**UNITED STATES DISTRICT COURT**
**SOUTHERN DISTRICT OF NEW YORK**

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| **SECURITIES AND EXCHANGE COMMISSION,**<br>**Plaintiff,**<br>**v.**<br>**SALIX PHARMACEUTICALS, LTD.,**<br>**Defendant.** | **Case No. 1:18-cv-08886** |

# COMPLAINT

Plaintiff Securities and Exchange Commission ("SEC" or "Commission"), for its Complaint against Salix Pharmaceuticals, Ltd. ("Salix") alleges as follows:

## SUMMARY OF ALLEGATIONS

1. Salix was a publicly traded pharmaceutical company that specialized in branded prescription drugs used to treat gastrointestinal diseases. Salix's flagship drugs were Xifaxan and Apriso. Salix's customers were primarily pharmaceutical wholesalers.

2. Salix's quarterly revenue targets drove its sales efforts each quarter, and those revenue targets grew steadily as the company grew.

3. From at least 2013 through 2014, to help meet revenue targets, Salix engaged in overselling demand—a practice whereby a company floods distribution channels using incentives to induce customers into purchasing more of its products, creating a bump in revenue for the seller but excess supply in the distribution chain that limits the company's ability to sell product to customers in the future.

4. As Salix engaged in overselling demand, wholesalers' inventory levels of Salix's products eventually grew so high that wholesalers did not need to purchase Salix products each

quarter to keep up with prescription or retail demand. By the start of 2013, Salix's sales practices left wholesalers with inventory levels well in excess of two to three months on hand for Salix's key products, Xifaxan and Apriso, and Salix's overselling in the first quarter pushed those levels to nine months. Salix continued overselling demand throughout 2013, leading wholesalers to cut back significantly on purchases of Xifaxan and Apriso in the first quarter of 2014, and resulting in the company failing to meet its earnings target for that quarter.

5. On earnings calls in 2013 and 2014, Salix, through its Chief Financial Officer ("CFO"), consistently responded to securities analysts' inquiries about wholesaler inventory levels by stating that its wholesalers' inventories were typically holding at ten to twelve weeks, or approximately two to three months, worth of inventory. These claims were false, misleading, and fraudulent, because Salix's wholesalers' inventories had grown to much higher levels than Salix indicated. This was significant because, with high inventories on hand, wholesalers were much less likely to purchase as much product from Salix in the future, and, therefore, Salix's future revenues and earnings were likely to be depressed. The Salix CFO either knew or recklessly disregarded the falsity and deceptive nature of his representations of material fact about Salix's wholesaler customers' inventories.

6. Salix's persistent overselling demand of Xifaxan and Apriso finally led wholesalers to cut back significantly on their purchases of those drugs in the first quarter of 2014, lowering Salix's earnings for that quarter. Moreover, instead of disclosing the risk that Salix's business practices and the resulting wholesaler inventory levels presented for investors, Salix, through its CFO, made material omissions in its quarterly reports filed with the Commission for the first two quarters of 2014.

7. Salix's sales collapsed in the third quarter of 2014 when confidential due diligence efforts by a company interested in acquiring Salix raised questions about the actual

levels of Salix products being held by its wholesaler customers. After an internal investigation, Salix revealed in its quarterly Report on Form 10-Q for the third quarter of 2014 that wholesaler inventory levels of Xifaxan and Apriso had remained at about nine months during the first and second quarters of 2014 – much higher than Salix had previously publicly represented – and predicted that it would take one to two years to drop wholesaler inventory levels to three months, during which time Salix's sales and revenue would be negatively impacted.

8. After these disclosures, Salix's stock price dropped approximately 34 percent.

## VIOLATIONS AND RELIEF SOUGHT

9. By virtue of the conduct alleged herein, Salix has violated (1) Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5(b) thereunder, 17 C.F.R. § 240.10b-5(b); (2) Section 13(a) of the Exchange Act, 15 U.S.C. § 78m(a), and Rule13a-13 thereunder, 17 C.F.R. § 240.13a-13; and (3) Section 17(a)(2) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77q(a)(2).

10. This Court should permanently enjoin Salix from violating the securities laws alleged herein, and order any other relief the Court may deem just and appropriate.

## JURISDICTION AND VENUE

11. The Court possesses jurisdiction over this action pursuant to Sections 20(b) and 22(a) of the Securities Act, 15 U.S.C. §§ 77t(b) and 77v(a), and Sections 21(d) and 27 of the Exchange Act, 15 U.S.C. §§ 78u(d) and 78aa.

12. Venue lies in this District pursuant to Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), and Section 27(a) of the Exchange Act, 15 U.S.C. § 78aa(a), because certain of the transactions, acts, practices, and courses of conduct constituting the violations alleged herein occurred in this District. Among other things, Salix's common stock traded on the NASDAQ

Stock Market, LLC ("NASDAQ"), which has its headquarters located in this District, and the misrepresentations at issue were communicated to analysts located in this District.

13. In connection with the conduct alleged in this Complaint, Salix, directly or indirectly, singly or in concert with others, made use of the means or instrumentalities of interstate commerce, and made use of the means or instruments of transportation or communication in interstate commerce, and of the mails and of the facilities of a national securities exchange to carry out the unlawful conduct alleged in this Complaint. Among other things, Salix was listed on the NASDAQ, and used the telephone, email, and fax in connection with the unlawful conduct alleged in this Complaint.

## DEFENDANT

14. **Salix Pharmaceuticals, Ltd.** is a Delaware corporation that specializes in licensing, developing, and marketing pharmaceutical products for the treatment of gastrointestinal diseases. From 2001 to 2015, it was headquartered in Raleigh, North Carolina. At the time of the misconduct discussed herein, Salix's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act, 15 U.S.C. § 78*l*(b), and traded on the NASDAQ under the symbol "SLXP." Accordingly, Salix filed periodic reports with the Commission in accordance with Section 13(a) of the Exchange Act, 15 U.S.C. § 78m(a). On April 1, 2015, Valeant Pharmaceuticals International, Inc. ("Valeant") acquired Salix. In July 2018, Valeant changed its name to Bausch Health Companies Inc. ("Bausch"). Salix now exists as a wholly-owned subsidiary of Bausch. All misconduct alleged herein occurred prior to Bausch's acquisition of Salix.

## FACTUAL ALLEGATIONS

### I. Salix's Business and Sales Practices

15. Salix's most profitable product was Xifaxan. Salix began selling Xifaxan in July 2004 in 200 milligram form, and it quickly became Salix's largest source of revenue.

16. Later, Salix began selling a 550 milligram form of Xifaxan ("Xifaxan 550"). From 2010 to 2013, Xifaxan sales accounted for approximately 70 percent of Salix's net revenue.

17. Salix's other key product was Apriso. Salix began selling Apriso in 2009, and, by 2013, Apriso sales accounted for approximately 10 percent of Salix's net revenue.

18. Since at least 2010, Salix continually attributed its rapid growth to sales of Xifaxan and Apriso. Salix's revenue tripled from $233 million in 2009 to $735 million in 2012.

19. Salix historically generated revenue primarily by selling products to pharmaceutical wholesalers. Sales to Salix's three major wholesaler customers, Wholesaler A, Wholesaler B, and Wholesaler C (collectively, the "Big Three"), together represented the vast majority of Salix's total revenues in 2013 and 2014.

20. As Salix struggled to meet its quarterly revenue targets, particularly starting around 2013, the company relied on Wholesaler D, a smaller regional wholesaler, as a customer of "last resort." Salix at times induced Wholesaler D to buy large quantities of product via increased discounts and high-dollar marketing agreements in an effort to boost Salix's quarterly revenue.

21. By approximately 2004, many pharmaceutical companies and wholesalers were entering into Inventory Management Agreements ("IMAs") or Distribution Services Agreements ("DSAs") that standardized the sales process. Pursuant to an IMA or DSA, a wholesaler agrees to maintain a certain inventory level of the pharmaceutical company's products and to provide

data to the pharmaceutical company concerning existing inventory levels. In return, the pharmaceutical company agrees to set terms and conditions for all sales, including a set percentage discount off the pharmaceutical company's wholesale acquisition cost ("WAC").

22. IMAs and DSAs essentially automated the sales process between a pharmaceutical company and a wholesaler, dictating the timing and terms of sales and providing both companies with stability and transparency to control and manage their inventories and existing cash flows. For the pharmaceutical company, IMAs and DSAs also ensured that its revenues would reasonably correspond with demand downstream at the retail level, and thus, allow it to reasonably forecast future revenues from sales to wholesalers.

23. By 2005, approximately 70 percent of wholesaler purchases in the pharmaceutical industry occurred pursuant to IMAs or DSAs.

24. Salix, however, did not use IMAs or DSAs when selling to wholesalers. Typically, Salix made sales to the Big Three through negotiated *ad hoc* deals during the second-half of each quarter, which Salix often referred to as quarterly "promotional buys." Salix based its quarterly promotional buys primarily upon its quarterly revenue guidance disclosed to the public, but also considered its earnings-per-share ("EPS") guidance.

25. Market demand for Salix's products, primarily Xifaxan and Apriso, rose steadily each quarter from 2010 through 2014. Salix's public quarterly revenue guidance, in turn, grew steadily over time, from $40 million in the first quarter 2010 to $395 million in the second quarter 2014.

26. Salix's Trade Relations group managed Salix's sales relationships with its wholesalers and other customers and worked to generate the sales needed to hit Salix's revenue targets. The group consisted of two individuals, the Director of Trade Relations ("Trade

Relations Director”) and his supervisor, the Executive Vice President of Business Development (“EVP”), who reported directly to Salix’s Chief Executive Officer (“CEO”).

27. Each quarter, the Trade Relations group worked to generate the sales needed to hit Salix’s revenue targets. In structuring wholesaler promotional offers, Trade Relations typically consulted with Salix’s Finance group to decide what mix of Salix’s products to pitch to wholesalers so Salix would hit its revenue target. As the end of the quarter approached, Trade Relations typically provided sales updates to Salix’s Finance group and to Salix’s CFO.

28. When offering a promotional buy, Salix typically asked wholesalers to purchase a certain dollar amount of product and offered various price discounts and other incentives if the wholesalers purchased that amount. Wholesalers’ appetite for purchasing Salix product hinged primarily on the amount of product wholesalers already had on hand, i.e., their inventories. As a result, the Trade Relations Director regularly discussed inventory levels with wholesalers when negotiating their quarterly promotional buys. Upon request, wholesalers would send their internal Salix inventory data to the Trade Relations Director to facilitate the parties’ negotiations. The Trade Relations Director typically discussed with or even forwarded this data to the EVP, and the EVP and Trade Relations Director occasionally discussed that data with Salix’s CFO, especially in the first two quarters of 2014 when Salix struggled to hit its quarterly revenue targets.

29. Because Salix’s sales practices were tied almost exclusively to achieving its quarterly revenue numbers without much regard to wholesaler inventory levels, wholesaler inventory levels grew steadily over time. By 2013, wholesalers had such a significant supply of Salix’s major products they rarely “needed” to purchase large amounts of Salix’s products each quarter to keep up with retail demand and resisted making the purchases that Salix needed to satisfy its quarterly revenue targets.

30. In response, Salix began to offer wholesalers greater incentives to purchase more product to ensure Salix made its quarterly revenue targets.

## II. Salix Fraudulently Misrepresented Wholesaler Inventory Levels in 2013 and 2014

31. Beginning in at least 2004, on Salix's quarterly earnings calls, securities analysts covering Salix stock consistently asked questions about the impact of wholesaler inventory levels on future demand for Salix's products and on its revenues.

32. Salix's CFO regularly handled those questions. He repeatedly stated that wholesalers had between two to three months of inventory of Salix's products (sometimes expressed as "eight-to-ten weeks" or "ten-to-twelve weeks," rather than in terms of months), and he would use that benchmark when answering questions as to whether Salix's wholesaler inventory levels had fluctuated over the reporting quarter.

33. Salix's Finance group estimated total product channel inventory (i.e., wholesaler, retail, and non-retail channels), for the purposes of setting its product return reserves. The Salix Finance group tracked total channel inventory by comparing data about Salix prescriptions, or "channel exit," that Salix obtained from third parties, with Salix's data about product shipments, or "channel entry," that was maintained by its third-party distribution and logistics company, to arrive at the total amount of product that remained in the channel. The Finance group maintained this data, and Salix's CFO oversaw this practice.

### A. On Its First Quarter 2013 Earnings Call, Salix Made Material Misrepresentations Concerning Its Wholesaler Inventory Levels

34. By the beginning of the first quarter 2013, Salix's overselling demand had resulted in wholesaler inventory levels well in excess of two to three months. In February 2013, Trade Relations began to develop its plan to meet Salix's quarterly revenue targets for that first

quarter. Trade Relations received inventory data from the Big Three that showed six to nine months' supply of Xifaxan and Apriso.

35. Using the Big Three's inventory data, the Trade Relations Director determined that Salix would need to increase inventory levels to 10 to 13 months at each of the Big Three to meet Salix's quarterly revenue targets. He further projected that, to convince the Big Three to accept such high inventory levels, Salix would have to offer the wholesalers a then-unprecedented 16 percent discount off WAC, as well as extended payment terms. Trade Relations discussed this proposed deal with Salix's Finance group, including its CFO, on February 12, 2013.

36. On or around February 19, 2013, Salix offered Wholesaler B a promotional buy that Salix estimated would bring Wholesaler B to about 13 months of inventory for Salix's products. Wholesaler B declined, due to its already high inventory levels, but agreed to a lesser deal that increased its inventory levels to about 12 months of Salix's products in exchange for unprecedented discounts, including an 18 percent discount off WAC for Xifaxan.

37. Similarly, in February 2013, Wholesaler C agreed to buy enough Salix products, including Xifaxan, to increase most of its inventories to approximately 10 months, in exchange for a 15 percent discount off WAC. And in early March 2013, Wholesaler A purchased approximately four additional months' worth of Xifaxan (and other products) for a 15 percent discount off WAC.

38. On March 20, 2013, Salix's CFO emailed the Trade Relations Director to ask if Salix had met its quarterly revenue targets. The Trade Relations Director responded that Salix was $16 million away from its quarterly goal and was awaiting a response from a large retail pharmacy on a proposed direct sale at a substantial discount, but that if that deal did not satisfy Salix's revenue targets, he would "lean on our wholesale customers for the rest."

39. In fact, when the retail pharmacy declined Salix's offer, the Trade Relations Director approached Wholesaler A again to propose another Xifaxan purchase at a 15 percent discount off WAC, and Wholesaler A agreed, bringing Wholesaler A's Xifaxan inventory to approximately eight months.

40. With the Wholesaler A purchase, Salix met its first quarter 2013 revenue targets, but Salix's overselling demand had increased wholesalers' inventory levels to an average of nearly nine months of Xifaxan and seven months of Apriso.

41. On May 9, 2013, Salix held an earnings call regarding its first quarter 2013 financial results. As had become routine on those calls, an analyst asked about wholesaler inventory: "[O]n Xifaxan – given the small sequential uptick, could we infer that there was a little bit of an inventory headwind in the quarter? How should we think about inventory in general? Salix's CFO responded, "Yes, inventories are in that 10-to-12 week range that we like to keep them." The analyst then asked, "Okay, so inventory has not changed significantly over the past quarter?" Salix's CFO replied, "No."

42. These statements were false and misleading. By this time, Salix had oversold demand such that its wholesalers had approximately 36 weeks (or about nine months) of Salix products in inventory, or almost three times the amount that Salix disclosed during the call. Wholesaler inventory was not in the 10-to-12 week range, and in fact, that range was not the one that Salix "like[d] to keep," as Salix for years had made sales to meet its revenue targets without any regard for maintaining 10 to 12 weeks of inventory. Thus, the Salix CFO's statements were false and misleading in misrepresenting the actual wholesaler inventory levels.

43. At the time these statements were made, given its sales activity in the first quarter 2013, Salix and its CFO knew, or were reckless in not knowing, that Salix's inventory levels had reached almost three times the levels Salix historically reported. Salix's CFO knew, or was

reckless in not knowing, that wholesalers were complaining that their inventories were well above three months, and that wholesalers had shared their internal data to support their claims.

### B. Salix Continued to Make False and Misleading Statements About Wholesaler Inventories Throughout 2013

44. By the second quarter of 2013, wholesalers' inventory levels were even higher than the prior quarter, and at least one wholesaler, Wholesaler C, threatened not to purchase any Salix products during the quarter.

45. On April 15, 2013, the Trade Relations Director told the EVP that, given wholesalers' high inventory levels and Wholesaler C's expressed intention not to purchase product, Salix was in "[u]nchartered waters here." The Trade Relations Director concluded that Salix only had quarterly sales potential of approximately $42 to $50 million, and that this result would require 15 percent discounts off WAC and would bring wholesalers' inventory levels up to 10 to 12 months.

46. On June 12, 2013, the Trade Relations Director emailed Wholesaler C to offer a new deal, noting that "it is very important that Salix has sales with Wholesaler C this [quarter]." As an incentive, the Trade Relations Director offered an 18 percent discount off WAC on Xifaxan. Wholesaler C accepted the offer.

47. Salix also pressed Wholesaler A, Wholesaler B, and Wholesaler D to make large purchases in the second quarter 2013, and ultimately succeeded by, among other things, offering up to 22 percent discounts off WAC on Xifaxan. After completing the deal with Wholesaler B, the Trade Relations Director emailed the EVP and stated, "I am still completely amazed at these deals and our customers. Back to 12 months for Xifaxan."

48. During Salix's second quarter earnings call on August 8, 2013, a securities analyst, noting the slight decline in Xifaxan revenues from the prior quarter, asked, "[W]as

inventory pressure behind that or is there something else we should be thinking about? And also, on APRISO compared to 1Q of this year, pretty big jump, so is inventory also playing a role there as well? Just help us understand that." Salix's CFO responded,

> No. Actually, with XIFAXAN, . . . it's come actually in line with demand. So the number that you saw last quarter, as we spoke last quarter, was ahead of demand. The number that was posted in second quarter, which is the $150.6 million number, is right in line with demand. So it's exactly where we would like for it to be. With respect to APRISO, as you know, in previous quarters, we have been shipping well under demand.

49. The securities analyst responded, "Okay. And just a quick follow-up to that. Just to be clear, the level of inventory on hand for both products basically in line with what we've seen historically?" Salix's CFO responded, "Yes."

50. These statements by Salix's CFO were false and misleading. Given that Salix and its CFO had consistently reported its inventory levels to be approximately two to three months, the securities analyst's reference to "historical[]" inventory levels could only mean that number of months' inventory. At that time, however, Salix and its CFO knew, or were reckless in not knowing, that wholesalers' inventory levels for Xifaxan and Apriso were running three times that amount.

51. Salix continued to oversell demand in the third and fourth quarters of 2013. While the Big Three continued to push back on purchasing more product, Salix offered generous incentives, including 15 to 20 percent discounts off WAC, to induce additional sales and hit its revenue targets.

52. For example, on September 26, 2013, Wholesaler C agreed to a deal that took its levels of Xifaxan and Apriso up to 300 days (i.e., approximately ten months) because of the substantial WAC discount Salix offered.

53. Despite increased growth in prescriptions for Salix's products, wholesaler inventory levels of Xifaxan and Apriso rose to approximately 10 months in the third quarter of 2013, and almost 11 months by the end of the fourth quarter.

54. Salix continued to mislead the public in its quarterly earnings calls. During the November 7, 2013 earnings call for the third quarter 2013, a securities analyst asked, "[O]n Xifaxan, anything unusual in the quarter, be it inventory, price, anything like that?" Salix's CFO responded, "[I]n terms of Xifaxan, so demand for the quarter was about $159 million, and of course, we shipped about $165 million, $166 million. So it was a little bit ahead of demand."

55. Similarly, during Salix's February 27, 2014, earnings call for the fourth quarter 2013, a securities analyst asked if "anything [was] going on in the quarter, inventory wise [with Xifaxan], which would prevent quarter-over-quarter growth." Salix's CFO responded, "[B]ased on the latest . . . run-rate data, we were right in line with demand and no changes with Xifaxan."

56. These statements were false and misleading. Salix's CFO's statements were intended to, and did, create the false appearance that inventory levels were "a little bit ahead of demand" or "right in line with demand and no changes with Xifaxan," meaning that Xifaxan wholesaler inventory levels had, at best, only slightly increased over a level of three months when, in fact, inventory levels were approximately three times that amount.

57. At the time these statements were made, Salix and its CFO knew, or were reckless in not knowing, that these statements were false and misleading. Since at least the end of the first quarter 2013, Salix and its CFO knew, or were reckless in not knowing, that Salix's overselling demand had resulted in wholesaler inventory levels well in excess of the CFO's public representations, and Salix's CFO discussed these high wholesaler inventory levels internally with Finance and Trade Relations.

### C. Salix's False and Misleading Statements About Wholesaler Inventories Continued in 2014

58. By the first quarter 2014, Salix knew that high wholesaler inventory levels of Xifaxan and Apriso would make it difficult to meet its publicly disclosed revenue guidance for the quarter. Indeed, Wholesaler A told Salix in late 2013 that it would purchase substantially less Xifaxan or Apriso in the first two quarters of 2014 due to its already high inventory levels.

59. On January 2, 2014, Salix acquired another pharmaceutical company, Santarus, Inc., and its portfolio of products, including flagship products, Glumetza and Uceris.

60. Santarus had used IMAs with its wholesalers, and, at the time of the acquisition, wholesaler inventory levels of Glumetza and Uceris were only approximately one to two months.

61. Shortly after acquiring Santarus, Salix cancelled those IMAs and aggressively pushed wholesalers to purchase significant amounts of Glumetza and Uceris to enable Salix to satisfy its quarterly revenue targets.

62. Around February 2014, Trade Relations met with Salix's CFO to discuss plans to continue to offer promotions to the Big Three to buy Xifaxan and Apriso and to increase wholesalers' inventory of Santarus products to five months as a means of offsetting expected reduced sales of Xifaxan and Apriso.

63. On February 28, 2014, Salix offered Wholesaler B a $116 million promotional buy for Apriso, Xifaxan, and other products, at a 16 percent discount off WAC. Wholesaler B initially responded, "[A] lot of items close to or over 365 days. Unlikely we'll be able to target $100M net = $116 @ WAC without the help of Santarus inventory."

64. By March 12, 2014, the Trade Relations Director wrote the EVP that Salix had "a little problem" – and advised that Wholesaler A's and Wholesaler C's high inventory levels threatened Salix's ability to meet its quarterly revenue guidance.

65. On March 20, 2014, Salix sold a significant amount of Xifaxan at a substantial discount to a retail pharmacy chain, despite knowing that this sale essentially would take sales away from wholesalers and thus would further inhibit the wholesalers' ability to work down their inventories.

66. By March 25, 2014 – only six days before the end of the quarter – Salix remained $77 million below its $160 million Xifaxan revenue target. On March 26, 2014, Wholesaler B informed Trade Relations that it would not purchase more Xifaxan because Wholesaler B's "CFO says nothing over 52 weeks this quarter." In response, Salix's EVP told the Trade Relations Director, "You need to sell everything that you can in order to get closer to the overall [revenue] number," and instructed the Trade Relations Director to offer Wholesaler B more Santarus products.

67. Wholesaler B ultimately purchased more Santarus products but declined to purchase more Xifaxan, even though Salix offered Wholesaler B an unprecedented 26 percent discount off WAC, stating that "[o]ur challenge is we are not able to exceed 12 months [of Xifaxan inventory]."

68. On March 28, 2014, the Trade Relations Director reported the Wholesaler B Santarus purchase to the EVP and Salix's Finance group. A Salix Finance group representative then forwarded that email to Salix's CFO who asked, "Where are the Xifaxan orders??"

69. As the end of the quarter grew closer, Salix's customer of "last resort" – Wholesaler D – had only tentatively agreed to purchase about $52 million of Xifaxan, Apriso, and other products, even given the unprecedented 26 percent discount off WAC. Salix projected, however, that it would still miss its EPS guidance and its Xifaxan revenue target even with Wholesaler D's order.

70. Thus, on March 28, 2014, the EVP approached Wholesaler B with another promotional buy that offered another unprecedented Xifaxan deal. Wholesaler B again declined due to its high inventory levels.

71. On March 28, 2014, Salix's CFO noted that even if Wholesaler D's order came through, Salix risked not being able to ship the product before quarter end as needed to recognize revenue. He concluded, "This is so F?!/&? Up!!!" Salix's CEO responded, "I agree. I've asked [the EVP] if he and I need to go to Wholesaler B . . . 1st thing Monday. I don't even know if there'll be anyone there to see us. It's just so hard to accept failure on this."

72. Later that evening, Salix's CEO asked Salix's CFO, "If the [Wholesaler D] order ships, do we meet our top line and bottom line guidance?" Salix's CFO responded, "The bigger issue is Xifaxan," to which Salix's CEO replied, "I know . . . just trying to salvage as much as we can, if it comes to that. This definitely sucks!"

73. On March 29, 2014, Wholesaler B declined Salix's invitation to meet and discuss another possible first quarter deal.

74. On March 31, 2014 – the last day of the quarter – the EVP reached out again to Wholesaler C for another Xifaxan buy. Wholesaler C declined and explained that it "just purchased over a year's worth of Xifaxan so I don't think we have any wiggle room to bring in more inventory."

75. That day, Salix also contacted Wholesaler B yet again, and Wholesaler B again declined, noting, "[W]e have made a decision based on our policy and the inventory on hand and that answer is: we are going to pass." Wholesaler B further instructed Salix to stop asking Wholesaler B to make another buy. In response, the Salix EVP noted that he and Salix's CEO were "disappointed" in Wholesaler B's decision, to which Wholesaler B responded, "I agree the

terms were generous[,] but we would not recognize profit until we sell the product so while it's a good long term buy it's not compelling in the short term and it goes past our 12 month limit."

76. Wholesaler D ultimately came through with an order that day, although it reduced the amount of Xifaxan from $52 million to approximately $30 million.

77. As for Wholesaler A, it followed through on its late-2013 warning. It greatly reduced its orders for Xifaxan and other Salix legacy products during the first quarter 2014 to allow it to reduce its already high inventory levels, which were about 300 days by the end of 2013. Wholesaler A instead purchased a larger volume of Santarus products in light of Salix's aggressive promotional price discounts. To make sales in first quarter 2014, Salix had given wholesalers unprecedented WAC discounts for many of its products as well as more favorable payment terms. Salix's Xifaxan discounts averaged 19 percent off WAC and reached as high as 26 percent, and Apriso discounts averaged 17 percent off WAC.

78. None of the wholesalers told Salix that the reason it did not buy more Xifaxan and Apriso was that it was focused on purchasing Santarus products. Instead, wholesalers made clear that existing high levels of Xifaxan and Apriso were the reason they did not purchase more of these products.

**A. Misrepresentations During the First Quarter 2014 Earnings Call**

79. Salix's sales activity in the first quarter of 2014 caused the company to report financial results that sparked concern among analysts. Although Salix made its revenue target, it missed its EPS guidance because the Santarus products had much lower margins than Xifaxan and Apriso. Furthermore, industry data indicated that Xifaxan and Apriso prescription rates had increased 19 percent and 58 percent, respectively, but Salix reported *declining* Xifaxan revenue (25 percent year-over-year), and flat Apriso revenue.

80. On Salix's first quarter 2014 earnings call, on May 8, 2014, Salix's CFO engineered a false excuse to justify the results to the investing public. When describing why Xifaxan revenue declined and Apriso revenue was flat despite strong prescription growth, Salix's CFO stated,

> This was due to wholesalers and drug chains, which have had very thin inventories for Santarus products**,** focusing on securing additional product during the quarter to establish adequate inventories in accordance with our preferred inventory levels. This resulted in strong revenue growth for Santarus products in the first quarter. With the wholesale inventories for Santarus products now at [] more appropriate levels, we expect Xifaxan 550 sales to exceed or to track in line with prescription demand in the second quarter of 2014, as wholesalers bring Xifaxan 550 inventories back to more typical levels.

81. Salix's financial results and its explanation confused analysts, and they asked whether Salix's wholesaler inventory levels were the cause.

82. One securities analyst questioned Salix's asserted reason for the dip in Xifaxan revenue, asking, "I just want to make sure I understand the inventory dynamics here. Why would the addition of the Santarus assets necessarily impact your inventory patterns on your existing products like Xifaxan?" Salix's CFO responded,

> I don't know – you may or may not be aware that Santarus did have inventory management agreements in place. And so shortly after the acquisition closed, we terminated those agreements, which I think caused a little angst with wholesalers with respect to their products. So they were focused and we were focused on wanting to make sure those inventory levels got to the level that we're comfortable with, which is typically in that 10 to 12 weeks. We didn't quite achieve that. We're probably more in the 2- to 3-month range with the Santarus products. So again, they were focused on getting there. We were focused on that as well. And they had existing inventories at the legacy Salix products, which they were comfortable with. So what we expect in second quarter is that Xifaxan 550 will rebound and more than likely exceed demand.

83. In claiming that Xifaxan and Apriso revenues were negatively impacted by wholesaler purchases of Santarus products, Salix and its CFO knew, or were reckless in not knowing, that Xifaxan and Apriso revenues were impacted solely by wholesalers' high inventory levels, which were approximately nine months, instead of the less than three months that Salix disclosed. Salix had numerous contacts during the quarter with wholesalers, most of which informed Salix that they would not be purchasing Xifaxan and Apriso due to already high inventory levels.

84. Another analyst asked, "And maybe you can clarify the comment about the inventory levels. You said 10 to 12 weeks and 3 months for – if you can just clarify for each of your products and the Santarus products where it stood at the end of the year and where it stands now since the difference between the run rates you gave and the 1Q sales for some of these products indicate a swing of several months' worth of demand trends." Salix's CFO responded,

> Yes. So we would expect by the end of second quarter that in – ideally, all of our inventories for all of our products would be in the 10- to 12-week range. Clearly, we'd be in a 2- to 3-month range, so we would fully expect that. Keep in mind that the shipments, especially the Santarus products, were happening very early in the quarter – in first quarter and so here we are in May. And so inventories are, again, at that 2- to 3-month timeframe. We would like for it to be 10 to 12 weeks and we expect it to be there by the end of second quarter.

85. These representations were false and misleading, and Salix and its CFO, knew, or were reckless in not knowing, that they were false. Salix's CFO had been aware of or involved in Salix's wholesaler negotiations, and he knew, or was reckless in not knowing, that as of May 8, 2014, wholesaler inventory levels significantly exceeded the disclosed amounts.

86. Salix's earnings-calls misrepresentations fraudulently misled analysts to believe that Salix's wholesaler inventories were not exceptionally high and would stabilize. For example, a securities analyst summarized the call by stating:

> The issue and the main questions on the call was why the channel shrinking its weeks in inventory of the legacy Salix products but growing the inventory for the acquired Santarus products (mainly Uceris and Glumetza) . . . [and the] message from SLXP after many questions seemed to be that the wholesalers are brin[g]ing all inventory levels to 7-8 weeks for all of the products. The channel issue is supposed to stabilize itself before the end of the year. Legacy Salix product had 12 weeks of channel inventory.

87. During 2014, the EVP directly confronted Salix's CFO about his statements on the call and made clear to Salix's CFO that the Big Three had well in excess of the stated 10 to 12 weeks of inventory. Yet neither Salix nor its CFO made any effort to correct these misstatements, and indeed Salix continued its misrepresentations beyond the first quarter of 2014.

**B. Salix Continued to Make False and Misleading Statements in the Second Quarter 2014 Earnings Call**

88. On May 9, 2014, the Trade Relations Director emailed the EVP copies of the Big Three's Salix inventory data and proposed a plan to meet Salix's second quarter revenue targets. Among other things, the Trade Relations Director noted that the Big Three had over $1 billion in Salix products on hand and concluded that Salix could likely sell about $136 million that quarter, but that wholesalers would have "to go over 52 weeks [of inventory] for this to work."

89. On or before May 22, 2014, Salix proposed a promotional buy to Wholesaler A, but Wholesaler A declined Salix's offer because "[w]e are working to bring our inventory position down." Wholesaler A attached its Salix inventory data and noted, "As you can see, we are still up over 200 days on legacy Salix products."

90. Later that quarter, Salix offered Wholesaler A another deal for Xifaxan, and Wholesaler A again sent Salix its inventory data, noting that Salix's offer would

> [add] an additional 168 days [of inventory]. This would be in addition to the 265 days that we already have on hand. From a business perspective, I hope you would agree that this doesn't make sense. [We] will continue to sell through the inventory that we have on hand. We will not be able to participate in a buy this quarter.

91. On May 22, 2014, Wholesaler C rejected Salix's initial promotional offer, noting that the offer "would require us to bring in close to 450 days [of inventory] and Sr. Management doesn't have an appetite to go that high unless we get something like 30% off I bet."

92. On May 27, 2014, Wholesaler C countered with a smaller proposed buy with a 17 percent discount off WAC and told Salix that small buy would "take our inventory to 365 days." Salix accepted the deal.

93. On May 29, 2014, Salix's CEO, CFO, the EVP, the Trade Relations Director, and others met with Wholesaler B at its headquarters. In advance of the meeting, Wholesaler B sent Salix a proposed meeting agenda that listed the first agenda item as, "Future Inventory Targets; [Wholesaler B]: 6 month base level Salix & Santarus Inventory Levels." On May 29, 2014, Salix's CEO, CFO, Trade Relations, and others discussed that draft agenda over email.

94. At the May 29, 2014, meeting, Wholesaler B and Salix discussed Wholesaler B's inventory levels. Wholesaler B told Salix it planned to reduce inventory levels and ultimately offered to purchase approximately $100 million in Salix products that quarter, which represented an almost 50 percent drop from the first quarter.

95. On June 26, 2014, the Trade Relations Director contacted Wholesaler D to solicit a promotional buy, noting that Salix was "[s]till looking for some Xifaxan." He later offered Wholesaler D a promotional buy for $25 million of Xifaxan with a 20 percent discount off

WAC. Wholesaler D ultimately purchased an unprecedented amount of product – about $143 million.

96. In the second quarter 2014, wholesalers maintained approximately nine months of Xifaxan and Apriso and approximately seven and five months of Glumetza and Uceris, respectively.

97. On August 7, 2014, Salix held its second quarter 2014 earnings call and again the metrics showed a discrepancy between the prescription demand for Xifaxan and Apriso and Salix's revenue for these products. As a result, Salix's wholesaler inventory levels became what one analyst called the "topic of the day."

98. Salix's CFO initially claimed on the call to not know what was causing Salix's inventory movements "other than wholesalers are wanting to lower their overall inventories." A securities analyst later asked, "What are your plans to get better clarity going forward. So we have more of a – is there anything you can do in terms of reaching out to customers? Is the former target of say 12, 13 weeks just too high for the wholesalers without some type of contractual arrangement?"

99. Salix's CFO responded, "Sure. So your first question, yes. I mean, obviously we have – we're in touch with our trade partners. But you['re] right. I mean, I think the reality of keeping that 3 months of inventory is no longer going to be the case. So they, again – they're softening, and we can expect them to continue to soften some in third quarter and more so normalized in the fourth quarter."

100. When another securities analyst asked what "normalized" meant and if Salix was now targeting a "new level . . . not 10 to 12 weeks, but something else," Salix's CFO replied that "from an overall portfolio standpoint, I would say that's in the 8-week or minus a little bit range for the entire channel."

101. Salix and its CFO knew, or were reckless in not knowing, that Salix's and its CFO's statements regarding inventory were false and misleading. Prior to the August 7, 2014, call, Salix's CFO, CEO, EVP, and Trade Relations Director discussed wholesaler inventory levels and their impact on Salix's ability to meet its quarterly revenue targets. Moreover, Salix's CEO and CFO attended the May 29, 2014, meeting with Wholesaler B and they received the meeting agenda that expressed Wholesaler B's intent to work down its Salix legacy product inventory to six months.

102. Later on the call, an analyst stated, "I don't think I heard your estimate for where you think inventory levels actually are at the end of the second quarter for Xifaxan and Apriso." Salix's CFO responded, "[W]e have visibility in inventories because we know what we shipped, we know what pulls through, we know what returns are, so we have an idea – a visibility into inventory levels." Salix's CFO further indicated his expectation that the inventory situation would "normalize around that 8-week or a little less level, and that would be true for both Xifaxan and Apriso."

103. Another analyst followed up with the CFO on Salix's representations concerning why wholesalers were buying less Xifaxan and Apriso, in the following exchange:

> Analyst: [J]ust conceptually, I know you've been asked a lot of inventory questions, but can you explain to us, conceptually, why wholesalers would be reducing inventory of your products because the Santarus – because the increasing inventory of Santarus products. Just – I'm just struggling to understand that . . . .
>
> Salix's CFO: I think it's a function of where the Santarus products were when we acquired a company. And again, as we talked about this in the first quarter how their products were razor-thin and they didn't have the distribution we wanted to have at the retail level. So we wanted to get that in order. So that's the only explanation I have for that.

> Analyst: I guess, what has that got to do with the Salix legacy products? That's my key question.
>
> Salix's CFO: Yes, I mean, I think, what we talked about on the first quarter call, we really don't know is the answer. But I think our customers are very comfortable with the Salix legacy products. And so I think they feel comfortable bringing those inventory levels down, and they've told us they want to bring those inventory levels down. And I think – that's why we say we think in the fourth quarter that things will normalize.

104. The CFO's statement that inventory levels would "normalize around that 8-week or a little less level" was false and misleading. At the time, Salix's wholesaler inventory levels remained around nine months, not the three months or less Salix and its CFO had repeatedly stated on the earnings call. At the time it made these statements about inventory, Salix and its CFO knew, or were reckless in not knowing, that these statements were false. As alleged above, Salix's overselling demand had continued through second quarter 2014, and Salix's CEO, CFO, Trade Relations, and Finance groups were all aware of Salix's on-going problems selling Xifaxan and Apriso due to wholesaler inventory levels reaching approximately nine months. As such, Salix and its CFO also knew, or were reckless in not knowing, that wholesaler inventory could not possibly "normalize" at eight weeks in or by the fourth quarter 2014.

105. An analyst concluded, on August 7, 2014, that Salix "continue[s] to see strong underlying [prescription] trends for key products and expect[s] normalization of inventory levels by year end," noting:

> Following cancellation of Santarus' inventory management agreements (IMAs) earlier this year, Salix's product sales have been distorted by the ongoing normalization of channel inventories, which have led to significant variances relative to consensus projections. On the Q1 call, mgt had expected wholesaler inventory to normalize in 2H14, with legacy Santarus inventories to fall in line with Salix's historical levels (10-12 weeks). Following further discussions with wholesalers during the quarter, mgt has now decided that ~8 weeks is a more appropriate level of inventory to have in the channel . . . . Mgt now believes

> that product sales will finally track more in line with Rx trends in Q4.

## VI. Salix Made Material Omissions in Salix's First and Second Quarter Reports in 2014

### A. Material Omissions Concerning Salix's "Risk Factors"

106. Item 503(c) of Regulation S-K, 17 C.F.R. § 229.303(c), requires a reporting company in its annual Report on Form 10-K to "provide under the caption 'Risk Factors' a discussion of the most significant factors that make the offering speculative or risky." Part II, Item IA of Form 10-Q requires a reporting company to disclose "any material changes from risk factors as previously disclosed" in its Form 10-K.

107. In its annual Report on Form 10-K for its fiscal year ended December 31, 2013, Salix disclosed numerous "Risk Factors" that could "materially adversely affect[]" Salix's "business, financial condition, results of operations or prospects," so that "the market price of our common stock could decline, and stockholders might lose all or part of their investment." Salix's lead risk factor was that "[f]uture sales of Xifaxan and our other marketed products might be less than expected." The discussion under that heading stated:

> We expect Xifaxan . . . to continue to be our most significant source of revenue in the future. If sales of our marketed products decline or if we experience product returns significantly in excess of estimated amounts recorded, particularly with respect to Xifaxan, it would have a material adverse effect on our business, financial condition and results of operations.

108. Salix's discussion under the lead risk factor regarding "[f]uture sales of Xifaxan" and Salix's other marketed products proceeded to discuss "a number of factors" that could affect future sales of Xifaxan and other products, including but not limited to: "price increases"; "patient and physician demand"; "the availability of sufficient commercial quantities of the products"; and Salix's "success in getting other companies to distribute our products outside of [certain U.S. markets]."

109. Salix repeated this risk factor and the accompanying language verbatim in the Risk Factors section of its quarterly Reports on Form 10-Q for the first quarter 2014, which it filed with the Commission on May 9, 2014, and for the second quarter 2014, which it filed with the Commission on August 8, 2014.

110. Salix did not, however, disclose in its Form 10-Q for the first quarter 2014 that years of overselling demand had resulted in a material change to the risk factor affecting Xifaxan and other product revenues. At the time, Salix knew, or was reckless in not knowing, that the overselling and resulting wholesaler inventory levels posed a nearly certain risk to its future sales.

111. By the time it filed its quarterly report for first quarter 2014, Salix knew, or was reckless in not knowing, that its sales practices had already had a material negative impact on its first quarter 2014 Xifaxan sales and overall earnings and remained a nearly certain risk to Salix's future sales and revenues. Therefore, its "Risk Factors" disclosures were misleading. Salix, however, repeated the language from its 2013 Form 10-K, and failed to disclose this nearly certain risk in its first and second quarter 2014 Forms 10-Q. The Salix CFO reviewed, approved, and signed the Forms 10-Q. Salix and its CFO knew, or were reckless in not knowing, that these disclosures were false and misleading.

### B. Salix Failed to Disclose Material Information in Its Management's Discussion and Analysis of Financial Condition and Results of Operations

112. Additionally, Salix failed to disclose requisite material information in the Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") section of its quarterly Reports on Form 10-Q for the first and second quarters 2014.

113. Pursuant to Item 303 of Regulation S-K, 17 C.F.R. § 229.303, reporting companies are required to disclose in the MD&A section of Form 10-K information "necessary

to an understanding of [the company's] financial condition, changes in financial condition and results of operations."

114. Item 303(b) of Regulation S-K, 17 C.F.R. § 229.303(b), sets forth the MD&A disclosure requirements applicable to quarterly Form 10-Q filings and provides that reporting companies must "[d]iscuss any material changes in the registrant's results of operations" with respect to that quarter and the corresponding quarter from the prior fiscal year.

115. Item 303(a)(3)(ii) of Regulation S-K, 17 C.F.R. § 229.303(a), sets forth disclosure requirements and provides that reporting companies must disclose, among other things, "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations."

116. In its quarterly Reports on Form 10-Q for the first and second quarters 2014, Salix failed to disclose: the trend, known to management, of regularly overselling demand; that the trend had created high wholesaler inventory levels that could not be sustained; that the trend was already having a material negative impact on sales of Salix's legacy products and its income from continuing operations; and that there was a reasonable expectation of adverse impact to sales, revenue, and income in the future.

117. As alleged above, Salix and its CFO knew of this trend. Salix's overselling demand had resulted in high wholesaler inventory levels at the end of each quarter, and the trend was reasonably likely to continue in the future and pose a substantial risk to Salix's future sales and revenue. The trend in fact already had had a direct material negative impact on Salix's first quarter 2014 sales margins and earnings and on the company's sales, revenue, and income for the second quarter 2014. Salix and its CFO knew, or were reckless in not knowing, of those facts and that the failure to disclose them made the first and second quarter 2014 Forms 10-Q

materially false and misleading. The Salix CFO reviewed, approved, and signed those quarterly reports.

## VII. Due Diligence Related to a Possible Acquisition of Salix Uncovered the False Statements About Wholesaler Inventories

118. In August 2014, a competing pharmaceutical company, Purchaser A, offered to acquire Salix for $205 per share in cash, subject to due diligence. The offered price was a premium over the average market price for Salix's stock at the time.

119. As part of its confidential due diligence, Purchaser A requested data on Salix's product channel inventory, including wholesaler inventory levels. Salix's CFO prepared a spreadsheet that showed wholesaler inventory levels that were artificially low – about 4.6 months of Xifaxan and 6.2 months of Apriso as of the end of June 2014. The Salix CFO obtained this result in the spreadsheet by taking total inventory and then inflating the level of Salix products held at retail pharmacies. Salix provided the spreadsheet to Purchaser A. Purchaser A questioned the data's validity, because it appeared to understate Salix's wholesaler inventory levels. Salix's EVP agreed.

120. Accordingly, in September 2014, at the request of Purchaser A, Salix asked its wholesaler customers to provide their internal data reflecting the amounts of Salix products on hand. Collectively, that data reflected that the Big Three had on hand an average of about nine months of Xifaxan, and almost 11 months of Apriso. After Salix revealed these facts to Purchaser A, Purchaser A's CEO wrote a letter to Salix's CEO identifying "several business and accounting practices that significantly concern[ed]" Purchaser A, including excessive in-channel inventories that appeared to be indicative of "potential channel stuffing practices."

121. Primarily due to Salix's high inventory levels, Purchaser A reduced its offer to $175 per share, an almost 15 percent decrease. Salix rejected the offer.

122. In October 2014, the Audit Committee of Salix's Board of Directors ("Audit Committee") launched an extensive independent investigation into Purchaser A's allegations. The Audit Committee self-reported the results of its investigation to the SEC. As a result of that investigation, Salix's Board requested and received the resignation of the CFO. Salix and Valeant subsequently removed Salix's executives.

123. On November 7, 2014, Salix released its quarterly report for the third quarter 2014 and disclosed its true wholesaler inventory levels. The Form 10-Q for the third quarter 2014 stated:

> Net product revenue for the nine-month period ended September 30, 2014 was lower than expected, primarily because prescription growth for some of our key products, while strong, was less than the Company anticipated, and wholesaler discounts were higher than budgeted.
>
> We estimate that, as of September 30, 2014, we had the following wholesaler inventory levels:
>
> - Xifaxan 550: approximately 9 months;
> - Apriso: approximately 9 months;
> - Glumetza: approximately 7 months; and
> - Uceris: approximately 5 months.
>
> Months of wholesaler inventory at quarter end represents the Company's estimate of wholesaler inventory, divided by the Company's estimate of the succeeding quarter's demand (not taking into account any future anticipated demand growth beyond the succeeding quarter). We estimate that wholesaler inventory levels of Xifaxan 550 and Apriso were largely constant during the first nine months of 2014. Wholesaler inventory levels of Uceris and Glumetza were approximately 2 months and less than 1 month, respectively, at the time of the consummation of the Santarus transaction.

124. Salix further disclosed that it would be changing its sales practices and would negotiate DSAs with wholesalers to, among other things, "better forecast revenue and expenses." It also noted that "[w]e expect that these agreements, when finalized, will enable us to achieve

our objective of predictably and deliberately reducing wholesaler inventory levels of Xifaxan 550, Apriso and Uceris to approximately 3 months at or before the end of 2016, depending on future demand for these products." Salix disclosed that it expected this change in business practice would negatively affect its revenue for about two years.

125. In addition, for the first time, Salix further disclosed that its wholesaler inventory levels were a "risk" to Salix's future financial results, by disclosing the following risks:

a. Salix's "expectation as to future revenues, which is subject to uncertainty due to the absence of distribution services agreements with our principal wholesalers, including our level of wholesaler discounts";

b. The risk regarding "the steps our principal wholesalers may take with respect to our key products following or in anticipation of the entry into distribution services agreements";

c. The risk regarding Salix's "ability to enter into distribution services agreements with our principal wholesalers and to reduce our wholesaler inventory levels of Xifaxan 550, Apriso and Uceris to approximately three months at or before the end of 2016."

126. On Salix's ensuing earnings call on November 6, 2014, analysts were stunned, asking numerous questions seeking to square Salix's prior statements concerning its inventory levels with the disclosures on its quarterly report. Salix's CEO and new acting CFO, however, declined to answer any such questions, citing the Audit Committee's ongoing investigation into these issues.

127. During this earnings call, Salix further confirmed that it expected wholesaler inventory levels would have a severe negative impact on Salix's future revenue stream. Given that Salix was going to reduce inventory levels by approximately six months by the end of 2016, Salix's acting CFO confirmed, in response to questions from analysts, that Salix expected it would lose approximately six months of revenues on its key products.

128. After these disclosures, Salix's closing stock price dropped nearly 34 percent, from a November 6, 2014, close of $138.55, to a close of $91.47 on November 7, 2014.

**VIII. Salix's Misrepresentations and Omissions Were Material**

129. Salix's earnings call misrepresentations alleged in this Complaint were material, and its omissions in the Risk Factors and MD&A sections of its first and second quarter 2014 Form 10-Qs were material as well. In Salix's industry, customer inventory levels were a crucial metric for assessing prospects for future sales and revenues, and thus for determining the value of Salix's stock. These facts were well known to Salix and its CFO at the time. The significance of inventory levels is illustrated by the numerous questions on that subject from securities analysts who covered Salix, as described above.

130. Since at least 2013, Salix fraudulently reported that its wholesaler inventory levels were approximately 12 weeks or less, when, in fact, its wholesalers had approximately three times that amount because Salix had been overselling demand for its products. The wholesalers' high inventory levels were critical to Salix's business operations and caused its inability to continue to sell product and grow its revenue. By overselling demand, Salix had made it virtually certain that future sales of its products would, at some point, drop precipitously.

131. Furthermore, Salix's misrepresentations and omissions created the false impression that Salix's product demand and growth were sustainable at levels that were materially higher than they actually were, because, in reality, Salix's high inventory levels presented a risk – realized by first quarter 2014 – that its product growth would be slowed due to higher-than-disclosed inventory levels.

132. In addition, the materiality of Salix's fraudulent statements and omissions is demonstrated by (1) analysts' consistent questions about wholesaler inventory levels of Salix's key products on earnings calls; (2) Purchaser A's approximately 15 percent reduction in its

offered acquisition price after learning of Salix's true inventory levels; (3) the 34 percent drop in Salix's stock price after it disclosed its true wholesaler inventory levels; (4) Salix's disclosed expectation in November 2014 that it would take two years to reduce its inventory levels and that revenues would be materially negatively impacted during that time; and (5) Salix's admission that a likely drop in future sales on its principal products was the leading risk factor for investors.

## IX. Salix Made Material Misrepresentations and Omissions in Connection with the Purchase and Sale of Securities, and in the Offer or Sale of Securities, and It Obtained Money or Property by Means of These Untrue Statements and Omissions

133. Salix's misrepresentations and omissions alleged in this Complaint occurred in connection with the purchase and sale, and in the offer and sale, of securities. Salix made these misrepresentations and omissions in its earnings calls and in filings with the Commission.

134. Salix also obtained money or property by means of the fraudulent statements and omissions, as alleged in this Complaint.

135. On multiple occasions in 2014, Salix received money from employees when it sold the employees common stock upon their exercise of stock options that the employees had previously obtained pursuant to a Salix compensation plan. That common stock was registered with the Commission pursuant to a series of Registration Statements on Form S-8 that each incorporated by reference all documents subsequently "filed by the Company pursuant to Sections 13(a), 13(c), 14, or 15(d) of the Exchange Act."

136. On June 6, 2014, and on July 29, 2014, Salix sold common stock to two employees, in connection with their exercise of Salix options. By the time of those transactions, Salix had recently filed (on May 9, 2014) its first quarter 2014 Form 10-Q, which fraudulently omitted material information.

137. Between August 22 and 26, 2014, Salix conveyed common stock to three employees, in connection with their exercise of Salix options. By the time of those transactions,

Salix also had filed (on August 8, 2014) its second quarter 2014 Form 10-Q, which fraudulently omitted material information, and it had filed (on August 11, 2014), pursuant to Securities Act Rule 425, the transcript of the earnings call for second quarter 2014, which was deemed filed with the Commission pursuant to Exchange Act Rule 14a-12.

138. Each of the foregoing filings was incorporated into the relevant registration statement and thus, in 2014, Salix sold the employees stock registered pursuant to registration statements that included fraudulent misstatements or fraudulently omitted material information. Salix thereby obtained money by means of the fraudulent misstatements and omissions.

## FIRST CLAIM FOR RELIEF

### Violations of Section 10(b) of the Exchange Act and Rule 10b-5(b) Thereunder

139. The Commission realleges and incorporates by reference each and every allegation contained in paragraphs 1 through 138 of this Complaint as if fully set forth herein.

140. As described above, during 2013 and 2014, Salix, directly or indirectly, used the means or instrumentalities of interstate commerce, or of the mails, or of the facilities of a national securities exchange, in connection with the purchase or sale of Salix securities, to knowingly or recklessly make untrue statements of material facts or omit to state material facts that were necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading in:

a. Salix earnings calls in 2013 and 2014, and

b. the Risk Factors and MD&A sections of Salix's quarterly Reports on Form 10-Q for the first and second quarters of 2014.

141. By reason of the foregoing, Salix, directly and indirectly violated Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5(b) thereunder, 17 C.F.R. § 240.10b-5(b).

## SECOND CLAIM FOR RELIEF

### Violations of Section 17(a)(2) of the Securities Act

142. The Commission realleges and incorporates by reference each and every allegation contained in paragraphs 1 through 138 as if fully set forth herein.

143. During 2014, Salix, directly and indirectly, singly or in concert, by use of the means or instruments of transportation or communication in interstate commerce and by the use of the mails, in the offer or sale of securities, obtained money or property by means of untrue statements of material facts and omissions to state material facts necessary to make the statements made, in the light of the circumstances under which they were made, not misleading.

144. By reason of the foregoing, Salix, directly and indirectly violated Section 17(a)(2) of the Securities Act, 15 U.S.C. § 77q(a)(2).

## THIRD CLAIM FOR RELIEF

### Violations of Section 13(a) of the Exchange Act and Rule 13a-13 Thereunder

145. The Commission realleges and incorporates by reference each and every allegation contained in paragraphs 1 through 138 as if fully set forth herein.

146. During 2014, pursuant to Section 13(a) of the Exchange Act, 15 U.S.C. § 78m(a), and Rule 13a-13 thereunder, 17 C.F.R. § 240.13a-13, Salix was required to file with the Commission Forms 10-Q (reporting quarterly results) that truthfully and accurately reported on Salix's revenues, earnings, other financial results, information about accounting practices, and other related information.

147. As described above, Salix failed to file truthful and correct quarterly reports with the Commission, and it failed to include material information in its required statements and reports as was necessary to make the required statements, in the light of the circumstances under which they were made, not misleading.

148. By reason of the foregoing, Salix violated Section 13(a) of the Exchange Act, 15 U.S.C. § 78m(a), and Rule 13a-13 thereunder, 17 C.F.R. § 240.13a-13.

## PRAYER FOR RELIEF

**WHEREFORE**, the Commission respectfully requests this Court issue a Final Judgment:

A. Permanently enjoining Salix from violating, directly or indirectly, Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a); Sections 10(b) and 13(a) of the Exchange Act, 15 U.S.C. §§ 78j(b) and 78m(a); and Exchange Act Rules 10b-5(b) and 13a-13, 17 C.F.R. §§ 240.10b-5(b) and 13a-13; and

B. Granting such other relief as this Court may deem just and appropriate.

Dated: September 28, 2018

Respectfully Submitted,

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