,800 shares, which were issued on February 29, 2016. Stock-based compensation expense for this award was recognized over the remaining service period beginning in the period the Company determined the achievement of the strategic performance goal or goals were probable. For the years ended December 31, 2016, 2015 and 2014, the Company recorded \$1.1 million, \$5.8 million and \$12.9 million, respectively, of compensation expense related to performance awards.

Restricted Stock Unit Awards with Performance Conditions

On March 15, 2016, pursuant to Board approval, the Company granted 130,310 RSU awards with performance-vesting conditions (the 2016 Base RSUs) under the 2006 Share Incentive Plan to certain executive officers. The vesting of the 2016 Base RSUs under this specific grant is contingent upon the achievement of a 2016 revenue target and a three-year service period. The number of RSUs awarded from the 2016 Base RSUs is determined based on the Company's performance against the revenue target which could range between 80% and 120%. Based on the Company's performance against the revenue target, the Company applied a multiplier of 103% will issue 134,219 shares on the first anniversary from the date of grant.

Stock-based compensation for these awards is recognized over the service period beginning in the period that the Company determined it is probable that the revenue target will be achieved. The cost of the 2016 Base RSUs was determined to be \$83.43 per RSU, based on the fair value of the common stock underlying the 2016 Base RSUs on the grant date. The Company recognized approximately \$3.0 million of compensation expense related to these awards during the year ended December 31, 2016.

On March 3, 2015, pursuant to Board approval, the Company granted 58,300 RSU awards with performance-vesting conditions (the 2015 Base RSUs) under the 2006 Share Incentive Plan to certain executive officers. The vesting of the

2015 Base RSUs under this specific grant is contingent upon the achievement of a 2015 revenue target and a three-year service period. The number of RSUs awarded from the 2015 Base RSUs is determined based on the Company's performance against the revenue target which could range between 80% to 120%. Based on the Company's performance against the revenue target, the Company applied a multiplier of 111% and issued 64,713 shares was issued on the first anniversary from the date of grant.

Stock-based compensation for these awards is recognized over the service period beginning in the period that the Company determined it is probable that the revenue target will be achieved. The cost of the 2015 Base RSUs was determined to be \$108.36 per RSU, based on the fair value of the common stock underlying the 2015 Base RSUs on the grant date. The Company recognized approximately \$2.3 million and \$1.8 million of compensation expense related to these awards during the year ended December 31, 2016 and 2015, respectively.

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

As of December 31, 2016, total unrecognized compensation costs of \$11.0 million related to RSU awards with performance-vesting conditions are expected to be recognized over a weighted average period of 2.0 years.

Compensation expense included in the Company's Consolidated Statements of Operations for all stock-based compensation arrangements was as follows:

	Years Ended December 31,		
	2016	2015	2014
Cost of sales	\$9,121	\$6,836	\$6,076
Research and development	58,279	49,399	33,835
Selling, general and administrative	67,241	55,290	46,499
Total stock-based compensation expense	\$134,641	\$111,525	\$86,410

Stock-based compensation of \$11.4 million, \$11.1 million and \$8.2 million was capitalized into inventory, for the years ended December 31, 2016, 2015 and 2014, respectively. Capitalized stock-based compensation is recognized as cost of sales when the related product is sold.

## (18) COMPREHENSIVE INCOME

The following table summarizes amounts reclassified out of Accumulated Other Comprehensive Income (AOCI) and their effect on the Company's Consolidated Statements of Operations for the years ended December 31, 2016 and 2015.

Details about AOCI Components	Amount Reclassified from AOCI (Gain) Loss		Consolidated Statement of Operations Classification
	Years Ended December 31, 2016	Years Ended December 31, 2015	
Gains on cash flow hedges:			
Forward foreign currency exchange contracts	\$ 6,112	\$ 17,715	Net product revenues
Forward foreign currency exchange contracts	4,161	1,889	Selling, general and administrative
Total gain on cash flow hedges	10,273	19,604	
Other-than-temporary impairment on	—	(1,160 )	Other income (expense)

available-for-sale securities			
Gain (loss) on sale of available-for-sale			
securities	(115	) 3,033	Other income (expense)
Total gain (loss) on available-for-sale securities	(115	) 1,873	
Less income tax effect of the above	42	681	Provision for (benefit from) income taxes
	\$ 10,116	\$ 20,796	Net loss

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

The following table summarizes changes in the accumulated balances for each component of other comprehensive loss, including current period reclassifications out of AOCI and other amounts of current-period other comprehensive income, for the years ended December 31, 2016 and 2015.

	Year Ended December 31, 2016			
	Gains and Losses on Cash Flow Hedges	Unrealized Gains on Available-for-Sale Securities	Foreign Currency Items	Total
AOCI balance at December 31, 2015	13,602	7,441	(10 )	21,033
Other comprehensive income (loss) before				
reclassifications	9,677	(12,104 )	(2 )	(2,429 )
Less net gain (loss) reclassified from AOCI	10,273	(115 )		10,158
Tax effect	—	4,370	—	4,370
Net current-period other comprehensive loss	(596 )	(7,619 )	(2 )	(8,217 )
AOCI balance at December 31, 2016	\$13,006	\$ (178 )	\$ (12 )	\$12,816

	Year Ended December 31, 2015			
	Gains and Losses on Cash Flow Hedges	Unrealized Gains on Available-for-Sale Securities	Foreign Currency Items	Total
AOCI balance at December 31, 2014	15,906	11,511	49	27,466
Other comprehensive income (loss) before				
reclassifications	17,300	(4,459 )	(59 )	12,782
Less gain reclassified from AOCI	19,604	1,873	—	21,477
Tax effect	—	2,262	—	2,262
Net current-period other comprehensive loss	(2,304 )	(4,070 )	(59 )	(6,433 )
AOCI balance at December 31, 2015	13,602	7,441	(10 )	21,033

(19) REVENUE AND CREDIT CONCENTRATIONS

Net Product Revenue - The Company considers there to be revenue concentration risks for regions where net product revenue exceeds 10% of consolidated net product revenue. The concentration of the Company's net product revenue within the regions below may have a material adverse effect on the Company's revenue and results of operations if sales in the respective regions experience difficulties.

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

The table below summarizes consolidated net product revenue concentrations based on patient location for Vimizim, Naglazyme, Kuvan and Firdapse which are sold directly by the Company and global sales of Aldurazyme which is marketed by Genzyme. Genzyme is the Company's sole customer for Aldurazyme and is responsible for marketing and selling Aldurazyme to third-parties.

	Years Ended December 31,					
	2016	2015	2014			
Region:						
United States	37 %	39 %	37 %			
Europe	23 %	19 %	18 %			
Latin America	13 %	16 %	16 %			
Rest of world	19 %	15 %	15 %			
Total net product revenues marketed by the						
Company	92 %	89 %	86 %			
Aldurazyme net product revenues marketed by						
Genzyme	8 %	11 %	14 %			
Total net product revenue	100 %	100 %	100 %			

The following table illustrates the percentage of the Company's consolidated net product revenues attributed to the Company's largest customers.

	For the Years Ended December 31,					
	2016	2015	2014			
Customer A	19 %	15 %	15 %			
Customer B	13 %	13 %	11 %			
Customer C	10 %	—	—			
Customer D	8 %	11 %	14 %			
Customer E	6 %	10 %	12 %			
Total	56 %	49 %	52 %			

On a consolidated basis, the Company's two largest customers accounted for 26% and 20% of the December 31, 2016 accounts receivable balance, respectively, compared to December 31, 2015 when the two largest customers accounted

for 37% and 18% of the accounts receivable balance, respectively. As of December 31, 2016 and 2015, accounts receivable balance for Genzyme included \$30.7 million and \$36.1 million, respectively, of unbilled accounts receivable related to net incremental Aldurazyme product transfers to Genzyme. The Company does not require collateral from its customers, but does perform periodic credit evaluations of its customers' financial condition and requires immediate payment in certain circumstances.

The Company is subject to credit risk from accounts receivable related to product sales. The majority of the Company's trade accounts receivable arises from product sales in the U.S. and the European Union (the EU). The Company's product sales to government-owned or government-funded customers in certain European countries, including Greece, Italy, Portugal, Spain and Russia, are subject to payment terms that are statutorily determined. Because these customers are government-owned or government-funded, the Company may be impacted by declines in sovereign credit ratings or sovereign defaults in these countries. A significant or further decline in sovereign credit ratings or a default in these countries may decrease the likelihood that the Company will collect accounts receivable or may increase the discount rates and the length of time until receivables are collected, which could result in a negative impact to the Company's operating results. In the year ended December 31, 2016, the Company's net product revenues for these countries was 6%. Additionally, approximately 11% of the Company's outstanding accounts receivable at December 31, 2016 related to such countries.

As of December 31, 2016, the Company's accounts receivable in certain European countries, specifically Greece, Italy, Portugal, Spain and Russia, totaled approximately \$23.5 million, of which \$1.6 million were greater than 90 days past due.

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

The Company also sells its products in other countries that face economic crises and local currency devaluation. Although the Company has historically collected receivables from customers in those countries, sustained weakness or further deterioration of the local economies and currencies may cause customers in those countries to be unable to pay for the Company's products. The Company has not historically experienced a significant level of uncollected receivables and has received continued payments from its more aged accounts. The Company believes that the allowances for doubtful accounts related to these countries is adequate based on its analysis of the specific business circumstances and expectations of collection for each of the underlying accounts in these countries.

## (20) SEGMENT INFORMATION

The Company operates in one business segment, which primarily focuses on the development and commercialization of innovative therapies for people with serious and life threatening rare diseases and medical conditions. All products are included in one segment because the majority of the Company's products have similar economic and other characteristics, including the nature of the products and production processes, type of customers, distribution methods and regulatory environment.

	Years Ended December 31,		
	2016	2015	2014
Net product revenues by product:			
Aldurazyme	\$93,749	\$97,912	\$105,616
Kuvan	348,009	239,336	202,987
Naglazyme	296,537	303,090	334,447
Vimizim	354,058	228,147	77,319
Firdapse	18,028	16,037	18,047
Total net product revenues	\$1,110,381	\$884,522	\$738,416

The following table summarizes total revenues from external customers and collaborative partners by geographic region. Net product revenues by geographic region are based on patient location for the Company's commercial products, except for Aldurazyme, which is based on the location of Genzyme's headquarters. Although Genzyme sells Aldurazyme worldwide, the revenues earned by the Company based on Genzyme's net sales are included in the U.S. region, as the transactions are with Genzyme whose headquarters are located in the U.S.

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	Years Ended December 31,		
	2016	2015	2014
Total revenues by geographic region:			
United States	\$507,539	\$444,075	\$383,770
Europe	252,633	171,216	136,251
Latin America	147,471	142,305	118,562
Rest of world	209,211	132,299	110,701
Total revenues	\$1,116,854	\$889,895	\$749,284

The following table summarizes non-monetary long-lived assets by geographic region. Non-monetary long-lived assets primarily consists of property, plant and equipment, intangible assets, goodwill and deferred tax assets.

	December 31,	
	2016	2015
Long-lived assets by geography:		
United States	\$1,183,938	\$940,512
Europe	812,833	865,233
Rest of world	2,568	2,253
Total long-lived assets	\$1,999,339	\$1,807,998

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

(21) COLLABORATIVE AGREEMENTS

Merck Serono

In May 2005, the Company entered into an agreement with Merck Serono for the further development and commercialization of 6R-BH4, both in Kuvan for PKU and for other indications, and pegvaliase (phenylalanine ammonia lyase). Through the agreement and subsequent amendment, Merck Serono acquired exclusive rights to market these products in all territories outside the U.S., Canada and Japan, and the Company retained exclusive rights to market these products in the U.S. and Canada. Through December 31, 2015, the Company and Merck Serono were individually responsible for the costs of commercializing the products within their respective territories, with pay the Company royalties on its net sales of these products. On January 1, 2016, the Merck PKU Business acquisition was completed. As of January 1, 2016, the Company and Merck Serono have no further rights or obligations under the License Agreement with respect to pegvaliase. As of December 31, 2016, the License Agreement, as amended in December 2016, will continue in effect in order for Merck Serono to provide critical transition services for the sales and distribution of Kuvan in four remaining countries until marketing authorizations can be transferred in such countries.

See Note 5 to these Consolidated Financial Statements for additional discussion regarding the acquisition.

Other Agreements

The Company is engaged in R&D collaborations with various other entities. These provide for sponsorship of R&D by the Company and may also provide for exclusive royalty-bearing intellectual property licenses or rights of first negotiation regarding licenses to intellectual property development under the collaborations. Typically, these agreements can be terminated for cause by either party upon 90 days written notice.

In September 2007, the Company licensed to Asubio Pharma Co., Ltd. (a subsidiary of Daiichi Sankyo) exclusive rights to data and intellectual property contained in the Kuvan new drug application. The Company receives royalties on net sales of the product in Japan.

In October 2012, the Company licensed to Catalyst Pharmaceutical Partners, Inc., (Catalyst) the North American rights to develop and market Firdapse. In consideration of this licensing arrangement, the Company received from Catalyst a \$5.0 million convertible promissory note. Under the terms of the note agreement, the Company received 6.7 million shares of Catalyst common stock upon the automatic conversion of the convertible promissory note on December 10, 2012. In exchange for the North American rights to Firdapse the Company may receive royalties of 7% to 10% on net product sales of Firdapse in North America. As of December 31, 2016, there were no amounts due from Catalyst for reimbursable development costs.

(22) COMPENSATION AGREEMENTS AND PLANS

Employment Agreements

The Company has entered into employment agreements with certain officers. Generally, these agreements can be terminated without cause by the Company upon prior written notice and payment of specified severance, or by the officer upon four weeks' prior written notice to the Company.

401(k) Plan

The Company sponsors the BioMarin Retirement Savings Plan (the 401(k) Plan). Most employees (Participants) are eligible to participate following the start of their employment, at the beginning of each calendar month. Participants may contribute to the 401(k) Plan up to the lesser of 100% of their current compensation or an amount up to a statutorily prescribed annual limit. The Company pays the direct expenses of the 401(k) Plan and matched 100% of each Participant's contributions, up to a maximum of the lesser of 6% of the employee's annual compensation or \$12,000 per year (\$14,000 per year effective January 1, 2017). The Company's matching

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## BIOMARIN PHARMACEUTICAL INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

contribution vests over four years from employment commencement and was approximately \$16.0 million, \$15.1 million and \$8.3 million for the years ended December 31, 2016, 2015 and 2014, respectively. Employer contributions not vested upon employee termination are forfeited.

## Deferred Compensation Plan

In December 2005, the Company adopted the Deferred Compensation Plan. The Deferred Compensation Plan allows eligible employees, including members of the Board, management and certain highly-compensated employees as designated by the Deferred Compensation Plan's Administrative Committee, the opportunity to make voluntary deferrals of compensation to specified future dates, retirement or death. Participants are permitted to defer portions of their salary, annual cash bonus and restricted stock. The Company may not make additional direct contributions to the Deferred Compensation Plan on behalf of the participants, without further action by the Board. Deferred compensation is held in trust and generally invested to match the investment benchmarks selected by participants. The recorded cost of any investments will approximate fair value. Company stock issued into the Deferred Compensation Plan is recorded and accounted for similarly to treasury stock in that the value of the employer stock is determined on the date the restricted stock vests and the shares are issued into the Deferred Compensation Plan. The Company stock issued into the Deferred Compensation Plan upon vesting is recorded in stockholders' equity. As of December 31, 2016 and 2015, the fair value of Company stock held by the Deferred Compensation Plan, was \$19.4 million and \$25.5 million, respectively, which is included in current and non-current liabilities. The change in market value amounted to a gain of \$5.0 million, a gain of \$2.5 million and a loss of \$4.8 million in the years 2016, 2015 and 2014, respectively. See Note 12 to these Consolidated Financial Statements for additional discussion regarding the fair value of the Deferred Compensation Plan assets and liabilities.

## (23) COMMITMENTS AND CONTINGENCIES

## Lease Commitments

The Company leases office space and research, testing and manufacturing laboratory space in various facilities under operating agreements expiring at various dates through 2025. Certain of the leases provide for options by the Company to extend the lease for multiple five-year renewal periods and also provide for annual minimum increases in rent, usually based on a consumer price index or annual minimum increases. Minimum lease payments for future years are as follows:

2017	\$9,051
2018	7,739
2019	4,893
2020	3,391

2021	2,728
Thereafter	6,637
Total	\$34,439

Rent expense for the years ended December 31, 2016, 2015 and 2014 was \$11.6 million, \$9.3 million and \$7.9 million, respectively. Deferred rent accruals at December 31, 2016 totaled \$2.4 million, of which \$2.0 million was current. Deferred rent accruals at December 31, 2015 totaled \$1.7 million, of which \$1.2 million was current.

#### Research and Development Funding and Technology Licenses

The Company uses experts and laboratories at universities and other institutions to perform certain R&D activities. These amounts are included as R&D expense as services are provided. The Company has also licensed technology, for which it is required to pay royalties upon future sales, subject to certain annual minimums.

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

Other Commitments

In the normal course of business, the Company enters into various firm purchase commitments primarily related to active pharmaceutical ingredients and certain inventory related items. As of December 31, 2016, these commitments for the next five years were approximately \$45.8 million. The amounts primarily related to active pharmaceutical ingredients represent minimum purchase requirements and post marketing commitments related to the Company's approved products.

Contingencies

From time to time the Company is involved in legal actions arising in the normal course of its business. The most significant of these actions are described below.

The process of resolving matters through litigation or other means is inherently uncertain and it is possible that an unfavorable resolution of these matters could adversely affect the Company, its results of operations, financial condition and cash flows. The Company's general practice is to expense legal fees as services are rendered in connection with legal matters, and to accrue for liabilities when losses are probable and reasonably estimable.

Paragraph IV Notices

The Company received a paragraph IV notice letter, dated January 22, 2015, from Par Pharmaceutical, Inc. (Par), notifying it that Par had filed an abbreviated new drug application (ANDA) seeking approval of a proposed generic version of Kuvan (sapropterin dihydrochloride) 100 mg oral tablets prior to the expiration of the Company's patents listed in the FDA's Approved Drug Products with Therapeutic Equivalence Evaluations (the Orange Book). Together with Merck & Cie, on March 6, 2015, the Company filed a lawsuit against Par in the U.S. District Court for the District of New Jersey alleging infringement of its patents relating to Kuvan tablets and seeking an injunction to prevent Par from introducing a generic version of Kuvan tablets that would infringe its patents prior to their expiration. The filing of that lawsuit triggered the automatic 30-month stay on the approval of Par's ANDA in accordance with the Hatch-Waxman Act, which expires in July 2017. In response, Par alleged, inter alia, that the asserted patents are not infringed and/or are invalid.

The Company also received a paragraph IV notice letter, dated January 14, 2016, from Par, notifying it that Par has filed a separate ANDA seeking approval of a proposed generic version of Kuvan 100 mg oral powder prior to the expiration of the Company's patents listed in the FDA's Orange Book. On February 22, 2016, the Company filed a lawsuit against Par in the U.S. District Court for the District of New Jersey alleging infringement of its patents relating to Kuvan powder and seeking an injunction to prevent Par from introducing a generic version of Kuvan powder that would infringe its patents prior to their expiration. The filing of that lawsuit triggered the automatic 30-month stay on the approval of Par's ANDA in accordance with the Hatch-Waxman Act, which expires in July 2018. In response, Par alleged, inter alia, that the asserted patents are not infringed and/or are invalid.

The two cases against Par have been consolidated in the District of New Jersey for all purposes, including pretrial and trial. The Court held a claim construction hearing on May 5, 2016 but has not yet issued its ruling. Fact discovery closed on September 22, 2016, and expert discovery closes on March 31, 2017. No trial date has been set, but the

Court has indicated that trial is likely to occur in May or June 2017.

The Company also received a paragraph IV notice letter, dated December 23, 2016, from Dr. Reddy's Laboratories, Inc. and Dr. Reddy's Laboratories, Ltd. (DRL), notifying it that DRL has filed a separate ANDA seeking approval of a proposed generic version of Kuvan 100 mg oral powder prior to the expiration of the Company's patents listed in the FDA's Orange Book. On February 6, 2017, the Company filed a lawsuit against DRL in the U.S. District Court for the District of New Jersey alleging infringement of its patents relating to Kuvan powder and seeking an injunction to prevent DRL from introducing a generic version of Kuvan powder that would infringe the Company's patents prior to their expiration. The filing of that lawsuit triggered the automatic 30-month stay on the approval of DRL's ANDA in accordance with the Hatch-Waxman Act, which expires in June 2019. DRL has not yet answered the complaint, and no schedule has been set by the Court to date.

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BIOMARIN PHARMACEUTICAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(In thousands of U.S. dollars, except per share amounts or as otherwise disclosed)

SEC Subpoena

In August 2016, the Company received a subpoena from the staff of the SEC requesting that the Company produce documents in connection with a non-public, fact-finding inquiry related to its former drisapersen program. The letter enclosing the subpoena states that the investigation and the subpoena do not mean that the Company or anyone else has broken the law, or that the SEC has a negative opinion of any person, entity or security. The Company intends to cooperate fully with the SEC in this matter. The Company is not able to predict whether any proceeding may be instituted in connection with the subpoena, or the outcome of any proceeding that may be instituted.

Contingent Payments

As of December 31, 2016, the Company is also subject to contingent payments totaling approximately \$576.5 million upon achievement of development and regulatory activities and commercial sales and licensing milestones if they occur before certain dates in the future. Of this amount, \$194.3 million (or €185 million based on the exchange rate of 1.05 USD per Euro in effect on December 31, 2016) relates to the Merck PKU Business acquisition and \$50.8 million relates to programs that are no longer being developed.

As of December 31, 2016, the Company has recorded \$161.6 million of contingent acquisition consideration payable on its Consolidated Balance Sheets in Short-term and Long-term Contingent Acquisition Consideration Payable, of which \$46.3 million is expected to be paid in the next twelve months.