

VERTEX PHARMACEUTICALS INC / MA

FORM 10-Q (Quarterly Report)

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2017

or

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

FOR THE TRANSITION PERIOD FROM _ TO _

Commission file number 000-19319

Vertex Pharmaceuticals Incorporated

(Exact name of registrant as specified in its charter)

Massachusetts

(State or other jurisdiction of
incorporation or organization)

50 Northern Avenue, Boston, Massachusetts

(Address of principal executive offices)

04-3039129

(I.R.S. Employer
Identification No.)

02210

(Zip Code)

Registrant's telephone number, including area code **(617) 341-6100**

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, par value \$0.01 per share

252,902,848

Class

Outstanding at October 20, 2017

VERTEX PHARMACEUTICALS INCORPORATED
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2017

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“We,” “us,” “Vertex” and the “Company” as used in this Quarterly Report on Form 10-Q refer to Vertex Pharmaceuticals Incorporated, a Massachusetts corporation, and its subsidiaries.

“Vertex,” “KALYDECO®” and “ORKAMBI®” are registered trademarks of Vertex. Other brands, names and trademarks contained in this Quarterly Report on Form 10-Q are the property of their respective owners.

Part I. Financial Information**Item 1. Financial Statements**

VERTEX PHARMACEUTICALS INCORPORATED
Condensed Consolidated Statements of Operations
(unaudited)
(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues:				
Product revenues, net	\$ 549,642	\$ 409,689	\$ 1,544,252	\$ 1,229,750
Royalty revenues	2,231	3,835	6,643	12,713
Collaborative revenues	26,292	259	286,123	1,008
Total revenues	578,165	413,783	1,837,018	1,243,471
Costs and expenses:				
Cost of product revenues	72,186	53,222	188,963	147,165
Royalty expenses	688	855	2,104	2,813
Research and development expenses	454,947	272,370	1,017,961	799,238
Sales, general and administrative expenses	120,710	106,055	361,285	322,921
Restructuring expenses, net	337	8	13,859	1,038
Intangible asset impairment charge	255,340	—	255,340	—
Total costs and expenses	904,208	432,510	1,839,512	1,273,175
Loss from operations	(326,043)	(18,727)	(2,494)	(29,704)
Interest expense, net	(13,574)	(20,140)	(45,003)	(60,993)
Other (expenses) income, net	(77,553)	(167)	(80,634)	3,025
Loss before (benefit from) provision for income taxes	(417,170)	(39,034)	(128,131)	(87,672)
(Benefit from) provision for income taxes	(125,903)	503	(117,581)	24,118
Net loss	(291,267)	(39,537)	(10,550)	(111,790)
Loss (income) attributable to noncontrolling interest	188,315	696	173,350	(33,207)
Net (loss) income attributable to Vertex	\$ (102,952)	\$ (38,841)	\$ 162,800	\$ (144,997)
Amounts per share attributable to Vertex common shareholders:				
Net (loss) income:				
Basic	\$ (0.41)	\$ (0.16)	\$ 0.66	\$ (0.59)
Diluted	\$ (0.41)	\$ (0.16)	\$ 0.64	\$ (0.59)
Shares used in per share calculations:				
Basic	250,268	244,920	247,963	244,529
Diluted	250,268	244,920	252,095	244,529

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

VERTEX PHARMACEUTICALS INCORPORATED
Condensed Consolidated Statements of Comprehensive Income (Loss)
(unaudited)
(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net loss	\$ (291,267)	\$ (39,537)	\$ (10,550)	\$ (111,790)
Changes in other comprehensive loss:				
Unrealized holding gains (losses) on marketable securities, net of tax of zero, respectively	5,961	(96)	(7,786)	104
Unrealized (losses) gains on foreign currency forward contracts, net of tax of \$0.9 million, \$0.2 million, \$2.9 million and \$(0.4) million, respectively	(5,453)	2,149	(27,379)	1,936
Foreign currency translation adjustment	(3,884)	(2,508)	(11,137)	(7,709)
Total changes in other comprehensive loss	(3,376)	(455)	(46,302)	(5,669)
Comprehensive loss	(294,643)	(39,992)	(56,852)	(117,459)
Comprehensive loss (income) attributable to noncontrolling interest	188,315	696	173,350	(33,207)
Comprehensive (loss) income attributable to Vertex	\$ (106,328)	\$ (39,296)	\$ 116,498	\$ (150,666)

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

VERTEX PHARMACEUTICALS INCORPORATED
Condensed Consolidated Balance Sheets
(unaudited)
(in thousands, except share and per share amounts)

	September 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,384,966	\$ 1,183,945
Marketable securities, available for sale	427,282	250,612
Restricted cash and cash equivalents (VIE)	1,803	47,762
Accounts receivable, net	263,493	201,083
Inventories	98,192	77,604
Prepaid expenses and other current assets	152,238	70,534
Total current assets	2,327,974	1,831,540
Property and equipment, net	759,978	698,362
Intangible assets	29,000	284,340
Goodwill	50,384	50,384
Cost method investments	20,447	20,276
Other assets	10,542	11,885
Total assets	\$ 3,198,325	\$ 2,896,787
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 77,138	\$ 61,451
Accrued expenses	378,554	315,249
Deferred revenues, current portion	13,003	6,005
Accrued restructuring expenses, current portion	4,205	6,047
Capital lease obligations, current portion	19,881	19,426
Customer deposits	190,272	73,416
Credit facility	—	300,000
Other liabilities, current portion	27,686	10,943
Total current liabilities	710,739	792,537
Deferred revenues, excluding current portion	2,917	6,632
Accrued restructuring expenses, excluding current portion	146	1,907
Capital lease obligations, excluding current portion	20,259	34,976
Deferred tax liability	10,682	134,063
Construction financing lease obligation, excluding current portion	547,051	486,359
Advance from collaborator	77,258	73,423
Other liabilities, excluding current portion	26,029	28,699
Total liabilities	1,395,081	1,558,596
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized; none issued and outstanding	—	—
Common stock, \$0.01 par value; 500,000,000 shares authorized; 252,683,346 and 248,300,517 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively	2,500	2,450
Additional paid-in capital	7,034,113	6,506,795
Accumulated other comprehensive (loss) income	(25,129)	21,173
Accumulated deficit	(5,220,407)	(5,373,836)
Total Vertex shareholders' equity	1,791,077	1,156,582
Noncontrolling interest	12,167	181,609
Total shareholders' equity	1,803,244	1,338,191
Total liabilities and shareholders' equity	\$ 3,198,325	\$ 2,896,787

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

VERTEX PHARMACEUTICALS INCORPORATED
Condensed Consolidated Statements of Shareholders' Equity and Noncontrolling Interest
(unaudited)
(in thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive (Loss) Income	Accumulated Deficit	Total Vertex Shareholders' Equity	Noncontrolling Interest	Total Shareholders' Equity
	Shares	Amount						
Balance at December 31, 2015	246,307	\$ 2,427	\$ 6,197,500	\$ 1,824	\$ (5,261,784)	\$ 939,967	\$ 153,661	\$ 1,093,628
Other comprehensive loss, net of tax	—	—	—	(5,669)	—	(5,669)	—	(5,669)
Net (loss) income	—	—	—	—	(144,997)	(144,997)	33,207	(111,790)
Issuance of common stock under benefit plans	1,722	19	50,875	—	—	50,894	—	50,894
Stock-based compensation expense	—	—	181,351	—	—	181,351	(73)	181,278
Balance at September 30, 2016	248,029	\$ 2,446	\$ 6,429,726	\$ (3,845)	\$ (5,406,781)	\$ 1,021,546	\$ 186,795	\$ 1,208,341
Balance at December 31, 2016	248,301	\$ 2,450	\$ 6,506,795	\$ 21,173	\$ (5,373,836)	\$ 1,156,582	\$ 181,609	\$ 1,338,191
Cumulative effect adjustment for adoption of new accounting guidance	—	—	9,371	—	(9,371)	—	—	—
Other comprehensive loss, net of tax	—	—	—	(46,302)	—	(46,302)	—	(46,302)
Net income (loss)	—	—	—	—	162,800	162,800	(173,350)	(10,550)
Issuance of common stock under benefit plans	4,382	50	298,956	—	—	299,006	33	299,039
Stock-based compensation expense	—	—	218,991	—	—	218,991	—	218,991
VIE noncontrolling interest upon deconsolidation	—	—	—	—	—	—	3,910	3,910
Other	—	—	—	—	—	—	(35)	(35)
Balance at September 30, 2017	252,683	\$ 2,500	\$ 7,034,113	\$ (25,129)	\$ (5,220,407)	\$ 1,791,077	\$ 12,167	\$ 1,803,244

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

VERTEX PHARMACEUTICALS INCORPORATED
Condensed Consolidated Statements of Cash Flows
(unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2017	2016
Cash flows from operating activities:		
Net loss	\$ (10,550)	\$ (111,790)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Stock-based compensation expense	215,334	178,623
Depreciation and amortization expense	44,965	45,947
Write-downs of inventories to net realizable value	11,138	—
Deferred income taxes	(113,969)	23,544
Impairment of property and equipment	1,946	—
Intangible asset impairment charge	255,340	—
Acquired in-process research & development	160,000	—
Deconsolidation of VIE	76,644	—
Other non-cash items, net	(4,787)	(904)
Changes in operating assets and liabilities:		
Accounts receivable, net	(54,455)	(9,760)
Inventories	(28,570)	(11,536)
Prepaid expenses and other assets	(90,006)	(8,979)
Accounts payable	6,925	(21,532)
Accrued expenses and other liabilities	148,102	26,121
Accrued restructuring expense	(3,863)	(8,151)
Deferred revenues	3,237	(10,204)
Net cash provided by operating activities	<u>617,431</u>	<u>91,379</u>
Cash flows from investing activities:		
Purchases of marketable securities	(431,653)	(616,625)
Maturities of marketable securities	247,149	535,379
Expenditures for property and equipment	(56,817)	(41,775)
Purchase of in-process research & development	(160,000)	—
(Decrease) increase in restricted cash and cash equivalents (VIE)	(15,643)	20,490
Investment in equity securities	—	(23,075)
Decrease (increase) in other assets	380	(93)
Net cash used in investing activities	<u>(416,584)</u>	<u>(125,699)</u>
Cash flows from financing activities:		
Issuances of common stock under benefit plans	298,205	51,165
Payments on revolving credit facility	(300,000)	—
Advance from collaborator	10,000	—
Payments on capital lease obligations	(14,188)	(13,330)
Proceeds from capital lease financing	—	2,030
Payments on construction financing lease obligation	(412)	(356)
Proceeds related to construction financing lease obligation	4,700	—
Repayments of advanced funding	(3,132)	—
Net cash (used in) provided by financing activities	<u>(4,827)</u>	<u>39,509</u>
Effect of changes in exchange rates on cash		
Net increase in cash and cash equivalents	<u>201,021</u>	<u>4,924</u>
Cash and cash equivalents—beginning of period	1,183,945	714,768
Cash and cash equivalents—end of period	<u>\$ 1,384,966</u>	<u>\$ 719,692</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 51,990	\$ 64,662
Cash paid for income taxes	\$ 4,154	\$ 1,617

Capitalization of costs related to construction financing lease obligation	\$	33,827	\$	824
Issuances of common stock from employee benefit plans receivable	\$	868	\$	19

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

VERTEX PHARMACEUTICALS INCORPORATED
Notes to Condensed Consolidated Financial Statements
(unaudited)

A. Basis of Presentation and Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements are unaudited and have been prepared by Vertex Pharmaceuticals Incorporated (“Vertex” or the “Company”) in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

The condensed consolidated financial statements reflect the operations of (i) the Company, (ii) its wholly-owned subsidiaries and (iii) consolidated variable interest entities (VIEs). All material intercompany balances and transactions have been eliminated. The Company operates in one segment, pharmaceuticals. As of September 30, 2017, the Company deconsolidated Parion Sciences, Inc. (“Parion”), a VIE the Company has consolidated since 2015. The Company’s consolidated balance sheet as of September 30, 2017 excludes Parion. Please refer to Note C, “Collaborative Arrangements and Acquisitions” for further information regarding the deconsolidation of Parion.

Certain information and footnote disclosures normally included in the Company’s annual financial statements have been condensed or omitted. These interim financial statements, in the opinion of management, reflect all normal recurring adjustments necessary for a fair presentation of the financial position and results of operations for the interim periods ended September 30, 2017 and 2016 .

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full fiscal year. These interim financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2016 , which are contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016 that was filed with the Securities and Exchange Commission (the “SEC”) on February 23, 2017 (the “ 2016 Annual Report on Form 10-K”).

Use of Estimates and Summary of Significant Accounting Policies

The preparation of condensed consolidated financial statements in accordance with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the amounts of revenues and expenses during the reported periods. Significant estimates in these condensed consolidated financial statements have been made in connection with the calculation of revenues, inventories, research and development expenses, stock-based compensation expense, restructuring expense, the fair value of intangible assets, goodwill, contingent consideration, noncontrolling interest, the consolidation and deconsolidation of VIEs, leases, the fair value of cash flow hedges and the provision for or benefit from income taxes. The Company bases its estimates on historical experience and various other assumptions, including in certain circumstances future projections that management believes to be reasonable under the circumstances. Actual results could differ from those estimates. Changes in estimates are reflected in reported results in the period in which they become known.

The Company’s significant accounting policies are described in Note A, “Nature of Business and Accounting Policies,” in the 2016 Annual Report on Form 10-K.

Recent Accounting Pronouncements

In 2014, the Financial Accounting Standards Board (“FASB”) issued new guidance applicable to revenue recognition that will be effective January 1, 2018. Early adoption was permitted for the year-ending December 31, 2017. The new guidance applies a more principles based approach to recognizing revenue. Under the new guidance, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration that an entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance must be adopted using either a modified retrospective approach or a full retrospective approach for all periods presented. Under the modified retrospective method, the cumulative effect of applying the standard would be recognized at the date of initial application within retained earnings. Under the full retrospective approach, the standard would be applied to each prior reporting period presented. Upon adoption, the Company will use the modified retrospective method. The Company continues to evaluate the new guidance and the effect the adoption will have on the condensed consolidated financial

VERTEX PHARMACEUTICALS INCORPORATED
Notes to Condensed Consolidated Financial Statements
(unaudited)

statements. The Company's project team is finalizing its review of existing customer contracts and current accounting policies to identify and assess the potential differences that would result from applying the requirements of the new standard. Based on the Company's assessment performed to date, the new revenue recognition guidance could impact the Company's accounting for product shipments to certain countries through early access programs, including the French early access programs, whereby the associated product has received regulatory approval but the price is not fixed or determinable based on the status of ongoing pricing discussions, and could impact the Company's accounting for certain reimbursement agreements that the Company plans to negotiate in the fourth quarter of 2017. As the Company completes its assessment, it is implementing appropriate changes to its controls to support revenue recognition and additional revenue-related disclosures under the new standard.

In 2016, the FASB issued amended guidance applicable to share-based compensation to employees that simplifies the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The amended guidance became effective for the Company during the first quarter of 2017. The amended guidance eliminates the requirement that excess tax benefits be realized as a reduction in current taxes payable before the associated tax benefit can be recognized as an increase in additional paid-in capital. This created approximately \$410.8 million of deferred tax asset ("DTA") relating to federal and state net operating losses ("NOLs") that are fully reserved by an equal increase in valuation allowance. The Company recorded DTAs of approximately \$404.7 million relating to Federal NOLs and approximately \$6.1 million relating to State NOLs, both of which are offset by a full valuation allowance. Upon adoption, the Company also elected to change its accounting policy to account for forfeitures of options and awards as they occur. The change was applied on a modified retrospective basis with a cumulative effect adjustment to the Company's accumulated deficit of \$9.4 million, which increased the accumulated deficit as of January 1, 2017. This change also resulted in an increase to the DTA of \$3.4 million, which is offset by a full valuation allowance. As a result, there was no cumulative-effect adjustment to accumulated deficit. The provisions related to the recognition of excess tax benefits in the income statement and classification in the statement of cash flows were adopted prospectively, and as such, the prior periods were not retrospectively adjusted.

In 2016, the FASB issued amended guidance related to the recording of financial assets and financial liabilities. Under the amended guidance, equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) are to be measured at fair value with changes in fair value recognized in net income. However, an entity has the option to either measure equity investments without readily determinable fair values at fair value or at cost adjusted for changes in observable prices minus impairment. Changes in measurement under either alternative will be recognized in net income. The amended guidance is effective for the year ending December 31, 2018. Early adoption is permitted. The Company expects the implementation of this standard to have an impact on its consolidated financial statements and related disclosures, as the Company held publicly traded equity investments as of September 30, 2017 as well as equity investments accounted for under the cost method. A cumulative-effect adjustment to the balance sheet will be recorded as of the beginning of the fiscal year of adoption. The implementation of this amended guidance is expected to increase volatility in net income as the volatility currently recorded in other comprehensive income related to changes in the fair market value of available-for-sale equity investments will be reflected in net income after adoption.

In 2016, the FASB issued amended guidance applicable to leases that will be effective for the year ending December 31, 2019. Early adoption is permitted. This guidance requires entities to recognize assets and liabilities for leases with lease terms of more than 12 months on the balance sheet. The Company is in the process of evaluating this guidance and determining the expected effect on its condensed consolidated financial statements.

In 2016, the FASB issued amended guidance related to intra-entity transfers other than inventory. This guidance removes the current exception in GAAP prohibiting entities from recognizing current and deferred income tax expenses or benefits related to transfer of assets, other than inventory, within the consolidated entity. The current exception to defer the recognition of any tax impact on the transfer of inventory within the consolidated entity until it is sold to a third party remains unaffected. The amended guidance is effective for the year ending December 31, 2018. Early adoption is permitted. The Company is in the process of evaluating this guidance and determining the expected effect on its condensed consolidated financial statements.

VERTEX PHARMACEUTICALS INCORPORATED
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In 2017, the FASB issued amended guidance related to business combinations. The amended guidance clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The new accounting guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those periods. Early adoption is permitted. The Company early adopted this new guidance as of January 1, 2017 and will apply this new guidance to future acquisitions.

In 2017, the FASB issued amended guidance related to measurements of goodwill. The amended guidance eliminates a step from the goodwill impairment test. Under the amended guidance, an entity should perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity would recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amended guidance is effective for the year-ending December 31, 2020. Early adoption is permitted. The Company does not expect a significant effect on its condensed consolidated financial statements upon adoption of this new guidance.

In 2017, the FASB issued amended guidance related to the scope of stock option modification accounting, to reduce diversity in practice and provide clarity regarding existing guidance. The new accounting guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those periods. Early adoption is permitted. The Company does not expect the adoption of this guidance to have a material effect on its condensed consolidated financial statements and related disclosures.

In 2017, the FASB issued amended guidance applicable to hedge accounting. The new accounting guidance is effective for annual periods beginning after December 15, 2018, including interim periods within those periods. Early adoption is permitted. The amended guidance helps simplify certain aspects of hedge accounting and enables entities to more accurately present their risk management activities in their financial statements. The Company is in the process of evaluating this guidance and determining the expected effect on its condensed consolidated financial statements.

For a discussion of other recent accounting pronouncements please refer to Note A, "Nature of Business and Accounting Policies—Recent Accounting Pronouncements," in the 2016 Annual Report on Form 10-K.

B. Product Revenues, Net

The Company sells its products principally to a limited number of specialty pharmacy providers in North America as well as government-owned and supported customers in international markets (collectively, its "Customers"). The Company's Customers in North America subsequently resell the products to patients and health care providers. The Company recognizes net revenues from product sales upon delivery to the Customer as long as (i) there is persuasive evidence that an arrangement exists between the Company and the Customer, (ii) collectibility is reasonably assured and (iii) the price is fixed or determinable.

In order to conclude that the price is fixed or determinable, the Company must be able to (i) calculate its gross product revenues from sales to Customers and (ii) reasonably estimate its net product revenues upon delivery to its Customers' locations. The Company calculates gross product revenues based on the price that the Company charges its Customers. The Company estimates its net product revenues by deducting from its gross product revenues (a) trade allowances, such as invoice discounts for prompt payment and Customer fees, (b) estimated government and private payor rebates, chargebacks and discounts, (c) estimated reserves for expected product returns and (d) estimated costs of co-pay assistance programs for patients, as well as other incentives for certain indirect customers.

The Company makes significant estimates and judgments that materially affect the Company's recognition of net product revenues. In certain instances, the Company may be unable to reasonably conclude that the price is fixed or determinable at the time of delivery, in which case it defers the recognition of revenues. Once the Company is able to determine that the price is fixed or determinable, it recognizes the net product revenues associated with the units in which revenue recognition was deferred.

Revenue recognition related to the Company's French early access programs could be impacted by the new revenue recognition guidance that is effective January 1, 2018 and described in Note A, "Basis of Presentation and Accounting

VERTEX PHARMACEUTICALS INCORPORATED
Notes to Condensed Consolidated Financial Statements
(unaudited)

Policies". The Company's ORKAMBI net product revenues to date do not include any revenues from product sales in France because the price is not fixed or determinable. The Company began distributing ORKAMBI through early access programs in France during the fourth quarter of 2015. As of September 30, 2017, the Company's condensed consolidated balance sheet includes \$190.3 million collected in France related to shipments of ORKAMBI under the early access programs that is classified as Customer deposits. The Company expects that the difference between the amounts collected based on the invoiced price and the final price for ORKAMBI in France will be returned to the French government.

If the Company concludes as of December 31, 2017 that the price of the ORKAMBI supplied under the early access programs is fixed or determinable based on, among other factors, the status of negotiations in France, it would record net product revenues for all sales since the inception of the early access programs for ORKAMBI based on the fixed or determinable price in the fourth quarter of 2017.

If the Company concludes that the price is not fixed or determinable as of December 31, 2017, these amounts would be subject to the new guidance applicable to revenue recognition effective January 1, 2018 using the modified retrospective adoption approach. Pursuant to the new guidance, the Company would record a cumulative effect adjustment to the Company's accumulated deficit in the first quarter of 2018. The amount of the adjustment to accumulated deficit would be determined based upon (i) the status of pricing discussions in France upon adoption and (ii) the Company's estimate of the amount of consideration the Company expects to retain related to the French ORKAMBI sales that occurred on or prior to December 31, 2017 that would not be subject to a significant reversal in amounts recognized. For French ORKAMBI sales after December 31, 2017 under the early access programs, the Company would recognize product revenues based on the Company's estimate of consideration the Company expects to retain for which it is probable that a significant reversal in amounts recognized will not occur. In future periods, if the Company's estimates regarding the amounts it will receive for ORKAMBI supplied pursuant to these programs change, the effect of the change in estimates would be reflected in net product revenues in the period in which the change in estimate occurred.

The following table summarizes activity in each of the product revenue allowance and reserve categories for the nine months ended September 30, 2017 :

	Trade Allowances	Rebates, Chargebacks and Discounts	Product Returns	Other Incentives	Total
	(in thousands)				
Balance at December 31, 2016	\$ 2,568	\$ 81,927	\$ 3,492	\$ 1,214	\$ 89,201
Provision related to current period sales	18,776	118,592	3,603	12,238	153,209
Adjustments related to prior period sales	(188)	(4,327)	(13)	(355)	(4,883)
Credits/payments made	(18,409)	(97,393)	(1,809)	(10,021)	(127,632)
Balance at September 30, 2017	<u>\$ 2,747</u>	<u>\$ 98,799</u>	<u>\$ 5,273</u>	<u>\$ 3,076</u>	<u>\$ 109,895</u>

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C. Collaborative Arrangements and Acquisitions

Cystic Fibrosis Foundation Therapeutics Incorporated

The Company has a research, development and commercialization agreement with Cystic Fibrosis Foundation Therapeutics Incorporated (“CFFT”) that was originally entered into in May 2004, and was most recently amended in October 2016 (the “2016 Amendment”). Pursuant to the agreement, as amended, the Company has agreed to pay royalties ranging from low-single digits to mid-single digits on potential sales of certain compounds first synthesized and/or tested between March 1, 2014 and August 31, 2016 and tiered royalties ranging from single digits to sub-teens on any approved drugs first synthesized and/or tested during a research term on or before February 28, 2014, including (i) KALYDECO (ivacaftor) and ORKAMBI (lumacaftor in combination with ivacaftor), which are the Company’s current products and (ii) tezacaftor in combination with ivacaftor. For combination products, such as ORKAMBI, sales will be allocated equally to each of the active pharmaceutical ingredients in the combination product.

In the first quarter of 2016, CFFT earned a commercial milestone payment of \$13.9 million from the Company upon achievement of certain sales levels of lumacaftor. There are no additional commercial milestone payments payable by the Company to CFFT pursuant to the agreement. Pursuant to the 2016 Amendment, the CFFT provided the Company an upfront program award of \$75.0 million and agreed to provide development funding to the Company of up to \$6.0 million annually. The program award plus any future development funding represent a form of financing pursuant to Accounting Standards Codification (ASC) 730, *Research and Development*, and thus the amounts are recorded as a liability on the condensed consolidated balance sheet, primarily reflected in Advance from collaborator. The liability is reduced over the estimated royalty term of the agreement. Reductions in the liability are reflected as an offset to cost of product revenues and as interest expense.

The Company has royalty obligations to CFFT for ivacaftor, lumacaftor and tezacaftor until the expiration of patents covering those compounds. The Company has patents in the United States and European Union covering the composition-of-matter of ivacaftor that expire in 2027 and 2025, respectively, subject to potential patent extensions. The Company has patents in the United States and European Union covering the composition-of-matter of lumacaftor that expire in 2030 and 2026, respectively, subject to potential extension. The Company has patents in the United States and European Union covering the composition-of-matter of tezacaftor that expire in 2027 and 2028, respectively, subject to potential extension.

CRISPR Therapeutics AG

In 2015, the Company entered into a strategic collaboration, option and license agreement (the “CRISPR Agreement”) with CRISPR Therapeutics AG and its affiliates (“CRISPR”) to collaborate on the discovery and development of potential new treatments aimed at the underlying genetic causes of human diseases using CRISPR-Cas9 gene editing technology. The Company has the exclusive right to license up to six CRISPR-Cas9-based targets, including targets for the potential treatment of sickle cell disease. In connection with the CRISPR Agreement, the Company made an upfront payment to CRISPR of \$75.0 million and a \$30.0 million investment in CRISPR pursuant to a convertible loan agreement that converted into preferred stock in January 2016. The Company expensed \$75.0 million to research and development, and the \$30.0 million investment was recorded at cost and was classified as a long-term asset on the Company’s condensed consolidated balance sheets. In the second quarter of 2016, the Company made an additional preferred stock investment in CRISPR of approximately \$3.1 million. In connection with CRISPR’s initial public offering in October 2016, the Company purchased \$10.0 million of common shares at the public offering price and the Company’s preferred stock investments in CRISPR converted into common shares. As of September 30, 2017, the Company recorded the fair value of its investment in CRISPR common shares of \$56.9 million in marketable securities and a \$13.7 million unrealized gain related to these common shares in accumulated other comprehensive income (loss) on the condensed consolidated balance sheet.

The Company will fund all of the discovery activities conducted pursuant to the CRISPR Agreement. For potential hemoglobinopathy treatments, including treatments for sickle cell disease, the Company and CRISPR will share equally all development costs and worldwide revenues. For other targets that the Company elects to license, the Company would lead all development and global commercialization activities. For each of up to six targets that the Company elects to license, other than hemoglobinopathy targets, CRISPR has the potential to receive up to \$420.0 million in development, regulatory and commercial milestones and royalties on net product sales.

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The Company may terminate the CRISPR Agreement upon 90 days' notice to CRISPR prior to any product receiving marketing approval or upon 270 days' notice after a product has received marketing approval. The CRISPR Agreement also may be terminated by either party for a material breach by the other, subject to notice and cure provisions. Unless earlier terminated, the CRISPR Agreement will continue in effect until the expiration of the Company's payment obligations under the CRISPR Agreement.

Merck KGaA

On January 10, 2017, the Company entered into a strategic collaboration and license agreement (the "Merck KGaA Agreement") with Merck KGaA, Darmstadt, Germany ("Merck KGaA"). Pursuant to the Merck KGaA Agreement, the Company granted Merck KGaA an exclusive worldwide license to research, develop and commercialize four oncology research and development programs. Under the Merck KGaA Agreement, the Company granted Merck KGaA exclusive, worldwide rights to two clinical-stage programs targeting DNA damage repair: its ataxia telangiectasia and Rad3-related protein inhibitor program, including VX-970 and VX-803, and its DNA-dependent protein kinase inhibitor program, including VX-984. In addition, the Company granted Merck KGaA exclusive, worldwide rights to two pre-clinical programs.

The Merck KGaA Agreement provided for an upfront payment from Merck KGaA to the Company of \$230.0 million. During the first quarter of 2017, the Company received \$193.6 million of the upfront payment and the remaining \$36.4 million was remitted to the German tax authorities. Pursuant to a tax treaty between the United States and Germany, the Company filed a refund application for the tax withholding and expects to receive the refund in the fourth quarter of 2017. The income tax receivable is included in Prepaid expenses and other current assets at September 30, 2017. In addition to the upfront payment, the Company will receive tiered royalties on potential sales of licensed products, calculated as a percentage of net sales, that range from (i) mid-single digits to mid-twenties for clinical-stage programs and (ii) mid-single digits to high single digits for the pre-clinical research programs. Merck KGaA has assumed full responsibility for development and commercialization costs for all programs.

The Company evaluated the deliverables, primarily consisting of a license to the four programs and the obligation to complete certain fully-reimbursable research and development and transition activities as directed by Merck KGaA, pursuant to the Merck KGaA Agreement, under the multiple element arrangement accounting guidance. The Company concluded that the license has stand-alone value from the research and development and transition activities based on the resources and know-how possessed by Merck KGaA, and thus concluded that there are two units of accounting in the arrangement. The Company determined the relative selling price of the units of accounting based on the Company's best estimate of selling price. The Company utilized key assumptions to determine the best estimate of selling price for the license, which included future potential net sales of licensed products, development timelines, reimbursement rates for personnel costs, discount rates, and estimated third-party development costs. The Company utilized a discounted cash flow model to determine its best estimate of selling price for the license and determined the best estimate of selling price for the research and development and transition activities based on what it would sell the services for separately. Based on this analysis, the Company recognized approximately \$231.7 million in collaborative revenues related to the upfront payment upon delivery of the license and to the research and development and transition activities provided during the first quarter of 2017. During the three and nine months ended September 30, 2017, the Company recorded the reimbursement for the research and development and transition activities of \$5.2 million and \$12.8 million, respectively, as revenue in the Company's consolidated statements of operations primarily due to the fact that the Company is the primary obligor in the arrangement. The Company is providing research and development and transition activities and will recognize the revenues and associated expenses as the services are provided.

Merck KGaA may terminate the Merck KGaA Agreement or any individual program by providing 90 days' notice, or, in the case of termination of a program with a product that has received marketing approval, 180 days' notice. The Merck KGaA Agreement also may be terminated by either party for a material breach by the other party, subject to notice and cure provisions. Unless earlier terminated, the Merck KGaA Agreement will continue in effect until the date on which the royalty term and all payment obligations with respect to all products in all countries have expired.

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Variable Interest Entities

The Company has entered into several agreements pursuant to which it has licensed rights to certain drug candidates from third-party collaborators, resulting in the consolidation of the third parties' financial statements into the Company's condensed consolidated financial statements as VIEs. In order to account for the fair value of the contingent payments, which consist of milestone, royalty and option payments, related to these collaborations under GAAP, the Company uses present-value models based on assumptions regarding the probability of achieving the relevant milestones, estimates regarding the timing of achieving the milestones, estimates of future product sales and the appropriate discount rates. The Company bases its estimate of the probability of achieving the relevant milestones on industry data for similar assets and its own experience. The discount rates used in the valuation model represent a measure of credit risk and market risk associated with settling the liabilities. Significant judgment is used in determining the appropriateness of these assumptions at each reporting period. Changes in these assumptions could have a material effect on the fair value of the contingent payments. The following collaborations are reflected in the Company's financial statements as consolidated VIEs for portions or all of the periods presented:

Parion Sciences, Inc.

In June 2015, the Company entered into a strategic collaboration and license agreement (the "Parion Agreement") with Parion. Pursuant to the agreement, the Company is collaborating with Parion to develop investigational epithelial sodium channel ("ENaC") inhibitors, including VX-371 (formerly P-1037) and VX-551 (formerly P-1055), for the potential treatment of CF and all other pulmonary diseases. The Company is leading development activities for VX-371 and VX-551 and is responsible for all costs, subject to certain exceptions, related to development and commercialization of the compounds.

Pursuant to the Parion Agreement, the Company has worldwide development and commercial rights to Parion's lead investigational ENaC inhibitors, VX-371 and VX-551, for the potential treatment of CF and all other pulmonary diseases and has the option to select additional compounds discovered in Parion's research program. Parion received an \$80.0 million up-front payment and has the potential to receive up to an additional (i) \$490.0 million in development and regulatory milestone payments for development of ENaC inhibitors in CF, including \$360.0 million related to global filing and approval milestones, (ii) \$370.0 million in development and regulatory milestones for VX-371 and VX-551 in non-CF pulmonary indications and (iii) \$230.0 million in development and regulatory milestones should the Company elect to develop an additional ENaC inhibitor from Parion's research program. The Company has agreed to pay Parion tiered royalties that range from the low double digits to mid-teens as a percentage of potential sales of licensed products.

The Company may terminate the Parion Agreement upon 90 days' notice to Parion prior to any licensed product receiving marketing approval or upon 180 days' notice after a licensed product has received marketing approval. If the Company experiences a change of control prior to the initiation of the first Phase 3 clinical trial for a licensed product, Parion may terminate the Parion Agreement upon 30 days' notice, subject to the Company's right to receive specified royalties on any subsequent commercialization of licensed products. The Parion Agreement also may be terminated by either party for a material breach by the other, subject to notice and cure provisions. Unless earlier terminated, the Parion Agreement will continue in effect until the expiration of the Company's royalty obligations, which expire on a country-by-country basis on the later of (i) the date the last-to-expire patent covering a licensed product expires or (ii) ten years after the first commercial sale in the country.

The Company determined that it had a variable interest in Parion via the Parion Agreement, and that the variable interest represented a variable interest in Parion as a whole because the fair value of the ENaC inhibitors represented more than half of the total fair value of Parion's assets. The Company also concluded that it was the primary beneficiary as it had the power to direct the activities that most significantly affect the economic performance of Parion and it had the obligation to absorb losses and right to receive benefits that potentially could be significant to Parion. Accordingly, the Company consolidated Parion's financial statements from June 4, 2015 through September 30, 2017. The Company deconsolidated Parion effective September 30, 2017. Notwithstanding the applicable accounting treatment, the Company's interests in Parion have been and continue to be limited to those accorded to the Company in the Parion Agreement.

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As of June 4, 2015, the Company consolidated Parion's financial statements, which included \$255.3 million of intangible assets on the Company's condensed consolidated balance sheet for Parion's in-process research and development assets. These in-process research and development assets relate to Parion's pulmonary ENaC platform, including the intellectual property related to VX-371 and VX-551, that are licensed by Parion to the Company. The Company also recorded the fair value of the net assets attributable to noncontrolling interest of \$164.3 million, deferred tax liability of \$91.0 million resulting primarily from a basis difference in the intangible assets and certain other net liabilities held by Parion of \$10.5 million. The difference between the fair values of the consideration and noncontrolling interest and the fair value of Parion's net assets was recorded as goodwill. When determining the valuation of goodwill, the fair value of consideration for the license was zero since there was no consideration transferred outside the condensed consolidated financial statements. While there was a transfer of \$80.0 million for the upfront payment to Parion, the cash remained within the Company's condensed consolidated balance sheet since Parion was part of the consolidated entity. The cash received, net of any cash spent by Parion, was classified as restricted cash and cash equivalents (VIE) within the condensed consolidated balance sheet as it was attributed to the noncontrolling interest holders of Parion.

In the second quarter of 2017, Parion signed a license agreement with an affiliate of Shire plc related to the development of a drug candidate for the potential treatment of dry eye disease. The Company evaluated the license agreement entered into by Parion as a reconsideration event to determine whether it should continue to consolidate Parion as a variable interest entity into its condensed consolidated financial statements. The Company determined that there was no substantive change in the design of Parion subsequent to Parion's agreement with Shire. Additionally, the Company concluded that it was appropriate to continue to consolidate the financial results of Parion because it continued to have (i) the power to direct the activities that most significantly affect the economic performance of Parion and (ii) the obligation to absorb losses and right to receive benefits that potentially could be significant to Parion. Based on the consolidation of Parion's financial statements, during the three and nine months ended September 30, 2017, the Company has recognized (i) \$20.0 million and \$40.0 million, respectively, of collaborative revenues and (ii) a tax provision of \$7.4 million and \$14.8 million, respectively, both of which were attributable to noncontrolling interest related to payments that Parion received from Shire in the three and nine months ended September 30, 2017. The Company has no interest in Parion's license agreement with Shire, including the economic benefits and/or obligations derived therefrom.

As of September 30, 2017, the Company determined that the fair value of Parion's pulmonary ENaC platform had declined significantly based on data received in September 2017 from a Phase 2 clinical trial of VX-371 that did not meet its primary efficacy endpoint. The Company recorded an impairment charge of \$255.3 million, which represented the entire value of the intangible asset in the third quarter of 2017. After evaluating the results of the clinical trial, the Company determined that it was no longer the primary beneficiary of Parion as it no longer had the power to direct the significant activities of Parion. The most important factor in this determination was the decrease in the fair value of Parion's pulmonary ENaC platform relative to Parion's other activities. Accordingly, the Company deconsolidated Parion as of September 30, 2017. The impairment charge of \$255.3 million, decrease in the fair value of the contingent payments payable by the Company to Parion of \$69.6 million and benefit from income taxes of \$126.2 million resulting from these charges were recorded in the third quarter of 2017 attributable to noncontrolling interest. The benefit from income taxes consisted of benefits of \$97.7 million and \$28.5 million attributable to the impairment charge and decrease in the fair value of contingent payments, respectively. The net effect of these charges and impact of the deconsolidation was a loss of \$7.1 million recorded in other income (expense), net attributable to Vertex in the consolidated statement of operations for the three and nine months ended September 30, 2017. The loss of \$7.1 million was approximately the difference between (i) the aggregate of \$85.0 million in upfront and milestone payments that the Company has made to Parion to date pursuant to the Parion Agreement and (ii) losses the Company recorded in 2015, 2016, and the first half of 2017 based on increases in the fair value of contingent payments payable by the Company to Parion.

Please refer to Note J, "Intangible Assets and Goodwill," for further information regarding the impairment of Parion's pulmonary ENaC platform.

In connection with the deconsolidation of Parion, the Company evaluated whether the results of Parion should be presented as discontinued operations for the three and nine month period ending September 30, 2017. The Company concluded that the deconsolidation of Parion based on data from the Phase 2 clinical trial of VX-371 is not a development that significantly impacts the Company's overall operations and financial results or plans to treat patients with CF. Research

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and development expenses incurred related to this program accounted for a minor portion of the Company’s overall annual research and development expenses and the Company remains focused on developing medicines to treat CF. Therefore, the Company has not presented the results related to Parion as discontinued operations in its condensed consolidated statements of operations for the three and nine month ending September 30, 2017.

BioAxone Biosciences, Inc.

In October 2014, the Company entered into a license and collaboration agreement (the “BioAxone Agreement”) with BioAxone Biosciences, Inc. (“BioAxone”), which resulted in the consolidation of BioAxone as a VIE beginning on October 1, 2014. The Company paid BioAxone initial payments of \$10.0 million in the fourth quarter of 2014.

BioAxone has the potential to receive up to \$90.0 million in milestones and fees, including development, regulatory and milestone payments and a license continuation fee. In addition, BioAxone would receive royalties and commercial milestones on future net product sales of VX-210, if any. The Company recorded an in-process research and development intangible asset of \$29.0 million for VX-210 and a corresponding deferred tax liability of \$11.3 million attributable to BioAxone. The Company holds an option to purchase BioAxone at a predetermined price. The option expires on the earliest of (a) the day the FDA accepts the Biologics License Application submission for VX-210, (b) the day the Company elects to continue the license instead of exercising the option to purchase BioAxone and (c) March 15, 2018, subject to the Company’s option to extend this date by one year.

Aggregate VIE Financial Information

An aggregate summary of net income attributable to noncontrolling interest related to the Company’s VIEs for the three and nine months ended September 30, 2017 and 2016 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(in thousands)			
Loss attributable to noncontrolling interest before (benefit from) provision for income taxes and changes in fair value of contingent payments	\$ 238,946	\$ 2,406	\$ 222,448	\$ 6,080
(Benefit from) provision for income taxes	(120,181)	(510)	(111,658)	20,063
Decrease (increase) in fair value of contingent payments	69,550	(1,200)	62,560	(59,350)
Net loss (income) attributable to noncontrolling interest	\$ 188,315	\$ 696	\$ 173,350	\$ (33,207)

The decreases in the noncontrolling interest holders’ claim to net assets with respect to the fair value of the contingent payments in the three and nine months ended September 30, 2017 were primarily due to the decrease in the fair value of Parion’s pulmonary ENaC platform described above. The increases in the fair value of the contingent payments in the three and nine months ended September 30, 2016 were primarily due to a separate Phase 2 clinical trial of VX-371 achieving its primary safety endpoint in the second quarter of 2016. During the three and nine months ended September 30, 2017 and 2016, the (increases) decreases in the fair value of the contingent payments related to the Company’s VIEs were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(in thousands)			
Parion	\$ 69,550	\$ (1,100)	\$ 63,460	\$ (58,500)
BioAxone	—	(100)	(900)	(850)

The fair value of the contingent payments related to the Parion Agreement and the BioAxone Agreement as of the dates set forth in the table:

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	September 30, 2017	December 31, 2016
	(in thousands)	
Parion	\$ —	\$ 238,800
BioAxone	18,900	18,000

The table below summarizes items related to the Company's VIEs included in the Company's condensed consolidated balance sheets as of the dates set forth in the table. Amounts as of September 30, 2017 related to BioAxone while amounts as of December 31, 2016 related to Parion and BioAxone.

	September 30, 2017	December 31, 2016
	(in thousands)	
Restricted cash and cash equivalents (VIE)	\$ 1,803	\$ 47,762
Prepaid expenses and other current assets	42	6,812
Intangible assets	29,000	284,340
Other assets	280	399
Accounts payable	455	415
Accrued expenses	1,021	1,330
Other liabilities, current portion	119	2,137
Deferred tax liability	8,338	131,446
Other liabilities, excluding current portion	—	300
Noncontrolling interest	12,167	181,609

The Company has recorded the VIEs' cash and cash equivalents as restricted cash and cash equivalents (VIE) because (i) the Company does not have any interest in or control over the VIEs' cash and cash equivalents and (ii) the Company's agreements with each VIE do not provide for the VIEs' cash and cash equivalents to be used for the development of the assets that the Company licensed from the applicable VIE. Assets recorded as a result of consolidating the Company's VIEs' financial condition into the Company's balance sheets do not represent additional assets that could be used to satisfy claims against the Company's general assets.

Other Collaborations

The Company has entered into various agreements pursuant to which it collaborates with third parties, including inlicensing and outlicensing arrangements. Although the Company does not consider any of these arrangements to be material, the most notable of these arrangements are described below.

Moderna Therapeutics, Inc.

In July 2016, the Company entered into a strategic collaboration and licensing agreement (the "Moderna Agreement") with Moderna Therapeutics, Inc. ("Moderna") pursuant to which the parties are seeking to identify and develop messenger Ribonucleic Acid ("mRNA") Therapeutics for the treatment of CF. In connection with the Moderna Agreement, in the third quarter of 2016, the Company made an upfront payment to Moderna of \$20.0 million and a \$20.0 million cost-method investment in Moderna pursuant to a convertible promissory note that converted into preferred stock in August 2016. Moderna has the potential to receive future development and regulatory milestones of up to \$275.0 million, including \$220.0 million in approval and reimbursement milestones, as well as tiered royalty payments on future sales.

Under the terms of the Moderna Agreement, Moderna will lead discovery efforts and the Company will lead all preclinical, development and commercialization activities associated with the advancement of mRNA Therapeutics that result from this collaboration and will fund all expenses related to the collaboration.

The Company may terminate the Moderna Agreement by providing advance notice to Moderna, with the required length of notice dependent on whether any product developed under the Moderna Agreement has received marketing approval. The Moderna Agreement also may be terminated by either party for a material breach by the other, subject to notice and cure.

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provisions. Unless earlier terminated, the Moderna Agreement will continue in effect until the expiration of the Company's payment obligations under the Moderna Agreement.

The Company evaluates the carrying value of its \$20.0 million cost-method investment in Moderna, which is not a publicly traded company, for impairment on a quarterly basis and has not recorded any adjustments to the carrying value of its investment to date.

Janssen Pharmaceuticals, Inc.

In June 2014, the Company entered into an agreement (the "Janssen Agreement") with Janssen Pharmaceuticals, Inc. ("Janssen Inc."), which was amended in October 2014 to clarify certain roles and responsibilities of the parties.

Pursuant to the Janssen Agreement, Janssen Inc. has an exclusive worldwide license to develop and commercialize certain drug candidates for the treatment of influenza, including JNJ-3872 (formerly VX-787). The Company received non-refundable payments of \$35.0 million from Janssen Inc. in 2014, which were recorded as collaborative revenue. The Company has the potential to receive development, regulatory and commercial milestone payments as well as royalties on future product sales, if any. Janssen Inc. may terminate the Janssen Agreement, subject to certain exceptions, upon six months' notice.

Janssen Inc. is responsible for costs related to the development and commercialization of the compounds. During the three and nine months ended September 30, 2017 the Company recorded reimbursement for these development activities of zero and \$1.8 million, respectively. During the three and nine months ended September 30, 2016 the Company recorded reimbursement for these development activities of \$2.8 million and \$10.6 million, respectively. The reimbursements are recorded as a reduction to development expense in the Company's condensed consolidated statements of operations primarily due to the fact that Janssen Inc. directs the activities and selects the suppliers associated with these activities.

Asset Acquisition

Concert Pharmaceuticals

In July 2017, the Company completed the acquisition of certain CF assets including VX-561 (formerly CTP-656) from Concert Pharmaceuticals Inc. ("Concert") pursuant to an asset purchase agreement that was entered into in March 2017 (the "Concert Agreement"). VX-561 is an investigational CFTR potentiator that has the potential to be used as part of future once-daily combination regimens of CFTR modulators that treat the underlying cause of CF. As part of the Concert Agreement, Vertex paid Concert \$160.0 million in cash for all worldwide development and commercialization rights to VX-561. If VX-561 is approved as part of a combination regimen to treat CF, Concert could receive up to an additional \$90.0 million in milestones based on regulatory approval in the U.S. and reimbursement in the UK, Germany or France. The Company determined that substantially all of the fair value of the Concert Agreement was attributable to a single in-process research and development asset, VX-561, which did not constitute a business. The Company cannot conclude that there is any alternative future use for the acquired in-process research and development asset. Thus, the Company recorded the \$160.0 million upfront payment as a research and development expense in the three and nine months ended September 30, 2017. The total purchase price for the transaction was \$165.1 million including \$5.1 million of transaction costs that were recorded as sales, general and administrative expenses. If the Company achieves one or more of the \$90.0 million of regulatory approval and reimbursement milestones, the Company will record the value of the milestone as an intangible asset and will begin amortizing the asset in cost of product revenues in the period that the relevant milestone is achieved.

D. Earnings Per Share

Basic net income (loss) per share attributable to Vertex common shareholders is based upon the weighted-average number of common shares outstanding during the period, excluding restricted stock and restricted stock units that have been issued but are not yet vested. Diluted net income (loss) per share attributable to Vertex common shareholders is based upon the weighted-average number of common shares outstanding during the period plus additional weighted-average common equivalent shares outstanding during the period when the effect is dilutive.

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The following table sets forth the computation of basic and diluted net income (loss) per share for the periods ended:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
(in thousands, except per share amounts)				
<i>Basic net income (loss) attributable to Vertex per common share calculation:</i>				
Net income (loss) attributable to Vertex common shareholders	\$ (102,952)	\$ (38,841)	\$ 162,800	\$ (144,997)
Less: Undistributed earnings allocated to participating securities	—	—	(203)	—
Net income (loss) attributable to Vertex common shareholders—basic	\$ (102,952)	\$ (38,841)	\$ 162,597	\$ (144,997)
Basic weighted-average common shares outstanding	250,268	244,920	247,963	244,529
Basic net income (loss) attributable to Vertex per common share	\$ (0.41)	\$ (0.16)	\$ 0.66	\$ (0.59)
<i>Diluted net income (loss) attributable to Vertex per common share calculation:</i>				
Net income (loss) attributable to Vertex common shareholders	\$ (102,952)	\$ (38,841)	\$ 162,800	\$ (144,997)
Less: Undistributed earnings allocated to participating securities	—	—	(200)	—
Net income (loss) attributable to Vertex common shareholders—diluted	\$ (102,952)	\$ (38,841)	\$ 162,600	\$ (144,997)
Weighted-average shares used to compute basic net income (loss) per common share	250,268	244,920	247,963	244,529
<i>Effect of potentially dilutive securities:</i>				
Stock options	—	—	2,700	—
Restricted stock and restricted stock units	—	—	1,204	—
Other	—	—	228	—
Weighted-average shares used to compute diluted net income (loss) per common share	250,268	244,920	252,095	244,529
Diluted net income (loss) attributable to Vertex per common share	\$ (0.41)	\$ (0.16)	\$ 0.64	\$ (0.59)

The Company did not include the securities in the following table in the computation of the dilutive net income (loss) per share attributable to Vertex common shareholders calculations because the effect would have been anti-dilutive during each period:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
(in thousands)				
Stock options	10,278	12,947	3,904	12,947
Unvested restricted stock and restricted stock units	4,241	3,624	281	3,624

E. Fair Value Measurements

The fair value of the Company's financial assets and liabilities reflects the Company's estimate of amounts that it would have received in connection with the sale of the assets or paid in connection with the transfer of the liabilities in an orderly transaction between market participants at the measurement date. In connection with measuring the fair value of its assets and liabilities, the Company seeks to maximize the use of observable inputs (market data obtained from sources independent from the Company) and to minimize the use of unobservable inputs (the Company's assumptions about how market

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participants would price assets and liabilities). The following fair value hierarchy is used to classify assets and liabilities based on the observable inputs and unobservable inputs used in order to value the assets and liabilities:

- Level 1: Quoted prices in active markets for identical assets or liabilities. An active market for an asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2: Observable inputs other than Level 1 inputs. Examples of Level 2 inputs include quoted prices in active markets for similar assets or liabilities and quoted prices for identical assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs based on the Company's assessment of the assumptions that market participants would use in pricing the asset or liability.

The Company's investment strategy is focused on capital preservation. The Company invests in instruments that meet the credit quality standards outlined in the Company's investment policy. This policy also limits the amount of credit exposure to any one issue or type of instrument. As of September 30, 2017, the Company's investments were primarily in money market funds, government-sponsored enterprise securities, corporate equity securities, corporate debt securities and commercial paper. Additionally, the Company utilizes foreign currency forward contracts intended to mitigate the effect of changes in foreign exchange rates on its condensed consolidated statement of operations.

As of September 30, 2017, all of the Company's financial assets and liabilities that were subject to fair value measurements were valued using observable inputs. The Company's financial assets valued based on Level 1 inputs consisted of money market funds, government-sponsored enterprise securities and corporate equity securities. The Company's financial assets and liabilities valued based on Level 2 inputs consisted of corporate debt securities and commercial paper, which consisted of investments in highly-rated investment-grade corporations and foreign currency forward contracts with highly reputable and creditworthy counterparties.

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The following table sets forth the Company's financial assets (excluding VIE cash and cash equivalents, which are recorded as Restricted cash and cash equivalents (VIE)) and liabilities subject to fair value measurements:

	Fair Value Measurements as of September 30, 2017			
	Total	Fair Value Hierarchy		
		Level 1	Level 2	Level 3
(in thousands)				
Financial instruments carried at fair value (asset position):				
Cash equivalents:				
Money market funds	\$ 466,702	\$ 466,702	\$ —	\$ —
Government-sponsored enterprise securities	14,979	14,979	—	—
Corporate debt securities	4,488	—	4,488	—
Commercial paper	14,608	—	14,608	—
Marketable securities:				
Corporate equity securities	56,944	56,944	—	—
Corporate debt securities	295,171	—	295,171	—
Commercial paper	75,167	—	75,167	—
Prepaid and other current assets:				
Foreign currency forward contracts	42	—	42	—
Other assets:				
Foreign currency forward contracts	8	—	8	—
Total financial assets	\$ 928,109	\$ 538,625	\$ 389,484	\$ —
Financial instruments carried at fair value (liability position):				
Other liabilities, current portion:				
Foreign currency forward contracts	\$ (13,897)	\$ —	\$ (13,897)	\$ —
Other liabilities, excluding current portion:				
Foreign currency forward contracts	(977)	—	(977)	—
Total financial liabilities	\$ (14,874)	\$ —	\$ (14,874)	\$ —
Fair Value Measurements as of December 31, 2016				
	Total	Fair Value Hierarchy		
		Level 1	Level 2	Level 3
(in thousands)				
Financial instruments carried at fair value (asset position):				
Cash equivalents:				
Money market funds	\$ 280,560	\$ 280,560	\$ —	\$ —
Marketable securities:				
Government-sponsored enterprise securities	15,508	15,508	—	—
Corporate equity securities	64,560	64,560	—	—
Commercial paper	59,404	—	59,404	—
Corporate debt securities	111,140	—	111,140	—
Prepaid and other current assets:				
Foreign currency forward contracts	14,407	—	14,407	—
Other assets:				
Foreign currency forward contracts	1,186	\$ —	1,186	\$ —
Total financial assets	\$ 546,765	\$ 360,628	\$ 186,137	\$ —
Financial instruments carried at fair value (liability position):				
Other liabilities, current portion:				
Foreign currency forward contracts	\$ (144)	\$ —	\$ (144)	\$ —
Total financial liabilities	\$ (144)	\$ —	\$ (144)	\$ —

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The Company's VIE invested in cash equivalents consisting of money market funds of \$1.5 million as of September 30, 2017, which are valued based on Level 1 inputs. These cash equivalents are not included in the table above. The Company's noncontrolling interest related to the Company's VIE includes the fair value of the contingent payments, which consist of milestone, royalty and option payments, which are valued based on Level 3 inputs. Please refer to Note C, "Collaborative Arrangements and Acquisitions," for further information.

F. Marketable Securities

A summary of the Company's cash, cash equivalents and marketable securities is shown below:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(in thousands)				
As of September 30, 2017				
Cash and cash equivalents:				
Cash and money market funds	\$ 1,350,891	\$ —	\$ —	\$ 1,350,891
Government-sponsored enterprise securities	14,979	—	—	14,979
Commercial paper	14,610	—	(2)	14,608
Corporate debt securities	4,488	—	—	4,488
Total cash and cash equivalents	\$ 1,384,968	\$ —	\$ (2)	\$ 1,384,966
Marketable securities:				
Corporate equity securities	43,213	13,731	—	56,944
Commercial paper (matures within 1 year)	75,186	1	(20)	75,167
Corporate debt securities (matures within 1 year)	235,679	8	(106)	235,581
Corporate debt securities (matures after 1 year)	59,651	—	(61)	59,590
Total marketable securities	\$ 413,729	\$ 13,740	\$ (187)	\$ 427,282
Total cash, cash equivalents and marketable securities	\$ 1,798,697	\$ 13,740	\$ (189)	\$ 1,812,248
As of December 31, 2016				
Cash and cash equivalents:				
Cash and money market funds	\$ 1,183,945	\$ —	\$ —	\$ 1,183,945
Total cash and cash equivalents	\$ 1,183,945	\$ —	\$ —	\$ 1,183,945
Marketable securities:				
Government-sponsored enterprise securities (matures within 1 year)	\$ 15,506	\$ 2	\$ —	\$ 15,508
Corporate equity securities	43,213	21,347	—	64,560
Commercial paper (matures within 1 year)	59,331	73	—	59,404
Corporate debt securities (matures within 1 year)	111,225	—	(85)	111,140
Total marketable securities	\$ 229,275	\$ 21,422	\$ (85)	\$ 250,612
Total cash, cash equivalents and marketable securities	\$ 1,413,220	\$ 21,422	\$ (85)	\$ 1,434,557

The Company has a limited number of marketable securities in insignificant loss positions as of September 30, 2017, which the Company does not intend to sell and has concluded it will not be required to sell before recovery of the amortized costs of the investment at maturity. There were no charges recorded for other-than-temporary declines in fair value of marketable securities nor gross realized gains or losses recognized in the three and nine months ended September 30, 2017 and 2016.

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G. Accumulated Other Comprehensive Income (Loss)

A summary of the Company's changes in accumulated other comprehensive income (loss) by component is shown below:

	Foreign Currency Translation Adjustment	Unrealized Holding Gains (Losses) on Marketable Securities, Net of Tax	Unrealized Gains (Losses) on Foreign Currency Forward Contracts, Net of Tax	Total
(in thousands)				
Balance at December 31, 2016	\$ (7,862)	\$ 17,521	\$ 11,514	\$ 21,173
Other comprehensive loss before reclassifications	(11,137)	(7,786)	(25,981)	(44,904)
Amounts reclassified from accumulated other comprehensive income (loss)	—	—	(1,398)	(1,398)
Net current period other comprehensive (loss) income	\$ (11,137)	\$ (7,786)	\$ (27,379)	\$ (46,302)
Balance at September 30, 2017	\$ (18,999)	\$ 9,735	\$ (15,865)	\$ (25,129)

	Foreign Currency Translation Adjustment	Unrealized Holding Gains on Marketable Securities	Unrealized Gains (Losses) on Foreign Currency Forward Contracts, Net of Tax	Total
(in thousands)				
Balance at December 31, 2015	\$ (2,080)	\$ 126	\$ 3,778	\$ 1,824
Other comprehensive (loss) income before reclassifications	(7,709)	104	6,715	(890)
Amounts reclassified from accumulated other comprehensive income (loss)	—	—	(4,779)	(4,779)
Net current period other comprehensive (loss) income	\$ (7,709)	\$ 104	\$ 1,936	\$ (5,669)
Balance at September 30, 2016	\$ (9,789)	\$ 230	\$ 5,714	\$ (3,845)

H. Hedging

The Company maintains a hedging program intended to mitigate the effect of changes in foreign exchange rates for a portion of the Company's forecasted product revenues denominated in certain foreign currencies. The program includes foreign currency forward contracts that are designated as cash flow hedges under GAAP having contractual durations from one to eighteen months.

The Company formally documents the relationship between foreign currency forward contracts (hedging instruments) and forecasted product revenues (hedged items), as well as the Company's risk management objective and strategy for undertaking various hedging activities, which includes matching all foreign currency forward contracts that are designated as cash flow hedges to forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the foreign currency forward contracts are highly effective in offsetting changes in cash flows of hedged items on a prospective and retrospective basis. If the Company determines that a (i) foreign currency forward contract is not highly effective as a cash flow hedge, (ii) foreign currency forward contract has ceased to be a highly effective hedge or (iii) forecasted transaction is no longer probable of occurring, the Company would discontinue hedge accounting treatment prospectively. The Company measures effectiveness based on the change in fair value of the forward contracts and the fair value of the hypothetical foreign currency forward contracts with terms that match the critical terms of the risk being hedged. As of September 30, 2017, all hedges were determined to be highly effective and the Company had not recorded any ineffectiveness related to the hedging program.

The following table summarizes the notional amount of the Company's outstanding foreign currency forward contracts designated as cash flow hedges under GAAP:

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Foreign Currency	As of September 30, 2017		As of December 31, 2016	
	(in thousands)			
Euro	\$	234,477	\$	164,368
British pound sterling		77,387		65,237
Australian dollar		31,283		23,776
Total foreign currency forward contracts	\$	343,147	\$	253,381

The following table summarizes the fair value of the Company's outstanding foreign currency forward contracts designated as cash flow hedges under GAAP included on the Company's condensed consolidated balance sheets:

As of September 30, 2017

Assets		Liabilities	
Classification	Fair Value	Classification	Fair Value
(in thousands)			
Prepaid and other current assets	\$ 42	Other liabilities, current portion	\$ (13,897)
Other assets	8	Other liabilities, excluding current portion	(977)
Total assets	\$ 50	Total liabilities	\$ (14,874)

As of December 31, 2016

Assets		Liabilities	
Classification	Fair Value	Classification	Fair Value
(in thousands)			
Prepaid and other current assets	\$ 14,407	Other liabilities, current portion	\$ (144)
Other assets	1,186	Other liabilities, excluding current portion	—
Total assets	\$ 15,593	Total liabilities	\$ (144)

As of September 30, 2017, the Company expects amounts recorded in prepaid and other current assets and other liabilities, current portion to be reclassified to earnings within twelve months.

The following table summarizes the potential effect of offsetting derivatives by type of financial instrument designated as cash flow hedges under GAAP on the Company's condensed consolidated balance sheets:

As of September 30, 2017

Foreign currency forward contracts	Gross Amounts Recognized	Gross Amounts Offset	Gross Amounts Presented	Gross Amounts Not Offset	Legal Offset
	(in thousands)				
Total assets	\$ 50	\$ —	\$ 50	\$ (50)	\$ —
Total liabilities	\$ (14,874)	\$ —	\$ (14,874)	\$ 50	\$ (14,824)

As of December 31, 2016

Foreign currency forward contracts	Gross Amounts Recognized	Gross Amounts Offset	Gross Amounts Presented	Gross Amounts Not Offset	Legal Offset
	(in thousands)				
Total assets	\$ 15,593	\$ —	\$ 15,593	\$ (144)	\$ 15,449
Total liabilities	\$ (144)	\$ —	\$ (144)	\$ 144	\$ —

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The Company also enters into foreign exchange forward contracts with contractual maturities of less than one month designed to mitigate the effect of changes in foreign exchange rates on monetary assets and liabilities including intercompany balances. The Company recognized losses of \$4.1 million and \$13.0 million, recorded in other income (expense), net, for the three and nine months ended September 30, 2017, respectively, related to foreign exchange contracts, which are not designated as hedging instruments under GAAP. The Company recognized a loss of \$1.2 million and a gain of \$0.5 million, for the three and nine months ended September 30, 2016, respectively, related to foreign exchange contracts not designated as hedging instruments.

As of September 30, 2017, the notional amount of foreign exchange contracts where hedge accounting under GAAP is not applied was \$113.8 million. The following table summarizes the fair value of the Company's outstanding foreign currency forward contracts not designated for hedge accounting included on the Company's condensed consolidated balance sheets:

	As of September 30, 2017	As of December 31, 2016
	(in thousands)	
Prepaid expenses and other current assets	\$ 1,709	\$ 660

I. Inventories

Inventories consisted of the following:

	As of September 30, 2017	As of December 31, 2016
	(in thousands)	
Raw materials	\$ 12,678	\$ 6,348
Work-in-process	67,826	56,672
Finished goods	17,688	14,584
Total	\$ 98,192	\$ 77,604

Based on its evaluation of, among other factors, information regarding tezacaftor's safety and efficacy, the Company has capitalized \$9.6 million of inventory costs for tezacaftor manufactured in preparation for its potential product launch as of September 30, 2017. In periods prior, the Company expensed costs associated with tezacaftor's raw materials and work-in-process as a development expense. The Company submitted a New Drug Application to the United States Food and Drug Administration and a Marketing Authorization Application to the European Medicines Agency for tezacaftor in combination with ivacaftor. The Company plans to continue to monitor the status of the tezacaftor regulatory process and the other factors used to determine whether or not to capitalize the tezacaftor inventory and, if there are significant negative developments regarding tezacaftor, the Company could be required to impair previously capitalized costs.

J. Intangible Assets and Goodwill

Intangible Assets

As of September 30, 2017 and December 31, 2016, in-process research and development intangible assets of \$29.0 million and \$284.3 million, respectively, were recorded on the Company's condensed consolidated balance sheet. In 2015, the Company recorded an in-process research development intangible asset of \$255.3 million related to Parion's pulmonary ENaC platform, including the intellectual property related to VX-371 and VX-551, that are licensed by Parion to the Company. In 2014, the Company recorded an in-process research development intangible asset of \$29.0 million related to VX-210 that is licensed by BioAxone to the Company.

In connection with its preparation of its financial statements for the three and nine months ended September 30, 2017, the Company determined that there were indicators that the value of the pulmonary ENaC platform intangible asset had become impaired. The Company determined that the fair value of the intangible asset had decreased significantly based on data received in September 2017 from a Phase 2 clinical trial of VX-371 that did not meet its primary efficacy endpoint. Based on this data, the Company evaluated the fair value of Parion's pulmonary ENaC platform using the discounted cash

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flow approach from the perspective of a market participant and determined that the fair value of the intangible asset was zero as of September 30, 2017. The discounted cash flow model pertaining to the impairment of the pulmonary ENaC platform includes (i) assumptions regarding the probability of obtaining marketing approval for the drug candidate, (ii) estimates regarding the timing of and the expected costs to develop and commercialize the drug candidate, (iii) estimates of future cash flows from potential product sales with respect to the drug candidate and (iv) appropriate discount and tax rates. The Company recorded a \$255.3 million impairment charge and a benefit from income taxes of \$97.7 million in the three and nine months ended September 30, 2017 attributable to noncontrolling interest.

Goodwill

As of September 30, 2017 and December 31, 2016, goodwill of \$50.4 million was recorded on the Company's condensed consolidated balance sheet.

K. Long-term Obligations

Fan Pier Leases

In 2011, the Company entered into two lease agreements, pursuant to which the Company leases approximately 1.1 million square feet of office and laboratory space in two buildings (the "Fan Pier Buildings") at Fan Pier in Boston, Massachusetts (the "Fan Pier Leases"). The Company commenced lease payments in December 2013, and will make lease payments pursuant to the Fan Pier Leases through December 2028. The Company has an option to extend the term of the Fan Pier Leases for an additional ten years.

Because the Company was involved in the construction project, the Company was deemed for accounting purposes to be the owner of the Fan Pier Buildings during the construction period and recorded project construction costs incurred by the landlord. Upon completion of the Fan Pier Buildings, the Company evaluated the Fan Pier Leases and determined that the Fan Pier Leases did not meet the criteria for "sale-leaseback" treatment. Accordingly, the Company began depreciating the asset and incurring interest expense related to the financing obligation in 2013. The Company bifurcates its lease payments pursuant to the Fan Pier Leases into (i) a portion that is allocated to the Buildings and (ii) a portion that is allocated to the land on which the Fan Pier Buildings were constructed. The portion of the lease obligations allocated to the land is treated as an operating lease that commenced in 2011.

Property and equipment, net, included \$479.0 million and \$489.0 million as of September 30, 2017 and December 31, 2016, respectively, related to construction costs for the Fan Pier Buildings. The carrying value of the Company's lease agreement liability for the Fan Pier Buildings was \$472.2 million and \$472.6 million as of September 30, 2017 and December 31, 2016, respectively.

San Diego Lease

On December 2, 2015, the Company entered into a lease agreement for 3215 Merryfield Row, San Diego, California with ARE-SD Region No. 23, LLC (the "San Diego Building"). Pursuant to this agreement, the Company agreed to lease approximately 170,000 square feet of office and laboratory space in a building to be built in San Diego, California. The lease will commence upon completion of the building, scheduled for the first half of 2018, and will extend for 16 years from the commencement date. Pursuant to the lease agreement, during the initial 16-year term, the Company will pay an average of approximately \$10.2 million per year in aggregate rent, exclusive of operating expenses. The Company has the option to extend the lease term for up to two additional five-year terms.

Because the Company is involved in the construction project, the Company is deemed for accounting purposes to be the owner of the San Diego Building during the construction period and recorded project construction costs incurred by the landlord. The Company bifurcates its lease payments pursuant to the San Diego Lease into (i) a portion that is allocated to the San Diego Building and (ii) a portion that is allocated to the land on which the San Diego Building was constructed. Although the Company will not begin making lease payments pursuant to the San Diego Lease until the commencement date, the portion of the lease obligation allocated to the land is treated for accounting purposes as an operating lease that commenced in the fourth quarter of 2016. Upon completion of the San Diego Building, the Company will evaluate the San

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Diego Lease and determine if the San Diego Lease meets the criteria for “sale-leaseback” treatment. If the San Diego Lease meets the “sale-leaseback” criteria, the Company will remove the asset and the related liability from its consolidated balance sheet and treat the San Diego Lease as either an operating or a capital lease based on the Company’s assessment of the accounting guidance. The Company expects that upon completion of construction of the San Diego Building the San Diego Lease will not meet the “sale-leaseback” criteria. If the San Diego Lease does not meet “sale-leaseback” criteria, the Company will treat the San Diego Lease as a financing obligation and will depreciate the asset over its estimated useful life.

Property and equipment, net, included \$73.9 million and \$15.0 million as of September 30, 2017 and December 31, 2016, respectively, related to construction costs for the San Diego Building. The carrying value of the Company’s lease agreement liability for the San Diego Building was \$71.8 million and \$12.6 million as of September 30, 2017 and December 31, 2016, respectively.

Revolving Credit Facility

In October 2016, the Company entered into a Credit Agreement (the “Credit Agreement”) with Bank of America, N.A., as administrative agent and the lenders referred to therein. The Credit Agreement provides for a \$500.0 million revolving facility, \$300.0 million of which was drawn at closing (the “Loans”) and was repaid in February 2017. The Credit Agreement also provides that, subject to satisfaction of certain conditions, the Company may request that the borrowing capacity under the Credit Agreement be increased by an additional \$300.0 million. The Credit Agreement matures on October 13, 2021.

The proceeds of the borrowing under the Credit Agreement were used primarily to repay the Company’s then outstanding indebtedness under the Macquarie Loan (as defined below). The Loans will bear interest, at the Company’s option, at either a base rate or a Eurodollar rate, in each case plus an applicable margin. Under the Credit Agreement, the applicable margins on base rate loans range from 0.75% to 1.50% and the applicable margins on Eurodollar loans range from 1.75% to 2.50%, in each case based on the Company’s consolidated leverage ratio (the ratio of the Company’s total consolidated debt to the Company’s trailing twelve-month EBITDA).

The Loans are guaranteed by certain of the Company’s domestic subsidiaries and secured by substantially all of the Company’s assets and the assets of the Company’s domestic subsidiaries (excluding intellectual property, owned and leased real property and certain other excluded property) and by the equity interests of the Company’s subsidiaries, subject to certain exceptions. Under the terms of the Credit Agreement, the Company must maintain, subject to certain limited exceptions, a consolidated leverage ratio of 3.00 to 1.00 and consolidated EBITDA of at least \$200.0 million, in each case to be measured on a quarterly basis.

The Credit Agreement contains customary representations and warranties and usual and customary affirmative and negative covenants. The Credit Agreement also contains customary events of default. In the case of a continuing event of default, the administrative agent would be entitled to exercise various remedies, including the acceleration of amounts due under outstanding loans.

Term Loan

In July 2014, the Company entered into a credit agreement with the lenders party thereto, and Macquarie US Trading LLC (“Macquarie”), as administrative agent. The credit agreement provided for a \$300.0 million senior secured term loan (the “Macquarie Loan”). On October 13, 2016, the Company terminated and repaid all outstanding obligations under the Macquarie Loan.

The Macquarie Loan initially bore interest at a rate of 7.2% per annum, which was reduced to 6.2% per annum based on the FDA’s approval of ORKAMBI. The Term Loan bore interest at a rate of LIBOR plus 5.0% per annum during the third year of the term.

The Company incurred \$5.3 million in fees paid to Macquarie that were recorded as a discount on the Macquarie Loan and were recorded as interest expense using the effective interest method over the term of the loan in the Company’s condensed consolidated statements of operations.

L. Stock-based Compensation Expense

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During the three and nine months ended September 30, 2017 and 2016, the Company recognized the following stock-based compensation expense:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(in thousands)			
Stock-based compensation expense by type of award:				
Stock options	\$ 25,969	\$ 28,773	\$ 80,865	\$ 86,859
Restricted stock and restricted stock units	46,737	30,966	131,388	88,107
ESPP share issuances	2,428	2,425	6,738	6,385
Less stock-based compensation expense capitalized to inventories	(1,364)	(955)	(3,657)	(2,728)
Total stock-based compensation included in costs and expenses	\$ 73,770	\$ 61,209	\$ 215,334	\$ 178,623
Stock-based compensation expense by line item:				
Research and development expenses	\$ 46,186	\$ 39,980	\$ 134,855	\$ 115,068
Sales, general and administrative expenses	27,584	21,229	80,479	63,555
Total stock-based compensation included in costs and expenses	\$ 73,770	\$ 61,209	\$ 215,334	\$ 178,623

The following table sets forth the Company's unrecognized stock-based compensation expense by type of award and the weighted-average period over which that expense is expected to be recognized:

	As of September 30, 2017	
	Unrecognized Expense	Weighted-average Recognition Period
	(in thousands)	(in years)
Type of award:		
Stock options	\$ 175,298	2.60
Restricted stock and restricted stock units	\$ 289,008	2.64
ESPP share issuances	\$ 2,636	0.46

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The following table summarizes information about stock options outstanding and exercisable at September 30, 2017 :

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted-average Remaining Contractual Life	Weighted-average Exercise Price	Number Exercisable	Weighted-average Exercise Price
	(in thousands)	(in years)	(per share)	(in thousands)	(per share)
\$18.93–\$20.00	128	0.35	\$ 18.93	128	\$ 18.93
\$20.01–\$40.00	834	2.21	\$ 34.51	834	\$ 34.51
\$40.01–\$60.00	877	4.83	\$ 49.17	877	\$ 49.17
\$60.01–\$80.00	821	6.46	\$ 75.62	649	\$ 75.44
\$80.01–\$100.00	4,587	8.33	\$ 89.37	1,397	\$ 89.47
\$100.01–\$120.00	1,137	7.36	\$ 109.34	586	\$ 109.24
\$120.01–\$140.00	1,260	7.88	\$ 130.24	688	\$ 129.86
\$140.01–\$160.00	—	0.00	\$ —	—	\$ —
\$160.01–\$163.74	634	9.80	\$ 162.94	3	\$ 162.94
Total	10,278	7.22	\$ 91.28	5,162	\$ 77.92

M. Other Arrangements

Sale of HIV Protease Inhibitor Royalty Stream

In 2008, the Company sold to a third party its rights to receive royalty payments from GlaxoSmithKline plc, net of royalty amounts to be earned by and due to a third party, for a one-time cash payment of \$160.0 million . These royalty payments relate to net sales of HIV protease inhibitors, which had been developed pursuant to a collaboration agreement between the Company and GlaxoSmithKline plc. As of September 30, 2017 , the Company had \$8.0 million in deferred revenues related to the one-time cash payment, which it is recognizing over the life of the collaboration agreement with GlaxoSmithKline plc based on the units-of-revenue method. In addition, the Company continues to recognize royalty revenues equal to the amount of the third-party subroyalty and an offsetting royalty expense for the third-party subroyalty payment.

N. Income Taxes

The Company is subject to United States federal, state, and foreign income taxes. For the three and nine months ended September 30, 2017 , the Company recorded a benefit from income taxes of \$125.9 million and \$117.6 million , respectively, which included a benefit of \$120.2 million and \$111.7 million , respectively, related to the Company's VIEs' income tax provision. The VIEs' benefit from income taxes during the the three and nine months ended September 30, 2017 related primarily to the impairment of Parion's pulmonary ENaC platform and decrease in the fair value of the contingent payments payable by the Company to Parion. The Company has no liability for taxes payable by the Company's VIEs and the income tax provision and related liability have been allocated to noncontrolling interest. For the three and nine months ended September 30, 2016 , the Company recorded a provision for income taxes of \$0.5 million and \$24.1 million , respectively, which included a benefit of \$0.5 million and a provision of \$20.1 million , respectively, related to the Company's VIEs' income tax provision.

As of September 30, 2017 and December 31, 2016 , the Company did not have unrecognized tax benefits. The Company recognizes interest and penalties related to income taxes as a component of income tax expense. As of September 30, 2017 , no interest and penalties have been accrued. The Company does not expect that its unrecognized tax benefits will materially increase within the next twelve months. The Company did not recognize any material interest or penalties related to uncertain tax positions as of September 30, 2017 and December 31, 2016 .

The Company continues to maintain a valuation allowance on the majority of its net operating losses and other deferred tax assets because it has a history of cumulative losses. Accordingly, the Company has not reported any tax benefit relating

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to the remaining net operating loss carryforwards (NOLs) and income tax credit carryforwards that will be utilized in future periods in these jurisdictions. The Company's U.S. federal net operating loss carryforwards totaled approximately \$4.1 billion as of December 31, 2016. On a quarterly basis, the Company reassesses the valuation allowance on its deferred income tax assets weighing positive and negative evidence to assess the recoverability of the deferred tax assets. Based on the Company's recent financial performance and its future projections, it could record a reversal of all, or a portion of the valuation allowance associated with U.S. deferred tax assets in future periods. However, any such change is subject to actual performance and other considerations that may present positive or negative evidence at the time of the assessment. The Company's total deferred tax asset balance subject to the valuation allowance was approximately \$1.7 billion at December 31, 2016.

As described in Note A, "Basis of Presentation and Accounting Policies", the Company adopted amended guidance, during the nine month period ended September 30, 2017. The amended guidance eliminates the requirement that excess tax benefits be realized as a reduction in current taxes payable before the associated tax benefit can be recognized as an increase in additional paid-in capital and requires excess tax benefits and tax deficiencies to be recorded in the condensed consolidated statement of operations when the awards vest or are settled. Amendments related to accounting for excess tax benefits have been adopted prospectively, resulting in a tax benefit of \$31.4 million and \$62.2 million for the three and nine months ended September 30, 2017, respectively. In connection with the adoption of this new standard, the Company recorded a cumulative-effect adjustment of \$410.8 million as of January 1, 2017 to accumulated deficit and deferred tax assets, with an equal offsetting adjustment to the Company's valuation allowance. In addition, the Company has recorded \$9.4 million related to the impact from adoption of the provisions related to forfeiture rates to accumulated deficit. This change also increased the Company's deferred tax assets by \$3.4 million that is offset by an increase to the valuation allowance in the same amount.

The Company files United States federal income tax returns and income tax returns in various state, local and foreign jurisdictions. The Company is no longer subject to any tax assessment from an income tax examination in the United States or any other major taxing jurisdiction for years before 2011, except where the Company has net operating losses or tax credit carryforwards that originate before 2011. The Company currently is under examination by the Canada Revenue Agency for the years ending December 31, 2011 through December 31, 2013. No adjustments have been reported.

At September 30, 2017, foreign earnings, which were not significant, have been retained indefinitely by foreign subsidiary companies for reinvestment; therefore, no provision has been made for income taxes that would be payable upon the distribution of such earnings, and it would not be practicable to determine the amount of the related unrecognized deferred income tax liability. Upon repatriation of those earnings, in the form of dividends or otherwise, the Company would be subject to United States federal income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to the various foreign countries.

O. Restructuring Liabilities

Research and Development Restructuring

In February 2017, the Company decided to consolidate its research activities into its Boston, Milton Park and San Diego locations and closed its research site in Canada affecting approximately 70 positions. The Company has incurred aggregate restructuring charges of approximately \$12.3 million in the nine months ended September 30, 2017. As of September 30, 2017, the restructuring liability primarily relates to laboratory and office space for the research site in Canada that terminates in October 2018. The Company does not anticipate any significant additional charges related to this restructuring event in the future.

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The restructuring charge and other activities recorded during the the three and nine months ended September 30, 2017 and the related liability balance as of September 30, 2017 were as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017		2017	
	(in thousands)			
Liability, beginning of the period	\$	3,507	\$	—
Restructuring (credits) expense		(125)		12,315
Cash payments		(750)		(7,869)
Asset impairments and other non-cash items		—		(1,814)
Liability, end of the period	\$	2,632	\$	2,632

2003 Kendall Restructuring

In 2003, the Company adopted a plan to restructure its operations to coincide with its increasing internal emphasis on advancing drug candidates through clinical development to commercialization. The restructuring liability relates to specialized laboratory and office space that is leased to the Company pursuant to a 15 -year lease that terminates in April 2018. The Company has not used more than 50% of this space since it adopted the plan to restructure its operations in 2003. This unused laboratory and office space currently is subleased to third parties.

The activities related to the restructuring liability for the three and nine months ended September 30, 2017 and 2016 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(in thousands)			
Liability, beginning of the period	\$ 1,990	\$ 6,388	\$ 4,328	\$ 7,944
Restructuring expense	227	30	1,054	222
Cash payments	(4,003)	(5,340)	(12,962)	(13,104)
Cash received from subleases	2,732	2,866	8,526	8,882
Liability, end of the period	\$ 946	\$ 3,944	\$ 946	\$ 3,944

Fan Pier Move Restructuring

In connection with the relocation of its Massachusetts operations to Fan Pier in Boston, Massachusetts, which commenced in 2013, the Company is incurring restructuring charges related to its remaining lease obligations at its facilities in Cambridge, Massachusetts. The majority of these restructuring charges were recorded in the third quarter of 2014 upon decommissioning three facilities in Cambridge. During 2015, the Company terminated two of these lease agreements resulting in a credit to restructuring expense equal to the difference between the Company's estimated future cash flows related to its lease obligations for these facilities and the termination payment paid to the Company's landlord on the effective date of the termination. The third major facility included in this restructuring activity is 120,000 square feet of the Kendall Square Facility that the Company continued to use for its operations following its 2003 Kendall Restructuring. The rentable square footage in this portion of the Kendall Square Facility was subleased to a third party in February 2015. The Company will continue to incur charges through April 2018 related to the difference between the Company's estimated future cash flows related to this portion of the Kendall Square Facility, which include an estimate for sublease income to be received from the Company's sublessee and its actual cash flows. The Company discounted the estimated cash flows related to this restructuring activity at a discount rate of 9%.

The activities related to the restructuring liability for the three and nine months ended September 30, 2017 and 2016 were as follows:

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(in thousands)			
Liability, beginning of the period	\$ 1,521	\$ 4,863	\$ 3,626	\$ 5,964
Restructuring expense	235	90	490	472
Cash payments	(3,262)	(4,199)	(10,578)	(10,451)
Cash received from subleases	2,279	2,539	7,235	7,308
Liability, end of the period	\$ 773	\$ 3,293	\$ 773	\$ 3,293

Other Restructuring Activities

The Company has engaged in several other restructuring activities that are unrelated to its Research and Development Restructuring, 2003 Kendall Restructuring and Fan Pier Move Restructuring. The most significant activity commenced in October 2013 when the Company adopted a restructuring plan that included (i) a workforce reduction primarily related to the commercial support of INCIVEK following the continued and rapid decline in the number of patients being treated with INCIVEK as new medicines for the treatment of HCV infection neared approval and (ii) the write-off of certain assets. This action resulted from the Company's decision to focus its investment on future opportunities in CF and other research and development programs.

The remaining restructuring activities were completed in 2016. As such, there was no outstanding liability as of September 30, 2017. The activities related to the Company's other restructuring liabilities for the three and nine months ended September 30, 2016 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016		2016	
	(in thousands)			
Liability, beginning of the period	\$ 1,233	\$ 1,450		
Restructuring expense	(112)	344		
Cash payments	(1,121)	(1,794)		
Liability, end of the period	\$ —	\$ —		

P. Commitments and Contingencies

Guaranties and Indemnifications

As permitted under Massachusetts law, the Company's Articles of Organization and By-laws provide that the Company will indemnify certain of its officers and directors for certain claims asserted against them in connection with their service as an officer or director. The maximum potential amount of future payments that the Company could be required to make under these indemnification provisions is unlimited. However, the Company has purchased directors' and officers' liability insurance policies that could reduce its monetary exposure and enable it to recover a portion of any future amounts paid. No indemnification claims currently are outstanding, and the Company believes the estimated fair value of these indemnification arrangements is minimal.

The Company customarily agrees in the ordinary course of its business to indemnification provisions in agreements with clinical trial investigators and sites in its drug development programs, sponsored research agreements with academic and not-for-profit institutions, various comparable agreements involving parties performing services for the Company and its real estate leases. The Company also customarily agrees to certain indemnification provisions in its drug discovery, development and commercialization collaboration agreements. With respect to the Company's clinical trials and sponsored research agreements, these indemnification provisions typically apply to any claim asserted against the investigator or the investigator's institution relating to personal injury or property damage, violations of law or certain breaches of the Company's contractual obligations arising out of the research or clinical testing of the Company's compounds or drug candidates. With respect to lease agreements, the indemnification provisions typically apply to claims asserted against the landlord relating to personal injury or property damage caused by the Company, to violations of law by the Company or to certain breaches of the Company's contractual obligations. The indemnification provisions appearing in the Company's collaboration agreements are similar to those for the other agreements discussed above, but in addition provide some limited indemnification for its collaborator in the event of third-party claims alleging infringement of intellectual property rights. In each of the cases above, the indemnification obligation generally survives the termination of the agreement for some extended period, although the Company believes the obligation typically has the most relevance during the contract term and for a short period of time thereafter. The maximum potential amount of future payments that the Company could be required to make under these provisions is generally unlimited. The Company has purchased insurance policies covering personal injury, property damage and general liability that reduce its exposure for indemnification and would enable it in many cases to recover all or a portion of any future amounts paid. The Company has never paid any material amounts to defend lawsuits or settle claims related to these indemnification provisions. Accordingly, the Company believes the estimated fair value of these indemnification arrangements is minimal.

Other Contingencies

The Company has certain contingent liabilities that arise in the ordinary course of its business activities. The Company accrues a reserve for contingent liabilities when it is probable that future expenditures will be made and such expenditures can be reasonably estimated. There were no material contingent liabilities accrued as of September 30, 2017 or December 31, 2016.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

We are in the business of discovering, developing, manufacturing and commercializing medicines for serious diseases. We use precision medicine approaches with the goal of creating transformative medicines for patients in specialty markets. Our business is focused on developing and commercializing therapies for the treatment of cystic fibrosis, or CF, and advancing our research and development programs in other indications. Our two marketed products are ORKAMBI (lumacaftor in combination with ivacaftor) and KALYDECO (ivacaftor) and we are currently seeking approval for tezacaftor in combination with ivacaftor, which is a two-drug combination regimen for patients with CF. We currently are evaluating multiple triple combination regimens that include next-generation CFTR corrector compounds in patients with CF in Phase 2 clinical trials and plan to initiate pivotal development of one or two triple-combination regimens in the first half of 2018.

Cystic Fibrosis

ORKAMBI and KALYDECO are collectively approved to treat approximately 40% of the 75,000 CF patients in North America, Europe and Australia. ORKAMBI is approved as a treatment for approximately 25,000 patients who have two copies of the F508del mutation, or F508del homozygous, in their cystic fibrosis transmembrane conductance regulator, or *CFTR*, gene. KALYDECO is approved for the treatment of approximately 6,000 CF patients who have the G551D mutation or other specified mutations in their *CFTR* gene. Our goal is to develop treatment regimens that will provide benefits to as many patients with CF as possible and will enhance the benefits that currently are being provided to patients taking our medicines.

If tezacaftor in combination with ivacaftor is approved, we expect that it would provide an additional treatment option primarily to CF patients who are currently eligible for either ORKAMBI or KALYDECO. If we are able to successfully develop a triple combination regimen that includes a next-generation CFTR corrector compound, including VX-440, VX-152, VX-659 or VX-445, we believe such regimen could potentially provide benefit to all CF patients who have at least one F508del mutation in their *CFTR* gene (approximately 90% of all CF patients). This would include (i) the first treatment option that treats the underlying cause of CF for patients who have one copy of the F508del mutation in their *CFTR* gene and a second mutation in their *CFTR* gene that results in minimal CFTR function, or F508del/Min patients, and (ii) an additional treatment option to CF patients who are eligible for either ORKAMBI, KALYDECO or, if approved, tezacaftor in combination with ivacaftor.

ORKAMBI

In October 2017, we obtained results from a 2-part open-label Phase 3 clinical trial of ORKAMBI in 60 patients with CF two to five years of age who have two copies of the F508del mutation in their *CFTR* gene. The clinical trial met its primary endpoint of safety, showing ORKAMBI was generally well tolerated and that there were no new safety concerns compared to prior clinical trials of ORKAMBI in patients six through eleven years of age. Secondary endpoints showed decreases in the sweat chloride and improvements in nutritional status as measured by change in weight (weight-for-age z score) and body mass index (BMI-for-age z score). Based on these results, we expect to submit a New Drug Application, or NDA, to the U.S. Food and Drug Administration, or FDA, and a Marketing Authorization Application, or MAA, line extension to the European Medicines Agency, or EMA, in the first quarter of 2018.

KALYDECO

We are evaluating KALYDECO in a Phase 3 clinical trial in patients with CF two years of age and younger with one of 10 gating and R117H mutations. The clinical trial will evaluate the safety of KALYDECO in this age group. We have completed enrollment in patients aged 12 to 24 months.

Tezacaftor in combination with ivacaftor

In the first quarter of 2017, we obtained positive results from two Phase 3 clinical trials of tezacaftor, a corrector compound, in combination with ivacaftor. The clinical trials demonstrated that the tezacaftor/ivacaftor combination provided statistically significant improvements in lung function (percent predicted forced expiratory volume in one second, or ppFEV1) in patients with CF 12 years of age and older who have certain mutations in their *CFTR* gene. The 24-week EVOLVE clinical trial evaluated tezacaftor in combination with ivacaftor in F508del homozygous patients with CF. This clinical trial met its primary endpoint with a mean absolute improvement in ppFEV1 through 24 weeks of 4.0 percentage points from baseline compared to placebo ($p < 0.0001$). The second clinical trial, EXPAND, was an 8-week crossover clinical trial that evaluated the combination treatment in patients with CF who have one mutation that results in residual CFTR function and one F508del mutation. This clinical trial met the primary endpoints of absolute change in ppFEV1 from baseline to the average of the Week

4 and Week 8 measurements, with the tezacaftor/ivacaftor combination treatment demonstrating a mean absolute improvement of 6.8 percentage points compared to placebo ($p < 0.0001$) and the ivacaftor monotherapy group demonstrating a mean absolute improvement of 4.7 percentage points compared to placebo ($p < 0.0001$). Across both clinical trials, the tezacaftor/ivacaftor combination treatment was generally well tolerated.

Based on these results, we submitted a NDA to the FDA and an MAA to the EMA for tezacaftor in combination with ivacaftor in patients with CF 12 years of age and older who are F508del homozygous or who have one copy of the F508del mutation in their *CFTR* gene and a second mutation in their *CFTR* gene that results in residual CFTR function. The FDA has granted us priority review of the NDA and the target date for the FDA to complete its review of the NDA under the Prescription Drug User Fee Act, or PDUFA, is February 28, 2018. We expect the EMA to complete its review in the second half of 2018.

In October 2017, we announced top-line results from a Phase 3, randomized, double-blind, parallel group, clinical trial evaluating the combination of tezacaftor and ivacaftor in patients with CF 12 years of age and older who were already receiving ivacaftor monotherapy with one copy of the F508del mutation and one copy of a gating mutation. The clinical trial enrolled 151 patients with CF. The clinical trial did not meet its primary endpoint of absolute change in ppFEV1 from baseline through 8 weeks. For those receiving the combination of tezacaftor and ivacaftor, ppFEV1 improved by 0.5 percentage points compared to 0.2 percentage points in those receiving placebo in addition to ivacaftor ($p=0.5846$). Safety data from the clinical trial showed that the combination of tezacaftor and ivacaftor was generally well tolerated and were consistent with prior Phase 3 clinical trials of the tezacaftor/ivacaftor combination. Secondary endpoints were changes in sweat chloride and change in CFQ-R. Sweat chloride decreased by 5.8 mmol/L in those who received tezacaftor in combination with ivacaftor as compared to those who received placebo in addition to ivacaftor ($p=0.0216$). There was no change in CFQ-R in the combination group compared to the ivacaftor monotherapy group. Based on these results, we do not plan to seek regulatory approval for tezacaftor in combination with ivacaftor for these patients, the vast majority of whom are eligible for KALYDECO monotherapy.

Next-generation CFTR corrector compounds

In July 2017, we obtained positive results from Phase 1 and Phase 2 clinical trials of three different triple combination regimens in patients with CF who have one copy of the F508del mutation in their *CFTR* gene and a second mutation that results in minimal CFTR function. Initial data from the Phase 2 clinical trials showed mean absolute improvements in ppFEV1 of 9.7 and 12.0 percentage points for VX-152 (200mg q12h) and VX-440 (600mg q12h), respectively, in triple combination with tezacaftor and ivacaftor. Initial data from the Phase 1 clinical trial showed mean absolute improvement in ppFEV1 of 9.6 percentage points for VX-659 in triple combination with tezacaftor and ivacaftor. We amended our ongoing Phase 2 clinical trials of VX-445 and VX-659 to include additional cohorts of patients to evaluate these next-generation CFTR corrector compounds as part of a potential once-daily combination with tezacaftor and VX-561 (formerly CTP-656), the latter of which we acquired from Concert Pharmaceuticals, Inc., or Concert, in the third quarter of 2017. We expect to report additional data on our next-generation corrector program in early 2018. Pending data from these clinical trials and discussions with regulatory agencies, we plan to initiate pivotal development of one or two triple combination regimens in the first half of 2018.

ENaC Inhibition

VX-371 is an investigational epithelial sodium channel, or ENaC, inhibitor, that we exclusively licensed from Parion Sciences, Inc., or Parion, in 2015. In October 2017, we announced the results of a Phase 2 28-day clinical trial evaluating VX-371 + hypertonic saline versus hypertonic saline alone in 142 patients with CF 12 years of age and older who are homozygous for the F508del mutation and were already receiving ORKAMBI and continued to receive ORKAMBI throughout the clinical trial. The clinical trial did not meet its primary efficacy endpoint. In patients being treated with ORKAMBI, the addition of hypertonic saline resulted in a decrease of 0.1 percentage points ppFEV1 at day 28. In patients being treated with ORKAMBI, the addition of VX-371 + hypertonic saline resulted in an increase of 0.1 percentage points ppFEV1 at day 28. Safety data from the clinical trial showed that the addition of VX-371, with or without hypertonic saline, was generally well tolerated in patients already receiving ORKAMBI, and the safety profile was consistent with that observed in prior clinical trials of VX-371 monotherapy. Based on the results of this clinical trial, we recognized an impairment charge related to Parion's pulmonary ENaC platform in third quarter of 2017 and deconsolidated Parion as a VIE, effective September 30, 2017.

A Phase 2 clinical trial of VX-371 monotherapy in patients with primary ciliary dyskinesia (PCD) is ongoing.

Research and Development

We are engaged in a number of other research and mid- and early-stage development programs, including VX-150 for pain and VX-210 for acute spinal cord injury. We have also entered into third-party collaborations, pursuant to which we are engaged in the discovery and development of nucleic acid-based therapies for a variety of diseases, including CF. We plan to continue investing in our research programs and fostering scientific innovation in order to identify and develop transformative medicines. Our current research programs include programs targeting cystic fibrosis, adrenoleukodystrophy, alpha-1 antitrypsin deficiency, sickle cell disease and polycystic kidney disease. We believe that pursuing research in diverse areas allows us to balance the risks inherent in drug development and may provide drug candidates that will form our pipeline in future years.

Discovery and development of a new pharmaceutical product is a difficult and lengthy process that requires significant financial resources along with extensive technical and regulatory expertise and can take 10 to 15 years or more. Potential drug candidates are subjected to rigorous evaluations, driven in part by stringent regulatory considerations, designed to generate information concerning efficacy, side-effects, proper dosage levels and a variety of other physical and chemical characteristics that are important in determining whether a drug candidate should be approved for marketing as a pharmaceutical product. Most chemical compounds that are investigated as potential drug candidates never progress into development, and most drug candidates that do advance into development never receive marketing approval. Because our investments in drug candidates are subject to considerable risks, we closely monitor the results of our discovery, research, clinical trials and nonclinical studies and frequently evaluate our drug development programs in light of new data and scientific, business and commercial insights, with the objective of balancing risk and potential. This process can result in abrupt changes in focus and priorities as new information becomes available and as we gain additional understanding of our ongoing programs and potential new programs, as well as those of our competitors.

If we believe that data from a completed registration program support approval of a drug candidate, we submit an NDA to the FDA requesting approval to market the drug candidate in the United States and seek analogous approvals from comparable regulatory authorities in foreign jurisdictions. To obtain approval, we must, among other things, demonstrate with evidence gathered in nonclinical studies and well-controlled clinical trials that the drug candidate is safe and effective for the disease it is intended to treat and that the manufacturing facilities, processes and controls for the manufacture of the drug candidate are adequate. The FDA and foreign regulatory authorities have substantial discretion in deciding whether or not a drug candidate should be granted approval based on the benefits and risks of the drug candidate in the treatment of a particular disease, and could delay, limit or deny regulatory approval. If regulatory delays are significant or regulatory approval is limited or denied altogether, our financial results and the commercial prospects for the drug candidate involved will be harmed.

Collaboration Arrangements

We have entered into collaborations with biotechnology and pharmaceutical companies in order to acquire rights or to license drug candidates or technologies that enhance our pipeline and/or our research capabilities. Over the last several years, we entered into collaboration agreements with:

- CRISPR Therapeutics AG, or CRISPR, pursuant to which we are collaborating on the discovery and development of potential new treatments aimed at the underlying genetic causes of human diseases using CRISPR-Cas9 gene editing technology;
- Parion, pursuant to which we are developing ENaC inhibitors for the treatment of pulmonary diseases;
- Moderna Therapeutics, Inc., or Moderna, pursuant to which we are seeking to identify and develop mRNA therapeutics for the treatment of CF; and
- BioAxone Biosciences, Inc., or BioAxone, pursuant to which we are evaluating VX-210 as a potential treatment for patients who have spinal cord injuries.

Generally, when we in-license a technology or drug candidate, we make upfront payments to the collaborator, assume the costs of the program and agree to make contingent payments, which could consist of milestone, royalty and option payments. Depending on many factors, including the structure of the collaboration, the significance of the drug candidate that we license to the collaborator's operations and the other activities in which our collaborators are engaged, the accounting for these transactions can vary significantly. For example, the upfront payments and expenses incurred in connection with our CRISPR and Moderna collaborations are being expensed as research expenses because (i) the collaboration represents a small portion of the overall business of these collaborators and (ii) the licenses associated with these collaborations do not represent a business pursuant to the consolidation accounting guidance. CRISPR's and Moderna's activities unrelated to our collaborations have no effect on our consolidated financial statements. Parion and BioAxone have historically been accounted for as variable interest entities, or VIEs, that were included in our consolidated financial statements due to (i) the significance

of the respective licensed programs to Parion and BioAxone as a whole, (ii) our power to control the significant activities under each collaboration and (iii) our obligation to absorb losses and right to receive benefits that potentially could be significant. As of September 30, 2017, we determined that the above conditions were no longer satisfied with respect to Parion following a determination that the fair value of the ENaC inhibitors licensed from Parion had declined significantly based on the results of a Phase 2 clinical trial of VX-371 that did not meet its primary efficacy endpoint. As a result, we no longer account for Parion as a VIE and have deconsolidated Parion from our consolidated financial statements as of September 30, 2017. BioAxone continues to be accounted for as a VIE and remains included in our consolidated financial statements as of September 30, 2017.

Collaborators we account for as a VIE may engage in activities unrelated to our collaboration. The revenues and expenses unrelated to the programs we in-license from our VIEs have historically been immaterial to our consolidated financial statements. With respect to each of Parion, prior to its deconsolidation as of September 30, 2017, and BioAxone, the activities unrelated to our collaboration have represented approximately 2% of our total revenues and total expenses on an annual basis. As a result of the deconsolidation of Parion, we expect these amounts to decrease in future periods. For any consolidated VIEs, we evaluate the fair value of the contingent payments payable by us on a quarterly basis. Changes in the fair value of these contingent future payments affect net income attributable to Vertex on a dollar-for-dollar basis, with increases in the fair value of contingent payments payable by us to a VIE resulting in a decrease in net income attributable to Vertex (or an increase in net loss attributable to Vertex) and decreases in the fair value of contingent payments payable by us to a VIE resulting in an increase in net income attributable to Vertex (or decrease in net loss attributable to Vertex).

We also out-licensed internally developed programs to collaborators who are leading the development of these programs. These outlicense arrangements include our collaboration agreements with:

- Merck KGaA, which is advancing four oncology research and development programs; and
- Janssen Pharmaceuticals, Inc., which is developing JNJ-3872 (formerly VX-787) for the treatment of influenza.

Pursuant to these out-licensing arrangements, our collaborators are responsible for the research, development and commercialization costs associated with these programs and we are entitled to receive contingent milestone and/or royalty payments. As a result, we do not expect to incur significant expenses in connection with these programs and have the potential for future collaborative and/or royalty revenues resulting from these programs.

Regulatory Compliance

Our marketing of pharmaceutical products is subject to extensive and complex laws and regulations. We have a corporate compliance program designed to actively identify, prevent and mitigate risk through the implementation of compliance policies and systems, and through the promotion of a culture of compliance. Among other laws, regulations and standards, we are subject to various U.S. federal and state laws, and comparable foreign laws pertaining to health care fraud and abuse, including anti-kickback and false claims statutes, and laws prohibiting the promotion of drugs for unapproved or off-label uses. Anti-kickback laws make it illegal for a prescription drug manufacturer to solicit, offer, receive or pay any remuneration to induce the referral of business, including the purchase or prescription of a particular drug. False claims laws prohibit anyone from presenting for payment to third-party payors, including Medicare and Medicaid, claims for reimbursed drugs or services that are false or fraudulent, claims for items or services not provided as claimed, or claims for medically unnecessary items or services. We expect to continue to devote substantial resources to maintain, administer and expand these compliance programs globally.

Reimbursement

Sales of our products depend, to a large degree, on the extent to which our products are covered by third-party payors, such as government health programs, commercial insurance and managed health care organizations. We dedicate substantial management and other resources in order to obtain and maintain appropriate levels of reimbursement for our products from third-party payors, including governmental organizations in the United States and ex-U.S. markets. In the United States, we continue to engage in discussions with numerous commercial insurers and managed health care organizations, along with government health programs that are typically managed by authorities in the individual states. In Europe and other ex-U.S. markets, we are working to obtain government reimbursement for ORKAMBI on a country-by-country basis, because in many foreign countries patients are unable to access prescription pharmaceutical products that are not reimbursed by their governments. To date, we have reached a pricing and reimbursement agreement for ORKAMBI with several European countries, including Germany, Ireland and Italy, and remain in negotiations with several others. Consistent with our experience with KALYDECO when it was first approved, we expect reimbursement discussions in ex-U.S. markets may take a significant period of time.

Recent Transaction

Concert Pharmaceuticals

In July 2017, we acquired certain CF assets, including VX-561, from Concert, pursuant to an agreement that we entered into in March 2017. VX-561 is an investigational CFTR potentiator that has the potential to be used as part of future once-daily combination regimens of CFTR modulators that treat the underlying cause of CF. Pursuant to the agreement, in the third quarter of 2017, we paid Concert \$160.0 million in cash for all worldwide development and commercialization rights to VX-561. If VX-561 is approved as part of a combination regimen to treat CF, Concert could receive up to an additional \$90.0 million in milestones based on regulatory approval in the U.S. and reimbursement in the UK, Germany or France. In the third quarter of 2017, we recorded the \$160.0 million payment as a research and development expense.

RESULTS OF OPERATIONS

	Three Months Ended September 30,		Increase/(Decrease)		Nine Months Ended September 30,		Increase/(Decrease)	
	2017	2016	\$	%	2017	2016	\$	%
	(in thousands)				(in thousands)			
Revenues	\$ 578,165	\$ 413,783	\$ 164,382	40%	\$ 1,837,018	\$ 1,243,471	\$ 593,547	48%
Operating costs and expenses	904,208	432,510	471,698	109%	1,839,512	1,273,175	566,337	44%
Other items, net	223,091	(20,114)	243,205	n/a	165,294	(115,293)	280,587	n/a
Net (loss) income attributable to Vertex	<u>\$ (102,952)</u>	<u>\$ (38,841)</u>	<u>\$ (64,111)</u>	n/a	<u>\$ 162,800</u>	<u>\$ (144,997)</u>	<u>\$ 307,797</u>	n/a

Net Income (Loss) Attributable to Vertex

Net loss attributable to Vertex was \$(103.0) million in the third quarter of 2017 as compared to a net loss attributable to Vertex of \$(38.8) million in the third quarter of 2016. Our revenues increased in the third quarter of 2017 as compared to the third quarter of 2016 primarily due to increased ORKAMBI and KALYDECO net product revenues. Our operating costs and expenses in the third quarter of 2017 included a \$255.3 million impairment charge related to Parion's pulmonary ENaC platform and a \$160.0 million payment to Concert in connection with the acquisition of VX-561, for which there were no comparable expenses in the third quarter of 2016. The increase in operating costs and expenses in the third quarter of 2017 as compared to the third quarter of 2016 also included increases in cost of product revenues, research and development expenses and sales, general and administrative expenses. Other items, net, in the third quarter of 2017 primarily reflects an income tax benefit and certain other benefits associated with the impairment of Parion's pulmonary ENaC platform, for which there were no comparable benefits in the third quarter of 2016.

Net income attributable to Vertex was \$162.8 million in the nine months ended September 30, 2017 as compared to a net loss attributable to Vertex of \$(145.0) million in the nine months ended September 30, 2016. Our revenues increased significantly in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016 due to increased ORKAMBI and KALYDECO net product revenues and \$230.0 million in one-time collaborative revenues related to the strategic collaboration and license agreement we established with Merck KGaA in the first quarter of 2017. Our operating costs and expenses in the nine months ended September 30, 2017 included a \$255.3 million impairment charge related to Parion's pulmonary ENaC platform and a \$160.0 million payment to Concert in connection with the acquisition of VX-561, for which there were no comparable expenses in the nine months ended September 30, 2016. The increase in operating costs and expenses in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016 also included increases in cost of product revenues, research and development expenses, sales, general and administrative expenses and restructuring expenses. Other items, net, in the nine months ended September 30, 2017 primarily reflects an income tax benefit and certain other benefits associated with the impairment of Parion's pulmonary ENaC platform, for which there were no comparable benefits in the nine months ended September 30, 2016.

Diluted Net Income (Loss) Per Share Attributable to Vertex Common Shareholders

Diluted net loss per share attributable to Vertex common shareholders was \$(0.41) in the third quarter of 2017 as compared to a diluted net loss per share attributable to Vertex common shareholders of \$(0.16) in the third quarter of 2016. Diluted net income per share attributable to Vertex common shareholders was \$0.64 in the nine months ended September 30, 2017 as compared to a diluted net loss per share attributable to Vertex common shareholders of \$(0.59) in the nine months ended September 30, 2016.

Revenues

	Three Months Ended September 30,		Increase/(Decrease)		Nine Months Ended September 30,		Increase/(Decrease)	
	2017	2016	\$	%	2017	2016	\$	%
	(in thousands)				(in thousands)			
Product revenues, net	\$ 549,642	\$ 409,689	\$ 139,953	34 %	\$ 1,544,252	\$ 1,229,750	\$ 314,502	26 %
Royalty revenues	2,231	3,835	(1,604)	(42)%	6,643	12,713	(6,070)	(48)%
Collaborative revenues	26,292	259	26,033	n/a	286,123	1,008	285,115	n/a
Total revenues	<u>\$ 578,165</u>	<u>\$ 413,783</u>	<u>\$ 164,382</u>	40 %	<u>\$ 1,837,018</u>	<u>\$ 1,243,471</u>	<u>\$ 593,547</u>	48 %

Product Revenues, Net

	Three Months Ended September 30,		Increase/(Decrease)		Nine Months Ended September 30,		Increase/(Decrease)	
	2017	2016	\$	%	2017	2016	\$	%
	(in thousands)				(in thousands)			
ORKAMBI	\$ 336,183	\$ 234,046	\$ 102,137	44%	\$ 955,451	\$ 702,670	\$ 252,781	36%
KALYDECO	213,461	175,608	37,853	22%	\$ 588,809	\$ 526,352	\$ 62,457	12%
INCIVEK	(2)	35	(37)	n/a	(8)	728	(736)	n/a
Total product revenues, net	<u>\$ 549,642</u>	<u>\$ 409,689</u>	<u>\$ 139,953</u>	34%	<u>\$ 1,544,252</u>	<u>\$ 1,229,750</u>	<u>\$ 314,502</u>	26%

In the third quarter and the nine months ended September 30, 2017, we recognized approximately \$43.1 million and \$110.9 million, respectively, in ex-U.S. ORKAMBI net product revenues, as compared to \$22.8 million and \$47.5 million in the third quarter and the nine months ended September 30, 2016, respectively. We believe that the level of our ORKAMBI revenues for the remainder of 2017 will be dependent upon whether, when and on what terms we are able to obtain reimbursement in additional ex-U.S. markets, the number and rate at which additional patients begin treatment with ORKAMBI, the proportion of initiated patients who remain on treatment and the compliance rates for patients who remain on treatment.

Under the current revenue recognition guidance applicable for the year ending December 31, 2017, we do not recognize any net product revenues on sales of products unless the price is fixed or determinable. Pursuant to new revenue recognition guidance that will become effective January 1, 2018 and is described in Note A, "Basis of Presentation and Accounting Policies" to our condensed consolidated financial statements, we will be required to make estimates of the amount of consideration that will be retained by us that will not be subject to a significant reversal in amounts recognized as net product revenues. Our condensed consolidated balance sheet includes \$190.3 million collected as of September 30, 2017 in France related to ORKAMBI supplied under early access programs at the invoiced price, which has not resulted in any net product revenues because the final price is not fixed or determinable under the current guidance.

If we conclude as of December 31, 2017, that the price of the ORKAMBI supplied under the French early access programs is fixed or determinable, we would record net product revenues for all sales since the inception of these programs based on the fixed or determinable price in the fourth quarter of 2017. If the price is not fixed and determinable as of December 31, 2017, these amounts will be subject to the new guidance. In this case, amounts for prior periods will be recognized in the first quarter of 2018 as a cumulative effect adjustment to our accumulated deficit based on an estimate of the amount of consideration that we would retain that would not be subject to a significant reversal in amounts recognized.

KALYDECO net product revenues increased in the third quarter of 2017 as compared to the third quarter of 2016 primarily due to additional patients being treated with KALYDECO as a result of label expansions. The increase in KALYDECO net product revenues in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016 included approximately \$9 million in one-time revenue credits in the first quarter of 2017 related to the finalization of reimbursement agreements in certain European countries. In the third quarter and the nine months ended September 30, 2017, we recognized approximately \$80.3 million and \$242.5 million, respectively, in ex-U.S. KALYDECO net product revenues, as compared to \$75.1 million and \$227.6 million in the third quarter and the nine months ended September 30, 2016, respectively.

We have withdrawn INCIVEK, which we previously marketed as a treatment for hepatitis C virus infection, from the market in the United States.

Royalty Revenues

Our royalty revenues were \$2.2 million and \$6.6 million in the third quarter and the nine months ended September 30, 2017, respectively, as compared to \$3.8 million and \$12.7 million in the third quarter and the nine months ended September 30, 2016, respectively. Our royalty revenues primarily consist of revenues related to a cash payment we received in 2008 when we sold our rights to certain HIV royalties.

Collaborative Revenues

Our collaborative revenues were \$26.3 million and \$286.1 million in the third quarter and the nine months ended September 30, 2017, respectively, as compared to \$0.3 million and \$1.0 million in the third quarter and the nine months ended September 30, 2016, respectively. The increase in our collaborative revenues during the third quarter of 2017 as compared to the third quarter of 2016 was primarily related to amounts received from Merck for transition activities we received pursuant to our collaboration with Merck KGaA and a \$20.0 million milestone payment received by Parion in the third quarter of 2017 pursuant to a license agreement it entered into with a third party. We are not a party to such license agreement and have no economic interest in either the license or the milestone payment. Parion was deconsolidated as a VIE as of September 30, 2017 and future payments received by Parion pursuant to this license agreement will no longer be recognized by us as collaborative revenue. The increase in our collaborative revenues during the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016 was primarily due to revenue recognized related to the one-time upfront payment Merck KGaA paid in the first quarter of 2017 and \$40 million in upfront and milestone payments received by Parion in 2017 pursuant to its license agreement with a third party. Our collaborative revenues have historically fluctuated significantly from one period to another and may continue to fluctuate in the future.

Operating Costs and Expenses

	Three Months Ended September 30,		Increase/(Decrease)		Nine Months Ended September 30,		Increase/(Decrease)	
	2017	2016	\$	%	2017	2016	\$	%
	(in thousands)				(in thousands)			
Cost of product revenues	\$ 72,186	\$ 53,222	\$ 18,964	36 %	\$ 188,963	\$ 147,165	\$ 41,798	28 %
Royalty expenses	688	855	(167)	(20)%	2,104	2,813	(709)	(25)%
Research and development expenses	454,947	272,370	182,577	67 %	1,017,961	799,238	218,723	27 %
Sales, general and administrative expenses	120,710	106,055	14,655	14 %	361,285	322,921	38,364	12 %
Restructuring expenses, net	337	8	329	n/a	13,859	1,038	12,821	n/a
Intangible asset impairment charge	255,340	—	255,340	n/a	255,340	—	255,340	n/a
Total costs and expenses	\$ 904,208	\$ 432,510	\$ 471,698	109 %	\$ 1,839,512	\$ 1,273,175	\$ 566,337	44 %

Cost of Product Revenues

Our cost of product revenues includes the cost of producing inventories that corresponded to product revenues for the reporting period, plus the third-party royalties payable on our net sales of our products. Pursuant to our agreement with Cystic Fibrosis Foundation Therapeutics Incorporated, or CFFT, our tiered third-party royalties on sales of KALYDECO and ORKAMBI, calculated as a percentage of net sales, range from the single digits to the sub-teens. As a result of the tiered royalty rate, our cost of product revenues as a percentage of CF product revenues is lower at the beginning of each calendar year.

In the third quarter of 2017, our cost of product revenues increased as compared to the third quarter of 2016 primarily due to the increased CF net product revenues. In the fourth quarter of 2017, we expect our cost of product revenues as a percentage of total CF product revenues to be similar to the cost of product revenues as a percentage of total CF product revenues in the third quarter of 2017.

In the nine months ended September 30, 2016, our cost of product revenues included a \$13.9 million commercial milestone that was earned by CFFT related to sales of ORKAMBI. There are no further commercial milestones payable to CFFT.

Royalty Expenses

Royalty expenses primarily consist of expenses related to a subroyalty payable to a third party on net sales of an HIV protease inhibitor sold by GlaxoSmithKline. Royalty expenses do not include royalties we pay to CFFT on sales of KALYDECO and ORKAMBI, which instead are included in cost of product revenues.

Research and Development Expenses

	Three Months Ended September 30,		Increase/(Decrease)		Nine Months Ended September 30,		Increase/(Decrease)	
	2017	2016	\$	%	2017	2016	\$	%
	(in thousands)				(in thousands)			
Research expenses	\$ 76,131	\$ 99,162	\$ (23,031)	(23)%	\$ 226,409	\$ 242,058	\$ (15,649)	(6)%
Development expenses	378,816	173,208	205,608	119 %	791,552	557,180	234,372	42 %
Total research and development expenses	\$ 454,947	\$ 272,370	\$ 182,577	67 %	\$ 1,017,961	\$ 799,238	\$ 218,723	27 %

Our research and development expenses include internal and external costs incurred for research and development of our drugs and drug candidates. We do not assign our internal costs, such as salary and benefits, stock-based compensation expense, laboratory supplies and other direct expenses and infrastructure costs, to individual drugs or drug candidates, because the employees within our research and development groups typically are deployed across multiple research and development programs. These internal costs are significantly greater than our external costs, such as the costs of services provided to us by clinical research organizations and other outsourced research, which we allocate by individual program. All research and development costs for our drugs and drug candidates are expensed as incurred.

Since January 1, 2014, we have incurred \$3.9 billion in research and development expenses associated with drug discovery and development. The successful development of our drug candidates is highly uncertain and subject to a number of risks. In addition, the duration of clinical trials may vary substantially according to the type, complexity and novelty of the drug candidate and the disease indication being targeted. The FDA and comparable agencies in foreign countries impose substantial requirements on the introduction of therapeutic pharmaceutical products, typically requiring lengthy and detailed laboratory and clinical testing procedures, sampling activities and other costly and time-consuming procedures. Data obtained from nonclinical and clinical activities at any step in the testing process may be adverse and lead to discontinuation or redirection of development activities. Data obtained from these activities also are susceptible to varying interpretations, which could delay, limit or prevent regulatory approval. The duration and cost of discovery, nonclinical studies and clinical trials may vary significantly over the life of a project and are difficult to predict. Therefore, accurate and meaningful estimates of the ultimate costs to bring our drug candidates to market are not available.

In 2016 and the nine months ended September 30, 2017, costs related to our CF programs represented the largest portion of our development costs. Any estimates regarding development and regulatory timelines for our drug candidates are highly subjective and subject to change. We recently submitted an NDA and an MAA for tezacaftor in combination with ivacaftor. The target date for the FDA to complete its review of the NDA under PDUFA is February 28, 2018 and we expect the EMA to complete its review of our in MAA in the second half of 2018. We cannot make a meaningful estimate when, if ever, our other clinical development programs will generate revenues and cash flows.

Research Expenses

	Three Months Ended September 30,		Increase/(Decrease)		Nine Months Ended September 30,		Increase/(Decrease)		
	2017	2016	\$	%	2017	2016	\$	%	
	(in thousands)				(in thousands)				
Research Expenses:									
Salary and benefits	\$ 20,445	\$ 21,525	\$ (1,080)	(5)%	\$ 61,486	\$ 61,503	\$ (17)	— %	
Stock-based compensation expense	15,641	14,023	1,618	12 %	44,366	38,088	6,278	16 %	
Laboratory supplies and other direct expenses	10,791	11,726	(935)	(8)%	33,980	33,410	570	2 %	
Outsourced services	10,230	10,054	176	2 %	29,644	20,749	8,895	43 %	
Collaboration and asset acquisition payments	425	22,000	(21,575)	(98)%	425	33,000	(32,575)	(99)%	
Infrastructure costs	18,599	19,834	(1,235)	(6)%	56,508	55,308	1,200	2 %	
Total research expenses	<u>\$ 76,131</u>	<u>\$ 99,162</u>	<u>\$ (23,031)</u>	<u>(23)%</u>	<u>\$ 226,409</u>	<u>\$ 242,058</u>	<u>\$ (15,649)</u>	<u>(6)%</u>	

We maintain a substantial investment in research activities. Our research expenses decreased by 23% in the third quarter of 2017 as compared to the third quarter of 2016 and decreased by 6% in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. Collaboration and asset acquisition payments in the third quarter of 2016 included a \$20.0 million payment to Moderna for which there was no comparable expense in the third quarter of 2017. Collaboration and asset acquisition payments in the nine months ended September 30, 2016 included both the Moderna payment and \$13.0 million in expenses related to the acquisition of early-stage research assets for which there were no comparable expenses in the nine months ended September 30, 2017. We expect to continue to invest in our research programs with a focus on identifying drug candidates with the goal of creating transformative medicines.

Development Expenses

	Three Months Ended September 30,		Increase/(Decrease)		Nine Months Ended September 30,		Increase/(Decrease)		
	2017	2016	\$	%	2017	2016	\$	%	
	(in thousands)				(in thousands)				
Development Expenses:									
Salary and benefits	\$ 54,125	\$ 44,788	\$ 9,337	21%	\$ 156,759	\$ 134,201	\$ 22,558	17 %	
Stock-based compensation expense	30,545	25,957	4,588	18%	90,489	76,980	13,509	18 %	
Laboratory supplies and other direct expenses	10,828	10,784	44	—%	34,171	32,039	2,132	7 %	
Outsourced services	89,637	60,838	28,799	47%	251,677	216,881	34,796	16 %	
Collaboration and asset acquisition payments	160,000	—	160,000	n/a	160,250	—	160,250	n/a	
Drug supply costs	3,151	2,655	496	19%	6,143	9,512	(3,369)	(35)%	
Infrastructure costs	30,530	28,186	2,344	8%	92,063	87,567	4,496	5 %	
Total development expenses	<u>\$ 378,816</u>	<u>\$ 173,208</u>	<u>\$ 205,608</u>	<u>119%</u>	<u>\$ 791,552</u>	<u>\$ 557,180</u>	<u>\$ 234,372</u>	<u>42 %</u>	

Our development expenses increased by 119% in the third quarter of 2017 as compared to the third quarter of 2016 and increased by 42% in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016, primarily due the \$160.0 million payment to Concert in connection with the acquisition of VX-561 in the third quarter of 2017 and to increased outsourced services expenses related to ongoing clinical trials, including trials involving our next-generation CFTR corrector compounds that we are evaluating as part of triple combination treatment regimens. In the fourth quarter of 2017, we expect our outsourced services expenses to increase as compared to the third quarter of 2017 due to expenses related to the advancement of our triple-combination regimens.

Sales, General and Administrative Expenses

	Three Months Ended September 30,		Increase/(Decrease)		Nine Months Ended September 30,		Increase/(Decrease)	
	2017	2016	\$	%	2017	2016	\$	%
	(in thousands)				(in thousands)			
Sales, general and administrative expenses	\$ 120,710	\$ 106,055	\$ 14,655	14%	\$ 361,285	\$ 322,921	\$ 38,364	12%

Sales, general and administrative expenses increased by 14% in the third quarter of 2017 as compared to the third quarter of 2016 and increased by 12% in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016, primarily due to increased global support for KALYDECO and ORKAMBI.

Restructuring Expenses, Net

We recorded restructuring expenses of \$0.3 million and \$13.9 million in the third quarter and the nine months ended September 30, 2017, respectively, as compared to restructuring expenses of \$8.0 thousand and \$1.0 million in the third quarter and the nine months ended September 30, 2016, respectively. The increases in our restructuring expenses in the nine months ended September 30, 2017 primarily relate to our decision to consolidate our research activities into our Boston, Milton Park and San Diego locations and to close our research site in Canada.

Intangible Asset Impairment Charge

In the third quarter of 2017, we recorded a \$255.3 million impairment charge related to Parion's pulmonary ENaC platform that we licensed from Parion in 2015 and a benefit from income taxes of \$97.7 million related to this impairment charge attributable to Parion. There were no corresponding intangible asset impairment charges in the third quarter and the nine months ended September 30, 2016.

Other Items**Interest Expense, Net**

Interest expense, net was \$13.6 million and \$45.0 million in the third quarter and the nine months ended September 30, 2017, respectively, as compared to \$20.1 million and \$61.0 million in the third quarter and the nine months ended September 30, 2016, respectively. The decrease in interest expense, net in the third quarter and the nine months ended September 30, 2017 as compared to the third quarter and the nine months ended September 30, 2016 was primarily due to the repayment of the \$300.0 million outstanding under our revolving credit facility in February 2017. In the fourth quarter of 2017, we expect to incur approximately \$15 million of interest expense associated with the leases for our corporate headquarters and our interest expense related to our revolving credit facility will be dependent on whether, and to what extent, we reborrow amounts under the existing facility.

Other (Expenses) Income, Net

Other (expense) income, net was an expense of \$77.6 million and \$80.6 million in the third quarter and the nine months ended September 30, 2017 as compared to expense of \$0.2 million in the third quarter of 2016 and income of \$3.0 million in the nine months ended September 30, 2016. Other (expense) income, net in the third quarter and the nine months ended September 30, 2017 was primarily related to the deconsolidation of Parion. Other (expense) income, net in the third quarter and the nine months ended September 30, 2016 was primarily due to foreign exchange gains and losses.

Income Taxes

We recorded a benefit from income taxes of \$125.9 million and \$117.6 million in the third quarter and the nine months ended September 30, 2017 as compared to a provision for income taxes of \$0.5 million and \$24.1 million in the third quarter and the nine months ended September 30, 2016. The benefit from income taxes in the third quarter and the nine months ended September 30, 2017 was primarily related to a benefit of \$126.2 million attributable to noncontrolling interest as a result of our impairment of Parion's pulmonary ENaC platform and decrease in the fair value of the contingent payments payable by us to Parion. The provision for income taxes in the third quarter and the nine months ended September 30, 2016 was primarily due to income tax on our VIEs.

We continue to maintain a valuation allowance on the majority of our net operating losses and other deferred tax assets because we have a history of cumulative losses. Accordingly, we have not reported any tax benefit relating to the remaining net operating loss carryforwards (NOLs) and income tax credit carryforwards that will be utilized in future periods in these

jurisdictions. Our U.S. federal net operating loss carryforwards totaled approximately \$4.1 billion as of December 31, 2016. On a quarterly basis, we reassess the valuation allowance on our deferred income tax assets weighing positive and negative evidence to assess the recoverability of the deferred tax assets. Based on our recent financial performance and our future projections, we could record a reversal of all, or a portion of the valuation allowance associated with U.S. deferred tax assets in future periods. However, any such change is subject to actual performance and other considerations that may present positive or negative evidence at the time of the assessment. Our total deferred tax asset balance subject to the valuation allowance was approximately \$1.7 billion at December 31, 2016.

Noncontrolling Interest (VIEs)

The net (income) loss attributable to noncontrolling interest (VIEs) recorded on our condensed consolidated statements of operations reflects Parion and BioAxone's net (income) loss for the reporting period, adjusted for any changes in the noncontrolling interest holders' claim to net assets, including contingent milestone, royalty and option payments. A summary of net income attributable to noncontrolling interest related to our VIEs for the three and nine months ended September 30, 2017 and 2016 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(in thousands)			
Loss attributable to noncontrolling interest before (benefit from) provision for income taxes and changes in fair value of contingent payments	\$ 238,946	\$ 2,406	\$ 222,448	\$ 6,080
(Benefit from) provision for income taxes	(120,181)	(510)	(111,658)	20,063
Decrease (increase) in fair value of contingent payments	69,550	(1,200)	62,560	(59,350)
Net loss (income) attributable to noncontrolling interest	\$ 188,315	\$ 696	\$ 173,350	\$ (33,207)

The net loss attributable to noncontrolling interest in the third quarter and nine months ended September 30, 2017 was primarily related to the \$255.3 million impairment charge related to Parion's pulmonary ENaC platform, a decrease in fair value of the contingent payments payable by us to Parion of \$69.6 million and benefit from income taxes of \$126.2 million related to these charges.

As of September 30, 2017, we have deconsolidated Parion.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2017, we had cash, cash equivalents and marketable securities of \$1.81 billion, which represented an increase of \$378 million from \$1.43 billion as of December 31, 2016. In the nine months ended of September 30, 2017, our cash, cash equivalents and marketable securities balance increased due to cash receipts from product sales, cash received from issuances of common stock under our employee benefit plans and cash received from our collaboration with Merck KGaA in the first quarter of 2017, partially offset by the \$300.0 million repayment of our revolving credit facility in the first quarter of 2017 and the \$160.0 million payment to Concert in connection with the acquisition of VX-561 in the third quarter of 2017. We expect that our future cash flows will be substantially dependent on CF product sales.

Sources of Liquidity

We intend to rely on our existing cash, cash equivalents and marketable securities together with cash flows from product sales as our primary source of liquidity. We are receiving cash flows from sales of ORKAMBI and KALYDECO from the United States and ex-U.S. markets. Future net product revenues for ORKAMBI from ex-U.S. markets will be dependent on, among other things, the timing of and ability to complete reimbursement discussions in European countries.

In February 2017, we repaid the \$300.0 million we had borrowed under our \$500.0 million revolving credit facility. We may repay and reborrow amounts under the revolving credit agreement without penalty. Subject to certain conditions, we may request that the borrowing capacity under this credit agreement be increased by an additional \$300.0 million.

In the nine months ended September 30, 2017, we received significant proceeds from the issuance of common stock under our employee benefit plans, but the amount and timing of future proceeds from employee benefits plans is uncertain. Other possible sources of liquidity include strategic collaborative agreements that include research and/or development funding, commercial debt, public and private offerings of our equity and debt securities, development milestones and

royalties on sales of products, software and equipment leases, strategic sales of assets or businesses and financial transactions. Negative covenants in our credit agreement may prohibit or limit our ability to access these sources of liquidity.

Future Capital Requirements

We incur substantial operating expenses to conduct research and development activities and to operate our organization. Under the terms of our credit agreement entered into in October 2016, we are required to repay any outstanding principal amounts in 2021. We also have substantial facility and capital lease obligations, including leases for two buildings in Boston, Massachusetts that continue through 2028 and capital expenditures for our building under construction in San Diego, California. As of September 30, 2017, we have collected approximately \$190.3 million from ORKAMBI early access programs in France for which the price is not fixed or determinable. We expect we will be required to repay a portion of the collected amounts to the French government based on the difference between the invoiced price of ORKAMBI and the final price for ORKAMBI in France.

In addition, we have entered into certain collaboration agreements with third parties that include the funding of certain research, development and commercialization efforts with the potential for future milestone and royalty payments by us upon the achievement of pre-established developmental and regulatory target and we may enter into additional business development transactions that require additional capital.

We expect that cash flows from ORKAMBI and KALYDECO, together with our current cash, cash equivalents and marketable securities will be sufficient to fund our operations for at least the next twelve months. The adequacy of our available funds to meet our future operating and capital requirements will depend on many factors, including the amounts of future revenues generated by ORKAMBI and KALYDECO and the potential introduction of one or more of our other drug candidates to the market, the level of our business development activities and the number, breadth, cost and prospects of our research and development programs.

Financing Strategy

We have a \$500.0 million revolving credit facility that we entered into in October 2016. We may repay and reborrow amounts under the revolving credit agreement without penalty. In addition, subject to certain conditions, we may request that the borrowing capacity under this credit agreement be increased by an additional \$300.0 million. We may raise additional capital through public offerings or private placements of our securities or securing new collaborative agreements or other methods of financing. We will continue to manage our capital structure and will consider all financing opportunities, whenever they may occur, that could strengthen our long-term liquidity profile. There can be no assurance that any such financing opportunities will be available on acceptable terms, if at all.

CONTRACTUAL COMMITMENTS AND OBLIGATIONS

Our commitments and obligations were reported in our Annual Report on Form 10-K for the year ended December 31, 2016, which was filed with the Securities and Exchange Commission, or SEC, on February 23, 2017. There have been no material changes from the contractual commitments and obligations previously disclosed in that Annual Report on Form 10-K, except that:

- In February 2017, we repaid the outstanding \$300 million balance of our revolving credit facility.
- In July 2017, we acquired certain CF assets including VX-561 from Concert pursuant to an asset purchase agreement. At closing, we paid Concert \$160 million in cash for all worldwide development and commercialization rights to VX-561 and may be required to pay up to an additional \$90 million in milestones based on regulatory approval in the U.S. and reimbursement in the UK, Germany or France.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States. The preparation of these financial statements requires us to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reported periods. These items are monitored and analyzed by management for changes in facts and circumstances, and material changes in these estimates could occur in the future. Changes in estimates are reflected in reported results for the period in which the change occurs. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from our estimates if past experience or other assumptions do not turn out to be substantially accurate. During the nine months ended September 30, 2017, there were no material changes to our critical accounting policies as reported in our Annual Report on Form 10-K for the year ended December 31, 2016, which was filed with the SEC on February 23, 2017.

RECENT ACCOUNTING PRONOUNCEMENTS

For a discussion of recent accounting pronouncements, please refer to Note A, “Basis of Presentation and Accounting Policies—Recent Accounting Pronouncements.”

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As part of our investment portfolio, we own financial instruments that are sensitive to market risks. The investment portfolio is used to preserve our capital until it is required to fund operations, including our research and development activities. None of these market risk-sensitive instruments are held for trading purposes.

Interest Rate Risk

We invest our cash in a variety of financial instruments, principally securities issued by the U.S. government and its agencies, investment-grade corporate bonds and commercial paper, and money market funds. These investments are denominated in U.S. dollars. All of our interest-bearing securities are subject to interest rate risk and could decline in value if interest rates fluctuate. Substantially all of our investment portfolio consists of marketable securities with active secondary or resale markets to help ensure portfolio liquidity, and we have implemented guidelines limiting the term-to-maturity of our investment instruments. Due to the conservative nature of these instruments, we do not believe that we have a material exposure to interest rate risk. If interest rates were to increase or decrease by 1%, the fair value of our investment portfolio would increase or decrease by an immaterial amount.

Foreign Exchange Market Risk

As a result of our foreign operations, we face exposure to movements in foreign currency exchange rates, primarily the Euro, British Pound, Australian Dollar and Canadian Dollar, against the U.S. dollar. The current exposures arise primarily from cash, accounts receivable, intercompany receivables, payables and inventories. Both positive and negative affects to our net revenues from international product sales from movements in foreign currency exchange rates are partially mitigated by the natural, opposite affect that foreign currency exchange rates have on our international operating costs and expenses.

We have a foreign currency management program with the objective of reducing the effect of exchange rate fluctuations on our operating results and forecasted revenues and expenses denominated in foreign currencies. We currently have cash flow hedges for the Euro, British Pound and Australian Dollar related to forecasted product revenues that qualify for hedge accounting treatment under U.S. GAAP. We do not seek hedge accounting treatment for our forward contracts related to monetary assets and liabilities that impact our operating results. As of September 30, 2017, we held foreign exchange forward contracts with notional amounts totaling \$456.9 million. As of September 30, 2017, our outstanding foreign exchange forward contracts had a net fair value of \$(13.1) million.

Based on our foreign currency exchange rate exposures at September 30, 2017, a hypothetical 10% adverse fluctuation in exchange rates would decrease the fair value of our foreign exchange forward contracts that are designated as cash flow hedges by approximately \$34.3 million at September 30, 2017. The resulting loss on these forward contracts would be offset by the gain on the underlying transactions and therefore would have minimal impact on future anticipated earnings and cash flows. Similarly, adverse fluctuations in exchange rates that would decrease the fair value of our foreign exchange forward contracts that are not designated as hedge instruments would be offset by a positive impact of the underlying monetary assets and liabilities.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q, have concluded that, based on such evaluation, as of September 30, 2017 our disclosure controls and procedures were effective and designed to provide reasonable assurance that the information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. In designing and evaluating our disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Controls Over Financial Reporting

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) occurred during the three months ended September 30, 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. Other Information

Item 1. Legal Proceedings

There have been no material changes from the legal proceedings previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016, which was filed with the Securities and Exchange Commission, or SEC, on February 23, 2017.

Item 1A. Risk Factors

Information regarding risk factors appears in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016, which was filed with the SEC on February 23, 2017. There have been no material changes from the risk factors previously disclosed in the Annual Report on Form 10-K, except that the first four risk factors set forth below shall replace the first three risk factors set forth in the Annual Report on Form 10-K and the fifth risk factor set forth below shall be added as a new risk factor.

All of our product revenues and the vast majority of our total revenues are derived from sales of medicines for the treatment of cystic fibrosis. If we are unable to continue to increase revenues from sales of our cystic fibrosis medicines or if we do not meet the expectations of investors or public equity market analysts, our business would be materially harmed and the market price of our common stock would likely decline.

Substantially all of our product revenues and the vast majority of our total revenues are derived from the sale of CF medicines. As a result, our future success is dependent on our ability to continue to increase revenues from sales of our CF medicines. In the near term, this will require us to maintain KALYDECO net product revenues and increase ORKAMBI net product revenues. In the medium term, this will require us to obtain approval for, and successfully commercialize, tezacaftor in combination with ivacaftor. In the longer term, this will require us to successfully develop, obtain approval for and commercialize at least one triple-combination therapy that will allow us to treat patients who have one copy of the F508del mutation in their *CFTR* gene and a second mutation in their *CFTR* gene that results in minimal *CFTR* function and to improve the treatment options available to patients with CF who are eligible for our current medicines. If we are unable to increase our CF product revenues or if we experience adverse developments with respect to development or commercialization of our CF medicines, our results of operations will be adversely affected and our business will be materially harmed.

We are investing significant resources in the development of our next-generation CFTR corrector compounds in triple combinations and if we are unable to show the safety and efficacy of these compounds, experience delays in doing so or are unable to successfully commercialize at least one of these medicines, our business would be materially harmed.

We are investing significant resources in the development of our next-generation CFTR corrector compounds, including VX-152, VX-440, VX-659 and VX-445, which we are evaluating as part of triple combination treatment regimens for the treatment of patients with CF. We believe that a significant portion of the long-term value attributed to our company by investors is based on the commercial potential of these triple-combination therapies. In July 2017, we obtained initial positive results from Phase 2 clinical trials of VX-152 and VX-440 and a Phase 1 clinical trial of VX-659. In each case, these clinical trials enrolled a limited number of patients with CF and we expect to receive additional information regarding these compounds in early 2018. Based on these results, we expect to initiate pivotal programs to evaluate one or two of these triple combination regimens in the first half of 2018.

In order to ultimately obtain approval for a triple-combination regimen, we will need to demonstrate that the compounds are safe and effective in a significantly larger number of patients than were involved in the clinical trials conducted to date. Initial results from ongoing clinical trials may differ materially from final results from such clinical trials. The results from preclinical and early clinical studies do not always accurately predict results in later, large-scale clinical

trials. If the data from our ongoing or planned clinical trials or non-clinical studies of triple combination regimens including our next-generation CFTR compounds are not favorable, the FDA and comparable foreign regulatory authorities may not approve these treatment regimens and/or we may be forced to delay or terminate the development of these treatment regimens, which would have an adverse effect on our business. Even successfully completed large-scale clinical trials may not result in marketable medicines. If a triple combination that includes a next-generation CFTR corrector compounds fails to achieve its primary endpoint in clinical trials, if safety issues arise or if the results from our clinical trials are otherwise inadequate to support regulatory approval of our triple combination therapies, commercialization of that combination regimen could be delayed or halted.

Even if we gain marketing approval for one or more combination therapies containing a next-generation CFTR corrector compound in a timely manner, we cannot be sure that such combination therapy will be commercially successful. In addition, since we expect that a significant portion of the patients for whom a triple combination treatment regimen would be indicated would also be eligible for our then existing medicines, a portion of the revenues from our triple combination regimens will likely displace revenues from our then marketed products reducing the overall effect of the commercialization of our triple combination regimens on our total revenues.

If the anticipated or actual timing of marketing approvals for these compounds, or the market acceptance of these compounds, if approved, including treatment reimbursement levels agreed to by third-party payors, do not meet the expectations of investors or public market analysts, the market price of our common stock would likely decline.

Our business currently depends heavily on ORKAMBI and KALYDECO net product revenues and we expect to continue to depend on these revenues at least until we obtain approval for tezacaftor in combination with ivacaftor.

Our two marketed medicines are ORKAMBI and KALYDECO, which are approved to treat patients with CF who have specific mutations in their *CFTR* gene. ORKAMBI and KALYDECO net product revenues represented approximately 52% and 32% of our total revenues in the nine months ended September 30, 2017, respectively, and we expect ORKAMBI and KALYDECO net product revenues to represent substantially all of our total revenues for the remainder of 2017.

A majority of our net product revenues are from sales of ORKAMBI and most of our ORKAMBI net product revenues have come from the United States. We have recognized limited ex-U.S. net product revenues due to the ongoing reimbursement discussions in many ex-U.S. countries and have experienced challenges in the commercialization of ORKAMBI both in the United States and in ex-U.S. markets. Our ORKAMBI U.S. revenues have been affected by uptake, discontinuations and compliance rates. Our ORKAMBI ex-U.S. revenues have been affected by the same factors as our U.S. ORKAMBI revenues and challenges with respect to obtaining reimbursement for ORKAMBI in ex-U.S. markets. Factors that affect our ORKAMBI net product revenues include:

- the rate at which patients initiate treatment of ORKAMBI, the proportion of initiated patients who remain on treatment and the compliance rate for patients who remain on treatment;
- the safety and efficacy profile of ORKAMBI;
- our ability to obtain reimbursement for ORKAMBI and any changes in reimbursement policies of payors and other third parties; and
- legal, administrative, regulatory or legislative developments, including pricing limitations.

Since the regulations that govern pricing, coverage and reimbursement for drugs vary widely from country to country, there is no assurance that coverage and reimbursement will be available outside of the United States and, even if it is available, the timing or the level of reimbursement may not be satisfactory. Adverse pricing limitations or a delay in obtaining coverage and reimbursement would decrease our future net product revenues and harm our business.

If we continue to experience challenges with the commercialization of ORKAMBI or are unable to sustain KALYDECO net product revenues or if either medicine were to become subject to problems such as safety or efficacy issues, the introduction or greater acceptance of competing products, changes in reimbursement policies of payors and other third parties, or adverse legal, administrative, regulatory or legislative developments, our ability commercialization of our products would be impaired and our stock price would likely decline.

Our business depends on the success of tezacaftor in combination with ivacaftor, which has not been approved by the FDA or the European Commission. If we are unable to obtain marketing approval or experience material delays in obtaining marketing approval for, or reimbursement arrangements relating to, tezacaftor in combination with ivacaftor, our business could be materially harmed.

In the first quarter of 2017, we obtained positive results from two Phase 3 clinical trials of tezacaftor in combination with ivacaftor that showed statistically significant improvements in lung function in patients with CF 12 years of age and older who have certain mutations in their *CFTR* gene. Based on these results, we submitted an NDA in the United States and an MAA in Europe for this potential combination regimen. The target date for the FDA to complete its review of the NDA under the Prescription Drug User Fee Act is February 28, 2018. We expect the EMA to complete its review in the second half

of 2018. Obtaining approval of an NDA or an MAA is a lengthy, expensive and uncertain process, and we may not be successful. Obtaining approval depends on many factors including:

- whether or not the FDA and European regulatory authorities determine that the evidence gathered in well-controlled clinical trials, other clinical trials and nonclinical studies demonstrates that the combination regimen is safe; and
- whether or not the FDA and European regulatory authorities are satisfied that the manufacturing facilities, processes and controls for the combination are adequate, that the labeling is satisfactory and that plans for post-marketing studies, safety monitoring and risk evaluation and mitigation are sufficient.

Obtaining marketing approval for the combination of tezacaftor and ivacaftor in one country or region does not ensure that we will be able to obtain marketing approval in any other country or region.

Even if a tezacaftor in combination with ivacaftor is approved, the FDA or the European Commission, as the case may be, may limit the indications for which the product may be marketed, require extensive warnings on the product labeling or require expensive and time-consuming clinical trials or reporting as conditions of approval. If we experience material delays in obtaining marketing approval for the combination of tezacaftor and ivacaftor in either the United States or Europe, our future net product revenues and cash flows will be adversely effected. If we do not obtain approval to market the combination of tezacaftor and ivacaftor in the United States or Europe, our business will be materially harmed. Additionally, even if the combination of tezacaftor and ivacaftor receives marketing approval, coverage and reimbursement may not be available and, even if it is available, the level of reimbursement may not be satisfactory.

We may not realize the anticipated benefits of our acquisition of VX-561 from Concert Pharmaceuticals, Inc.

In July 2017, we acquired certain CF assets from Concert Pharmaceuticals, Inc., or Concert, including VX-561, an investigational CFTR potentiator that has the potential to be used as part of future once-daily combination regimens of CFTR modulators that treat the underlying cause of CF. We amended our ongoing Phase 2 clinical trials of VX-445 and VX-659 to include additional cohorts of patients to evaluate these next-generation CFTR corrector compounds in combination with tezacaftor and VX-561. Acquisitions are inherently risky and we may not realize the anticipated benefits of such transaction, which involves numerous risks including:

- that we fail to successfully develop and/or integrate VX-561 into our pipeline in order to achieve our strategic objectives;
- that we receive inadequate or unfavorable data from clinical trials evaluating the VX-561 in combination with other CFTR modulators; and
- the potential failure of the due diligence processes to identify significant problems, liabilities or other shortcomings or challenges of VX-561 or any of the other assets acquired from Concert, including but not limited to, problems, liabilities or other shortcomings or challenges with respect to intellectual property, product quality, safety, and other known and unknown liabilities.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q and, in particular, our Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Part I-Item 2, contain or incorporate a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding:

- our expectations regarding the amount of, timing of and trends with respect to our revenues, costs and expenses and other gains and losses, including those related to net product revenues from KALYDECO and ORKAMBI;
- our expectations regarding clinical trials, development timelines, timing of our receipt of data from our ongoing and planned clinical trials and regulatory authority filings and submissions for our products and drug candidates, including the NDA and MAA submission for tezacaftor in combination with ivacaftor and the ongoing and planned clinical trials to evaluate our next-generation CFTR correctors;
- our ability to successfully market KALYDECO and ORKAMBI or any of our other drug candidates for which we obtain regulatory approval;

- the data that will be generated by ongoing and planned clinical trials and the ability to use that data to advance compounds, continue development or support regulatory filings;
- our beliefs regarding the support provided by clinical trials and preclinical and nonclinical studies of our drug candidates for further investigation, clinical trials or potential use as a treatment;
- our plan to continue investing in our research and development programs and our strategy to develop our drug candidates, alone or with third party-collaborators;
- the establishment, development and maintenance of collaborative relationships;
- potential business development activities;
- our post-closing integration of the assets acquired from Concert;
- potential fluctuations in foreign currency exchange rates;
- our ability to use our research programs to identify and develop new drug candidates to address serious diseases and significant unmet medical needs; and
- our liquidity and our expectations regarding the possibility of raising additional capital.

Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q may turn out to be wrong. They can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Many factors mentioned in this Quarterly Report on Form 10-Q will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially from expected results. We also provide a cautionary discussion of risks and uncertainties under “Risk Factors” in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016, which was filed with the SEC on February 23, 2017. These are factors and uncertainties that we think could cause our actual results to differ materially from expected results. Other factors and uncertainties besides those listed there could also adversely affect us.

Without limiting the foregoing, the words “believes,” “anticipates,” “plans,” “intends,” “expects” and similar expressions are intended to identify forward-looking statements. There are a number of factors and uncertainties that could cause actual events or results to differ materially from those indicated by such forward-looking statements, many of which are beyond our control. In addition, the forward-looking statements contained herein represent our estimate only as of the date of this filing and should not be relied upon as representing our estimate as of any subsequent date. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

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

Issuer Repurchases of Equity Securities

The table set forth below shows all repurchases of securities by us during the three months ended September 30, 2017 :

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
July 1, 2017 to July 31, 2017	2,040	\$0.01	—	—
August 1, 2017 to August 31, 2017	15,811	\$0.01	—	—
September 1, 2017 to September 30, 2017	2,589	\$0.01	—	—
Total	20,440	\$0.01	—	—

The repurchases were made under the terms of our Amended and Restated 2006 Stock and Option Plan and our Amended and Restated 2013 Stock and Option Plan. Under these plans, we award shares of restricted stock to our employees that typically are subject to a lapsing right of repurchase by us. We may exercise this right of repurchase if a restricted stock recipient’s service to us is terminated. If we exercise this right, we are required to repay the purchase price paid by or on behalf of the recipient for the repurchased restricted shares, which typically is the par value per share of \$0.01. Repurchased shares are returned and are available for future awards under the terms of our Amended and Restated 2013 Stock and Option Plan.

Item 6. Exhibits

Exhibit Number	Exhibit Description
10.1	Employment Agreement, dated as of September 6, 2017, between Vertex Pharmaceuticals Incorporated and Tom Granev.*
10.2	Change of Control Agreement, dated as of September 6, 2017, between Vertex Pharmaceuticals Incorporated and Tom Granev.*
31.1	Certification of the Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer and the Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation
101.LAB	XBRL Taxonomy Extension Labels
101.PRE	XBRL Taxonomy Extension Presentation

* Management contract, compensatory plan or agreement.

SIGNATURES

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

Vertex Pharmaceuticals Incorporated

October 30, 2017

By:

/s/ Thomas Graney

Thomas Graney

*Senior Vice President and Chief Financial Officer
(principal financial officer and
duly authorized officer)*

EMPLOYMENT AGREEMENT

This Employment Agreement (this “Agreement”) is made and entered into as of this 6th day of September, 2017, by and between Vertex Pharmaceuticals Incorporated, a Massachusetts corporation (together with its successors and assigns, the “Company”), and Tom Graney (the “Executive”).

WITNESSETH

WHEREAS, the Company is employing the Executive as the Company’s Senior Vice President, Chief Financial Officer; and

WHEREAS, the Executive has been designated as an Executive Officer of the Company;

NOW, THEREFORE, in consideration of the promises and mutual covenants contained herein and for other good and valuable consideration, the receipt of which mutually is acknowledged, the Company and the Executive (each individually a “Party”, and together the “Parties”) agree as follows:

1. DEFINITIONS.

“Base Salary” shall mean the Executive’s base salary in accordance with Section 4 below.

“Board” shall mean the Board of Directors of the Company.

“Cause” shall mean (i) the Executive is convicted of a crime involving moral turpitude, (ii) the Executive commits a material breach of any provision of this Agreement not involving the performance or nonperformance of duties, or (iii) the Executive, in carrying out the Executive’s duties, acts or fails to act in a manner that is determined, in the sole discretion of the Board, after written notice of any such act or failure to act and a reasonable opportunity to cure the deficiency has been provided to the Executive, to be (A) willful gross neglect or (B) willful gross misconduct resulting, in either case, in material harm to the Company unless such act, or failure to act, was believed by the Executive, in good faith, to be in the best interests of the Company.

“Change of Control” shall have the meaning set forth in the Change of Control Agreement.

“Change of Control Agreement” shall mean the Change of Control letter agreement between the Company and the Executive of even date herewith.

“Code” shall mean the Internal Revenue Code of 1986, as amended.

“Common Stock” shall mean the common stock of the Company.

“Disability” or “Disabled” shall mean a disability as determined under the Company’s long-term disability plan or program in effect at the time the disability first occurs, or if no such

plan or program exists at the time of disability, then a “disability” as defined under Section 22(e)(3) of the Code.

“Effective Date” shall mean September 13, 2017.

“Good Reason” shall mean that, without the Executive’s consent, one or more of the following events occurs:

- (i) the Executive’s duties are materially diminished to an extent that results in the Executive no longer being an “officer,” as such term is defined in Rule 16a-1(f) promulgated under the Securities Exchange Act of 1934; or
- (ii) the Executive’s Base Salary is decreased unless such reduction is part of an across-the-board proportionate reduction in the salaries of the Company’s senior management team; or
- (iii) the office to which the Executive is assigned is relocated to a place 35 or more miles away and such relocation is not at the Executive’s request or with the Executive’s prior agreement (and other than, for Executives assigned to the Company’s principal executive offices, in connection with a change in location of the Company’s principal executive offices);

provided that Good Reason shall not exist unless and until within 30 days after the event giving rise to Good Reason under either (i) or (ii) above has occurred, the Executive delivers a written termination notice to the Company stating that an event giving rise to Good Reason has occurred and identifying with reasonable detail the event that the Executive asserts constitutes Good Reason under either (i) or (ii) above and the Company fails or refuses to cure or eliminate the event giving rise to Good Reason on or within 30 days after receiving such notice and, with respect to the event giving rise to Good Reason under (iii) above, the Executive delivers a written termination notice to the Company within 30 days after the event giving rise to Good Reason occurs. To avoid doubt, the termination of the Executive’s employment would become effective at the close of business on the thirtieth day after the Company receives the Executive’s termination notice, unless, in the case of an event giving rise to Good Reason under either (i) or (ii) above, the Company cures or eliminates the event giving rise to Good Reason prior to such time.

“Severance Payment” shall mean an amount equal to the sum of the Base Salary in effect on the date of termination of Executive’s employment, plus the amount of the Target Bonus for the Executive for the year in which the Executive’s employment is terminated; provided, however, that if the Executive terminates the Executive’s employment for Good Reason based on a reduction in Base Salary, then the Base Salary to be used in calculating the Severance Payment shall be the Base Salary in effect immediately prior to such reduction in Base Salary.

“Target Bonus” shall mean the target cash bonus for which the Executive is eligible on an annual basis, at a level consistent with the Executive’s title and responsibilities, under the Company’s bonus program then in effect and applicable to the Company’s senior executives generally.

2. TERM OF EMPLOYMENT.

The Company hereby employs the Executive, and the Executive hereby accepts such employment, continuing until termination in accordance with the terms of this Agreement. The period during which the Executive is employed hereunder is referred to in this Agreement as the “term of employment.”

3. POSITION.

On the Effective Date, the Executive is employed as the Company’s Senior Vice President, Chief Financial Officer, reporting to the Company’s Executive Vice President, Chief Operating Officer.

4. BASE SALARY.

The Executive’s annualized Base Salary as of the date of this Agreement is \$550,000, payable in accordance with the regular payroll practices of the Company. The Base Salary shall be reviewed no less frequently than annually, and any changes thereto (which shall thereafter be deemed the Executive’s Base Salary) shall be solely within the discretion of the Board.

5. TARGET BONUS PROGRAM.

During the term of employment, the Executive shall be eligible to participate in the Company’s annual cash incentive compensation program applicable to the Company’s senior executives, as any such programs are established and modified from time to time by the Board in its sole discretion, and in accordance with the terms of such program, with a Target Bonus as determined by the Board.

6. INCENTIVE COMPENSATION PROGRAMS/SIGN-ON AWARDS.

(a) During the term of employment, the Executive shall be eligible to participate in the Company’s incentive compensation programs applicable to the Company’s senior executives, as such programs may be established and modified from time to time by the Board in its sole discretion.

(b) **Sign-On Cash Bonus** : The Executive shall receive a sign-on cash bonus in the amount of \$150,000 payable (with appropriate deductions as required by law) to the Executive at the first regular pay date applicable to the Executive after the Effective Date. If the Executive terminates this Agreement without Good Reason, and other than as a result of death or Disability, during the period commencing on the Effective Date and ending on the first anniversary of the

Effective Date, the Executive shall repay the sign-on cash bonus to the Company within 60 days of such termination.

(c) **Sign-On Restricted Stock Unit Grant** : Subject to approval from the Board, the Executive will receive, in accordance with the terms of a Restricted Stock Unit agreement executed and delivered to the Company by the Executive on the Effective Date (the “Grant Date”), restricted stock units with respect to shares of Common Stock with a fair market value (average of high and low stock price) on Executive’s date of hire equal to \$1,500,000 pursuant to Vertex Pharmaceuticals Incorporated’s Stock and Option Plan. This grant, including but not limited to the vesting schedule and the forfeiture provision contained therein, shall be subject to the other terms and conditions specified in a separate Restricted Stock Unit agreement attached hereto as Exhibit A.

7. EMPLOYEE BENEFIT PROGRAMS.

During the term of employment, the Executive shall be entitled to participate in all employee welfare and pension benefit plans, programs and/or arrangements offered by the Company to its senior executives, as such plans, programs and arrangements may be amended from time to time, to the same extent and on the same terms applicable to other senior executives. Nothing in this section shall preclude the Company from amending or terminating any of its employee benefit plans, programs or arrangements.

8. VACATION.

During the term of employment, the Executive shall be entitled to paid vacation days each calendar year in accordance with the Company’s vacation policy then in effect.

9. TERMINATION OF EMPLOYMENT.

(a) **Termination in Connection with a Change of Control** . To the extent the Executive is entitled, in connection with the Executive’s termination of employment, to severance or other benefits under the Change of Control Agreement, the Executive shall not be entitled to corresponding benefits under this Section 9.

(b) **Termination by the Company for Cause; or Termination by the Executive without Good Reason**. If the Company terminates the Executive’s employment for Cause, or if the Executive voluntarily terminates the Executive’s employment, other than for Good Reason, death or Disability, the term of employment shall end as of the date specified below, and the Executive shall be entitled to the following:

- (i) Base Salary earned by Executive but not paid through the date of termination of Executive’s employment under this Section 9(b); and
- (ii) any amounts earned, accrued or owing to the Executive but not yet paid under Sections 5, 6, or 7 above.

Termination by Company for Cause shall be effective as of the date noticed by the Company. Voluntary termination by Executive other than for Good Reason, death or Disability shall be effective upon 90 days' prior written notice to the Company and shall not be deemed a breach of this Agreement.

(c) Termination by the Company Without Cause; or Termination by the Executive for Good Reason. If the Executive's employment is terminated by the Company without Cause (other than due to death or Disability), or is terminated by the Executive for Good Reason (in accordance with the notice and cure provisions set forth in the definition of "Good Reason" above), the Executive shall be entitled to the following (provided that, with respect to (iii) and (v) such amounts shall be subject to and in exchange for a general release of all claims against the Company, its subsidiaries, and their officers, directors, agents and representatives, which is executed by Executive and becomes enforceable and non-revocable within 60 days of the date of termination):

- (i) Base Salary earned by Executive but not paid through the date of termination of Executive's employment under this Section 9(c);
- (ii) all incentive compensation awards earned by Executive but not paid prior to the date of termination of Executive's employment under this Section 9(c);
- (iii) a lump sum cash payment to the Executive in an amount equal to the Severance Payment, payable within ten days after the execution of a general release and expiration, without revocation, of any applicable revocation periods under the general release provided that if the 60-day period during which the release is required to become effective and irrevocable begins in one calendar year and ends in another calendar year, the Severance Payment shall not be made before the first day of the second calendar year;
- (iv) any amounts earned, accrued or owing to the Executive but not yet paid under Sections 5, 6 or 7 above;
- (v) if COBRA coverage is elected by the Executive, the Company shall pay the cost of insurance continuation premiums on the Executive's behalf (whether or not covered by COBRA) to continue standard medical, dental and life insurance coverage for the Executive (or the cash equivalent of same in the event the Executive is ineligible for continued coverage), on a monthly basis, until the earlier of:
 - (A) the date 12 months after the date the Executive's employment is terminated; or
 - (B) the date, or dates, on which the Executive receives equivalent coverage and benefits under the plans, programs and/or arrangements of a subsequent

employer (such coverage and benefits to be determined on a coverage-by-coverage or benefit-by-benefit basis).

If Executive is a “specified employee” under Section 409A(a)(2)(B)(i) of the Code, any payment of “nonqualified deferred compensation” (as defined under Section 409A of the Code and related guidance and as determined by the Company) attributable to a “separation from service” (as defined under Section 409A of the Code, after giving effect to the presumptions contained therein, and related guidance) shall not commence until the first full business day that is six months and one day after the applicable separation from service (or, if earlier, the Executive’s Death) (“Deferred Payment Date”). Any payments that would otherwise have been made between the separation from service and the Deferred Payment Date, but for this paragraph, shall be made in a lump sum on the Deferred Payment Date. Payments that, in any case, are scheduled to be made after the Deferred Payment Date shall continue according to the applicable payment schedule. For purposes of this Agreement, all references to “termination of employment” and correlative phrases shall be construed to require a “separation from service” (as defined above”), to the extent required to comply with Section 409A of the Code.

10. ASSIGNABILITY; BINDING NATURE.

This Agreement shall be binding upon and inure to the benefit of the Parties and their respective successors, heirs (in the case of the Executive) and assigns. No rights or obligations of the Company under this Agreement may be assigned or transferred by the Company except that such rights or obligations may be assigned or transferred pursuant to a merger or consolidation in which the Company is not the continuing entity, or the sale or liquidation of all or substantially all of the assets of the Company; provided, however, that the assignee or transferee is the successor to all or substantially all of the assets of the Company and such assignee or transferee assumes the liabilities, obligations and duties of the Company, as contained in this Agreement, either contractually or as a matter of law.

11. REPRESENTATIONS.

The Company represents and warrants that it is fully authorized and empowered to enter into this Agreement, and that the performance of its obligations under this Agreement will not violate any agreement between it and any other person, firm or organization. The Executive represents and warrants that no agreement exists between her and any other person, firm or organization that would be violated by the performance of the Executive’s obligations under this Agreement.

12. INDEMNIFICATION; INSURANCE.

The Executive shall at all times be indemnified and eligible for advancement of expenses on the same basis as is provided for the Company’s other executive officers and in accordance with the provisions of the Company’s charter and by-laws then in effect. The Executive shall

also be covered under all of the Company's policies of liability insurance maintained for the benefit of its directors and officers on the same basis as is provided for its other executive officers.

13. ENTIRE AGREEMENT; TERMINATION.

This Agreement, the agreements referenced herein and the Employee Non-Disclosure, Non-Competition & Inventions Agreement between the Executive and the Company contain the entire understanding and agreement between the Parties concerning the subject matter hereof and supersedes all prior agreements, understandings, discussions, negotiations and undertakings, whether written or oral, between the Parties with respect thereto. Subject to the terms of this Agreement, the Company shall be entitled to terminate the Executive's employment at any time, and the Executive may terminate the Executive's employment by the Company, at any time subject to the provisions of Section 9(b) of this Agreement, in each case by written notice provided in accordance with Section 20 of this Agreement.

14. AMENDMENT OR WAIVER.

No provision in this Agreement may be amended unless such amendment is agreed to in writing and signed by the Executive and an authorized officer of the Company provided that the Company may, without the Executive's consent, unilaterally adopt amendments that may be required so that this Agreement continues to comply with applicable law or regulations, including without limitation Section 409A of the Code. No waiver by either Party of any breach by the other Party of any condition or provision contained in this Agreement to be performed by such other Party shall be deemed a waiver of a similar or dissimilar condition or provision at the same or any prior or subsequent time. Any waiver must be in writing and signed by the Executive or an authorized officer of the Company, as the case may be.

15. SEVERABILITY.

If any provision or portion of this Agreement shall be determined to be invalid or unenforceable for any reason, in whole or in part, the remaining provisions of this Agreement shall be unaffected thereby and shall remain in full force and effect to the fullest extent permitted by law.

16. SURVIVORSHIP.

The respective rights and obligations of the Parties hereunder shall survive any termination of the Executive's employment to the extent necessary to the intended preservation of such rights and obligations.

17. BENEFICIARIES/REFERENCES.

The Executive shall be entitled, to the extent permitted under any applicable law, to select and change a beneficiary or beneficiaries to receive any compensation or benefit payable

hereunder following the Executive's death by giving the Company written notice thereof. In the event of the Executive's death or a judicial determination of the Executive's incompetence, reference in this Agreement to the Executive shall be deemed, where appropriate, to refer to the Executive's beneficiary, estate or other legal representative.

18. GOVERNING LAW/JURISDICTION.

This Agreement shall be governed by and construed and interpreted in accordance with the laws of The Commonwealth of Massachusetts without reference to principles of conflict of laws.

19. RESOLUTION OF DISPUTES.

Any disputes arising under or in connection with this Agreement may, at the election of the Executive or the Company, be resolved by binding arbitration, to be held in Massachusetts in accordance with the Rules and Procedures of the American Arbitration Association. If arbitration is elected, the Executive and the Company shall mutually select the arbitrator. If the Executive and the Company cannot agree on the selection of an arbitrator, each Party shall select an arbitrator and the two arbitrators shall select a third arbitrator, and the three arbitrators shall form an arbitration panel that shall resolve the dispute by majority vote. Judgment upon the award rendered by the arbitrator or arbitrators may be entered in any court having jurisdiction thereof. Costs of the arbitrator or arbitrators and other similar costs in connection with an arbitration shall be shared equally by the Parties; all other costs, such as attorneys' fees incurred by each Party, shall be borne by the Party incurring such costs.

20. NOTICES.

All notices that are required or permitted hereunder shall be in writing and sufficient if delivered personally, sent by facsimile (and promptly confirmed by personal delivery, registered or certified mail or overnight courier), sent by nationally-recognized overnight courier or sent by registered or certified mail, postage prepaid, addressed as follows:

If to the Company: Vertex Pharmaceuticals Incorporated

50 Northern Avenue

Boston, MA 02210

Attn: Chief Executive Officer

If to the Executive: at the Executive's home address listed in the Company records.

Any such notice shall be deemed to have been given: (a) when delivered if personally delivered or sent by facsimile on a business day; (b) on the business day after dispatch if sent by nationally-recognized overnight courier; and/or (c) on the fifth business day following the date of mailing if sent by mail.

21. HEADINGS.

The headings of the sections contained in this Agreement are for convenience only and shall not be deemed to control or affect the meaning or construction of any provision of this Agreement.

22. COUNTERPARTS.

This Agreement may be executed in two or more counterparts.

23. SECTION 409A OF THE CODE.

It is the intention of the Company and the Executive that this Agreement and the payments provided for herein are either exempt from or meet the requirements of Section 409A of the Code. The Company and the Executive agree to cooperate in good faith in preparing and executing such amendments to this Agreement, if any, as the Company or Executive may reasonably request solely for the purpose of assuring that this Agreement and the payments provided hereunder remain exempt from or meet the requirements of Section 409A, as applicable. Nothing in this Section 23 shall require the Company to increase the Executive's compensation or make the Executive whole for any such changes. Each payment in a series of payments provided to the Executive pursuant to this Agreement will be deemed a separate payment for purposes of Section 409A. In no event, however, shall the Company have any liability relating to the failure or alleged failure of any payment or benefit under this Agreement to comply with, or be exempt from, the requirements of Section 409A of the Code.

Each payment made under this Agreement shall be treated as a separate payment and the right to a series of installment payments under this Agreement is to be treated as a right to a series of separate payments. The Executive's right to payment or reimbursement for any expenses hereunder shall be subject to the following additional rules: (i) the amount of expenses eligible for payment or reimbursement during any calendar year shall not affect the expenses eligible for payment or reimbursement in any other calendar year, (ii) payment or reimbursement shall be made not later than December 31 of the calendar year following the calendar year in which the expense or payment was incurred, and (iii) the right to payment or reimbursement is not subject to liquidation or exchange for any other benefit.

24. TAX WITHHOLDING; NO GUARANTEE OF ANY TAX CONSEQUENCES.

All payments hereunder shall be subject to all applicable withholding for any federal, state or local income taxes including any excise taxes under the Code. Notwithstanding any other provision of this Agreement to the contrary or other representation, the Company does not in any way guarantee the tax consequences of any payment or compensation under this Agreement including, without limitation, under Section 409A of the Code.

IN WITNESS WHEREOF, the undersigned have executed this Agreement as of the date first written above.

Vertex Pharmaceuticals Incorporated

By: /s/ Ian Smith
Executive Vice President, Chief
Operating and Financial Officer

Executive

/s/ Tom Graney
Tom Graney

Tom Graney
September 6, 2017

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September 6, 2017

Tom Graney
88 Pembroke Street
Boston, MA 02118

RE: Change of Control Agreement

Dear Tom:

You are a key member of the senior management team of Vertex Pharmaceuticals Incorporated (the “Company”). As a result, the Company would like to provide you with the following “change of control” benefits to help ensure that if the Company becomes involved in a “change of control” transaction, there will be no distraction from your attention to the needs of the Company.

- I. *Definitions*. For the purposes of this Amended and Restated Change of Control Agreement (this “Agreement”), capitalized terms shall have the following meanings:
1. “Cause” shall mean:
 - (a) your conviction of a crime involving moral turpitude;
 - (b) your willful refusal or failure to follow a lawful directive or instruction of the Company’s Board of Directors or the individual(s) to whom you report, provided that you receive prior written notice of the directive(s) or instruction(s) that you failed to follow, and provided further that the Company, in good faith, gives you 30 days to correct such failure and further provided that if you correct the failure(s), any termination of your employment on account of such failure shall not be treated for purposes of this Agreement as a termination of employment for “Cause”;
 - (c) in carrying out your duties you commit (i) willful gross negligence, or (ii) willful gross misconduct, resulting in either case in material harm to the Company, unless such act, or failure to act, was believed by you, in good faith, to be in the best interests of the Company; or
 - (d) your violation of the Company’s policies made known to you regarding confidentiality, securities trading or inside information.
 2. “Change of Control” shall mean that:
 - (a) any “person” or “group” as such terms are used in Sections 13(d) and 14(d)(2) of the Securities Exchange Act of 1934 (the “Act”), becomes a beneficial owner, as such term is used in Rule 13d-3 promulgated under the Act, of securities of the Company representing more than 50% of the combined voting power of the outstanding securities of the Company having the right to vote in the election of directors; or

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- (b) all or substantially all the business or assets of the Company are sold or disposed of, or the Company or a subsidiary of the Company combines with another company pursuant to a merger, consolidation, or other similar transaction, other than (i) a transaction solely for the purpose of reincorporating the Company or one of its subsidiaries in a different jurisdiction or recapitalizing or reclassifying the Company's stock; or (ii) a merger or consolidation in which the shareholders of the Company immediately prior to such merger or consolidation continue to own at least a majority of the outstanding voting securities of the Company or the surviving entity immediately after the merger or consolidation.
3. "Code" shall mean the Internal Revenue Code of 1986, as amended.
4. "Disability" shall mean a disability as determined under the Company's long-term disability plan or program in effect at the time the disability first occurs, or if no such plan or program exists at the time of disability, then a "disability" as defined Section 22(e) (3) of the Code.
5. "Good Reason" shall mean one of the following events has occurred without your consent:
- (a) You suffer a material reduction in the authorities, duties or job title and responsibilities associated with your position as Senior Vice President, Chief Financial Officer for the Company as of the date hereof;
 - (b) your annual base salary is decreased;
 - (c) the office to which you are assigned is relocated to a place 35 or more miles away; or
 - (d) following a Change of Control, the Company's successor fails to assume the Company's rights and obligations under this Agreement;
- provided that Good Reason shall not exist unless and until within 30 days after the event giving rise to Good Reason under (a), (b), (c) or (d) above has occurred, you deliver a written termination notice to the Company stating that an event giving rise to Good Reason has occurred and identifying with reasonable detail the event that you assert constitutes Good Reason under (a), (b), (c) or (d) above and the Company fails or refuses to cure or eliminate the event giving rise to Good Reason on or within 30 days after receiving your notice. To avoid doubt, the termination of your employment would become effective at the close of business on the thirtieth day after the Company receives your termination notice, unless the Company cures or eliminates the event giving rise to Good Reason prior to such time.
6. "Termination Date" shall mean the last day of your employment with the Company.
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II. *Severance Benefits upon Change of Control* . If:

- (A) your employment is terminated by the Company (except for termination for Cause or due to a Disability) and the Termination Date is within 90 days prior to a Change of Control or within 12 months after a Change of Control; or
- (B) you, of your own initiative, (i) terminate your employment for Good Reason (in accordance with the notice and cure provisions set forth in Section I.5 above) and (ii) the event giving rise to Good Reason occurs within 90 days prior to a Change of Control or within 12 months after a Change of Control;

then, you shall receive the following benefits:

- I. *Severance Payment* . In exchange for your execution within 60 days of the Termination Date of a general release, in a form satisfactory to the Company, of all claims against the Company, its subsidiaries, and its and their officers, directors and representatives, that becomes enforceable and irrevocable within such 60-day period, the Company shall make a cash payment (the “Severance Payment”) to you in an amount equal to:
 - (a) (i) your annual base salary (provided, however, that if you terminate your employment for Good Reason based on a reduction in your annual base salary, then the annual base salary to be used in calculating the Severance Payment shall be your annual base salary in effect immediately prior to such reduction in annual base salary) plus your target bonus under any bonus program applicable to you for the year in which the Termination Date occurs; plus
 - (b) a prorata portion of your target bonus for the portion of the year in which the Termination Date occurs under any bonus program applicable to you; plus
 - (c) all cash incentive compensation awards earned by you but not paid prior to the Termination Date; provided that, if a fiscal year has been completed and the incentive award for such fiscal year has not been determined, the incentive compensation for such completed fiscal year shall equal the target bonus for such fiscal year.

Except with respect to any portion of the Severance Payment that is delayed as set forth in this paragraph, the Severance Payment shall be made in cash within ten days after the execution by you of the general release referred to above and expiration without revocation of any applicable revocation periods under such general release (or, if the Change of Control resulting in your becoming entitled to such benefits occurs after such execution and expiration, within ten days after the Change of Control), provided that, if the 60-day period during which the general release is required to become effective and irrevocable begins in one calendar year and ends in another calendar year, the Severance Payment shall not be

made before the first day of the second calendar year. The Severance Payment shall be divided into two portions, consisting of a portion that does not constitute “nonqualified deferred compensation” within the meaning of Section 409A of the Code and a portion, if any, that does constitute nonqualified deferred compensation. If you are a “specified employee” as defined in Section 409A(a)(2)(B)(i) of the Code, the commencement of the delivery of any such payments that constitute nonqualified deferred compensation payable upon a “separation from service” under Section 409A(a)(2)(A)(i) of the Code will be delayed until the first business day that is more than six months after your Termination Date. The determination of whether, and the extent to which, any of the payments to be made to you hereunder are nonqualified deferred compensation shall be made after the application of all applicable exclusions, including those set forth under Treasury Reg. § 1.409A-1(b)(9). Any payments that are intended to qualify for the exclusion for separation pay due to involuntary separation from service set forth in Reg. § 1.409A-1(b)(9)(iii) must be paid no later than the last day of the second taxable year following the taxable year in which the Termination Date occurs. To the extent that the termination of your employment does not constitute a separation of service under Section 409A(a)(2)(A)(i) of the Code (as the result of further services that are reasonably anticipated to be provided by you to the Company at the time your employment is terminated), the payment of any non-qualified deferred compensation will be further delayed until the first business day that is more than six months after the date of a subsequent event constituting a separation of service under Section 409A(a)(2)(A)(i) of the Code.

2. *Accelerated Vesting.*

- (a) On the Termination Date, stock options for the purchase of the Company’s securities held by you as of the Termination Date and not then exercisable shall immediately become exercisable in full. The options to which this accelerated vesting applies shall remain exercisable until the earlier of (a) the end of the 90-day period immediately following the later of (i) the Termination Date or (ii) the date of the Change of Control and (b) the date the stock option(s) would otherwise expire; and
- (b) On the Termination Date, the Company’s lapsing repurchase right with respect to shares of restricted stock held by you shall lapse in full (subject to your making satisfactory arrangements with the Company providing for the payment to the Company of all required withholding taxes).

Notwithstanding anything to the contrary in this Agreement, the terms of any option agreement or restricted stock agreement shall govern the acceleration, if any, of vesting or lapsing of the Company’s repurchase rights and period of exercisability of such awards, as applicable, except to the extent that the terms of this Agreement are more favorable to you.

3. *Continued Insurance Coverage* . If COBRA coverage is elected by you, the Company shall pay the cost of insurance continuation premiums on your behalf (whether or not covered by

COBRA) to continue standard medical, dental and life insurance coverage for you (or the cash equivalent of same if you are ineligible for continued coverage) until the earlier of (i) the date 12 months after the Termination Date or (ii) the date you begin receiving substantially equivalent coverage and benefits through a subsequent employer.

4. *No Mitigation.* You shall not be required to mitigate the amount of the Severance Payment or any other benefit provided under this Agreement by seeking other employment or otherwise, nor shall the amount of any payment or benefit provided for in this Agreement be reduced (except as provided in Article II Section 3(ii)) by any compensation earned by you as the result of other employment, by retirement benefits, or be offset against any amount claimed to be owed by you to the Company or otherwise (except for any required withholding taxes); provided, that if the Company makes any other severance payments to you under any other program or agreement, such amounts shall be offset against the payments the Company is obligated to make pursuant to this Agreement.

III. *Miscellaneous .*

1. *Employee's Obligations .* Upon the termination of employment, you shall promptly deliver to the Company all property of the Company and all material documents, statistics, account records, programs and other similar tangible items which may be in your possession or under your control and which relate in a material way to the business or affairs of the Company or its subsidiaries, and no copies of any such documents or any part thereof shall be retained by you.
 2. *Entire Agreement .* This Agreement and the “ *Employee Non-Disclosure, Non-Competition & Inventions Agreement* ” previously executed by you covers the entire understanding of the parties as to the subject matter hereof, superseding all prior understandings and agreements related hereto, including the previous Change of Control Agreement between you and the Company. No modification or amendment of the terms and conditions of this Agreement shall be effective unless in writing and signed by the parties or their respective duly authorized agents, provided, however, that the Company may, without your consent, unilaterally adopt amendments that may be required so that this Agreement continues to comply with applicable law or regulation, including without limitation Section 409A of the Code, provided such amendments do not adversely affect the benefits to be provided to you under Section II of this Agreement.
 3. *Governing Law .* This Agreement shall be governed by the laws of The Commonwealth of Massachusetts, as applied to contracts entered into and performed entirely in Massachusetts by Massachusetts residents.
 4. *Successors and Assigns .* This Agreement may be assigned by the Company upon a sale, transfer or reorganization of the Company. Upon a Change of Control, the Company shall
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Tom Graney
September 6, 2017

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require the successor to assume the Company's rights and obligations under this Agreement. The Company's failure to do so shall constitute a material breach of this Agreement. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their successors, permitted assigns, legal representatives and heirs.

Tom Graney
September 6, 2017

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Kindly indicate your acceptance of the foregoing by signing and dating this Agreement as noted below, and returning one fully executed original to my attention.

Very truly yours,

Vertex Pharmaceuticals Incorporated

By: /s/ Jeffrey M. Leiden

M.D., Ph.D.

Jeffrey M. Leiden,
Chairman, President &
Chief Executive Officer

ACCEPTED AND AGREED:

/s/ Tom Graney
Tom Graney

CERTIFICATION

I, Jeffrey M. Leiden, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Vertex Pharmaceuticals Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 30, 2017

/s/ Jeffrey M. Leiden

Jeffrey M. Leiden
Chief Executive Officer and President

CERTIFICATION

I, Thomas Graney, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Vertex Pharmaceuticals Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 30, 2017

/s/ Thomas Graney

Thomas Graney
Senior Vice President and Chief Financial Officer

SECTION 906 CEO/CFO CERTIFICATION

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) each of the undersigned officers of Vertex Pharmaceuticals Incorporated, a Massachusetts corporation (the "Company"), does hereby certify, to such officer's knowledge, that the Quarterly Report on Form 10-Q for the quarter ended September 30, 2017 (the "Form 10-Q") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 30, 2017

/s/ Jeffrey M. Leiden

Jeffrey M. Leiden
Chief Executive Officer and President

Date: October 30, 2017

/s/ Thomas Graney

Thomas Graney
Senior Vice President and Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.
