

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

FORM 10-Q

Mark One

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2008

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: 001-33093

**LIGAND PHARMACEUTICALS INCORPORATED**

(Exact Name of Registrant as Specified in its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**77-0160744**  
(I.R.S. Employer  
Identification No.)

**10275 Science Center Drive**  
**San Diego, CA**  
(Address of Principal Executive Offices)

**92121-1117**  
(Zip Code)

**Registrant's Telephone Number, Including Area Code: (858) 550-7500**

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

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company   
(Do not check if a smaller reporting company)

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

As of October 31, 2008, the registrant had 94,941,557 shares of common stock outstanding.

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**LIGAND PHARMACEUTICALS INCORPORATED**  
**QUARTERLY REPORT**

**FORM 10-Q**

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**SIGNATURE**

\* No information provided due to inapplicability of item.

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**LIGAND PHARMACEUTICALS INCORPORATED**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**  
**(in thousands, except share data)**

	<u>September 30,</u> <u>2008</u>	<u>December 31,</u> <u>2007</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 11,801	\$ 76,812
Short-term investments	59,311	17,596
Current portion of co-promote termination payments receivable	10,824	10,467
Other current assets	4,029	5,068
Total current assets	85,965	109,943
Restricted investments	1,411	1,411
Property and equipment, net	1,687	2,865
Long-term portion of co-promote termination payments receivable	47,911	48,989
Restricted indemnity account	10,217	10,070
Total assets	<u>\$ 147,191</u>	<u>\$ 173,278</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 9,014	\$ 12,682
Accrued liabilities	29,183	24,327
Current portion of deferred gain	1,964	1,964
Current portion of co-promote termination liability	10,824	10,467
Current portion of equipment financing obligations	716	1,528
Total current liabilities	51,701	50,968
Long-term portion of co-promote termination liability	47,911	48,989
Long-term portion of equipment financing obligations	172	627
Deferred revenue, net	2,546	2,546
Long-term portion of deferred gain	23,783	25,256
Other long-term liabilities	6,779	3,432
Total liabilities	132,892	131,818
Commitments and contingencies		
Common stock subject to conditional redemption; 997,568 shares issued and outstanding at September 30, 2008 and December 31, 2007	12,345	12,345
Stockholders' equity:		
Convertible preferred stock, \$0.001 par value; 5,000,000 shares authorized; none issued	—	—
Common stock, \$0.001 par value; 200,000,000 shares authorized; 100,551,894 and 100,543,370 shares issued at September 30, 2008 and December 31, 2007, respectively	101	101
Additional paid-in capital	653,883	651,038
Accumulated other comprehensive income	103	9
Accumulated deficit	(609,999)	(581,512)
Total stockholders' equity	44,088	69,636
Treasury stock, at cost; 6,607,905 and 6,263,151 shares at September 30, 2008 and December 31, 2007, respectively	(42,134)	(40,521)
Total stockholders' equity	<u>1,954</u>	<u>29,115</u>
Total liabilities and stockholders' equity	<u>\$ 147,191</u>	<u>\$ 173,278</u>

*See accompanying notes.*

**LIGAND PHARMACEUTICALS INCORPORATED**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)  
(in thousands, except share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
<b>Revenues:</b>				
Royalties	\$ 5,248	\$ 5,229	\$ 14,926	\$ 6,639
Collaborative research and development and other revenues	—	250	—	485
Total revenues	<u>5,248</u>	<u>5,479</u>	<u>14,926</u>	<u>7,124</u>
<b>Operating costs and expenses:</b>				
Research and development	6,165	9,838	19,707	34,191
General and administrative	5,929	4,856	20,579	26,539
Total operating costs and expenses	<u>12,094</u>	<u>14,694</u>	<u>40,286</u>	<u>60,730</u>
Accretion of deferred gain on sale leaseback	(491)	(491)	(1,473)	(1,473)
Loss from operations	<u>(6,355)</u>	<u>(8,724)</u>	<u>(23,887)</u>	<u>(52,133)</u>
<b>Other income (expense):</b>				
Interest income	421	1,546	1,899	7,359
Interest expense	(45)	(143)	(136)	(603)
Other, net	(155)	99	(1,427)	161
Total other income (expense), net	<u>221</u>	<u>1,502</u>	<u>336</u>	<u>6,917</u>
Loss before income taxes	(6,134)	(7,222)	(23,551)	(45,216)
Income tax (expense) benefit	(2,990)	2,360	(179)	15,779
Loss from continuing operations	<u>(9,124)</u>	<u>(4,862)</u>	<u>(23,730)</u>	<u>(29,437)</u>
<b>Discontinued operations:</b>				
Income from discontinued operations before income taxes	—	—	—	5,993
Gain on sale of AVINZA Product Line before income taxes	122	6,892	7,287	317,306
Gain (loss) on sale of Oncology Product Line before income taxes	(12,799)	(2,138)	(12,569)	7,669
Income tax benefit (expense) on discontinued operations	3,676	1,356	525	(25,781)
Discontinued operations	<u>(9,001)</u>	<u>6,110</u>	<u>(4,757)</u>	<u>305,187</u>
Net income (loss)	<u>\$ (18,125)</u>	<u>\$ 1,248</u>	<u>\$ (28,487)</u>	<u>\$ 275,750</u>
<b>Basic and diluted per share amounts:</b>				
Loss from continuing operations	\$ (0.10)	\$ (0.05)	\$ (0.25)	\$ (0.30)
Discontinued operations	(0.09)	0.06	(0.05)	3.08
Net income (loss)	<u>\$ (0.19)</u>	<u>\$ 0.01</u>	<u>\$ (0.30)</u>	<u>\$ 2.78</u>
Weighted average number of common shares	<u>95,068,102</u>	<u>96,541,752</u>	<u>95,059,166</u>	<u>99,020,141</u>

*See accompanying notes.*

**LIGAND PHARMACEUTICALS INCORPORATED**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
**(in thousands)**

	<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating activities:</b>		
Net income (loss)	\$ (28,487)	\$ 275,750
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Gain on sale of AVINZA Product Line before income taxes	(7,287)	(317,306)
(Gain) loss on sale of Oncology Product Line before income taxes	12,569	(7,669)
Amortization of deferred gain on sale leaseback	(1,473)	(1,473)
Amortization of acquired technology and license rights	—	909
Non-cash lease costs	4,975	—
Depreciation and amortization of property and equipment	814	1,342
Realized loss on investment	1,395	—
Loss on asset write-offs	776	755
Stock-based compensation	2,787	6,996
Non-cash co-promote termination expense	—	(1,409)
Other	8	324
Changes in operating assets and liabilities:		
Accounts receivable, net	—	11,523
Inventories, net	—	930
Other current assets	1,039	3,616
Restricted indemnity account	(147)	(9,969)
Accounts payable and accrued liabilities	(13,219)	(45,030)
Other liabilities	(568)	428
Deferred revenue, net	—	(8,657)
Net cash used in operating activities	<u>(26,818)</u>	<u>(88,940)</u>
<b>Investing activities:</b>		
Proceeds from sale of AVINZA Product Line	8,058	289,361
Additional proceeds from sale of Oncology Product Line	—	10,000
Proceeds from sale of property and equipment	42	311
Purchases of short-term investments	(62,373)	(23,626)
Proceeds from sale of short-term investments	19,263	7,982
Decrease in restricted cash	—	39,229
Purchases of property and equipment	(454)	(369)
Other, net	80	70
Net cash (used in) provided by investing activities	<u>(35,384)</u>	<u>322,958</u>
<b>Financing activities:</b>		
Principal payments on equipment financing obligations	(1,267)	(1,625)
Repayment of debt	—	(37,750)
Proceeds from issuance of common stock	71	4,349
Dividend paid	—	(252,742)
Dividend received on treasury stock held by Company	—	185
Repurchase of common stock	(1,613)	(35,535)
Net cash used in financing activities	<u>(2,809)</u>	<u>(323,118)</u>
Net decrease in cash and cash equivalents	(65,011)	(89,100)
Cash and cash equivalents at beginning of period	<u>76,812</u>	<u>158,401</u>
Cash and cash equivalents at end of period	<u>\$ 11,801</u>	<u>\$ 69,301</u>
<b>Supplemental disclosure of cash flow information:</b>		
Interest paid	\$ 172	\$ 1,280
Taxes paid	\$ 95	\$ 6,296

*See accompanying notes.*

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**LIGAND PHARMACEUTICALS INCORPORATED**  
**Notes to Condensed Consolidated Financial Statements**  
**(Unaudited)**

**1. Basis of Presentation**

The accompanying condensed consolidated financial statements of Ligand Pharmaceuticals Incorporated (the “Company” or “Ligand”) were prepared in accordance with instructions for this Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 and, therefore, do not include all information necessary for a complete presentation of financial condition, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America. However, all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for a fair presentation of the condensed consolidated financial statements, have been included. The results of operations for the three and nine months ended September 30, 2008 and 2007 and cash flows for the nine months ended September 30, 2008 and 2007 are not necessarily indicative of the results that may be expected for the entire fiscal year or any other future period. These statements should be read in conjunction with the consolidated financial statements and related notes, which are included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

As further discussed in Note 2, the Company sold its oncology product line (“Oncology”) on October 25, 2006 and its AVINZA product line (“AVINZA”) on February 26, 2007. The operating results for Oncology and AVINZA have been presented in the accompanying condensed consolidated financial statements as “Discontinued Operations.”

The Company’s other potential products are in various stages of development. Potential products that are promising at early stages of development may not reach the market for a number of reasons. A significant portion of the Company’s revenues to date have been derived from research and development agreements with major pharmaceutical collaborators. Prior to generating revenues from these products, the Company or its collaborators must complete the development of the products in the human health care market. No assurance can be given that: (1) product development efforts will be successful, (2) required regulatory approvals for any indication will be obtained, (3) any products, if introduced, will be capable of being produced in commercial quantities at reasonable costs or, (4) patient and physician acceptance of these products will be achieved. There can be no assurance that the Company will ever achieve or sustain annual profitability.

The Company faces risks common to companies whose products are in various stages of development. These risks include, among others, the Company’s potential need for additional financing to complete its research and development programs and commercialize its technologies. The Company has incurred significant losses since its inception. At September 30, 2008, the Company’s accumulated deficit was \$610.0 million. Management expects to continue to incur substantial research and development expenses.

Management believes that patents and other proprietary rights are important to its business. Its policy is to file patent applications to protect technology, inventions and improvements to its inventions that are considered important to the development of its business. The patent positions of pharmaceutical and biotechnology firms, including the Company, are uncertain and involve complex legal and technical questions for which important legal principles are largely unresolved.

*Principles of Consolidation*

The condensed consolidated financial statements include the Company’s wholly owned subsidiaries, Ligand Pharmaceuticals International, Inc., Ligand Pharmaceuticals (Canada) Incorporated, Seragen, Inc. (“Seragen”) and Nexus Equity VI LLC (“Nexus”). Intercompany accounts and transactions have been eliminated in consolidation.

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### *Use of Estimates*

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, including disclosure of contingent assets and contingent liabilities, at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. The Company's critical accounting policies are those that are both most important to the Company's financial condition and results of operations and require the most difficult, subjective or complex judgments on the part of management in their application, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Because of the uncertainty of factors surrounding the estimates or judgments used in the preparation of the consolidated financial statements, actual results may materially vary from these estimates.

### *Income (Loss) Per Share*

Net income (loss) per share is computed using the weighted average number of common shares outstanding. Basic and diluted income (loss) per share amounts are equivalent for the periods presented as the inclusion of potential common shares in the number of shares used for the diluted computation would be anti-dilutive to loss per share from continuing operations. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, *Earnings Per Share*, no potential common shares are included in the computation of any diluted per share amounts, including income (loss) per share from discontinued operations and net income (loss) per share, as the Company reported a loss from continuing operations for all periods presented. Potential common shares, the shares that would be issued upon the exercise of outstanding stock options and the vesting of restricted shares, were 4.0 million and 3.9 million at September 30, 2008 and 2007, respectively.

### *Guarantees and Indemnifications*

The Company accounts for and discloses guarantees in accordance with FASB Interpretation No. 45 ("FIN 45"), *Guarantor's Accounting and Disclosure Requirements for Guarantees Including Indirect Guarantees of Indebtedness of Others*, an interpretation of FASB Statements Nos. 5, 57 and 107 and rescission of FIN 34. The following is a summary of the Company's agreements that management has determined are within the scope of FIN 45:

Under its amended and restated bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer's or director's serving in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company has a directors and officers liability insurance policy that limits its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, management believes the estimated fair value of these indemnification agreements is minimal and has no liabilities recorded for these agreements as of September 30, 2008 and December 31, 2007. These insurance policies, however, do not cover the ongoing legal costs or the fines, if any, that may become due in connection with the ongoing SEC investigation of the Company, following the use of prior directors and officers liability insurance policy limits to settle certain shareholder litigation matters (see discussion of SEC investigation at Note 6). The SEC investigation is ongoing, and management is currently unable to assess the duration, extent, and cost of such investigation. Further, management is unable to assess the amount of such costs that may in turn be required to be reimbursed to any individual director or officer under the Company's indemnification agreements as the scope of the investigation cannot be apportioned amongst the Company and the indemnified officers and directors. Accordingly, a liability has not been recorded for the fair value of the ongoing and ultimate obligations, if any, related to the SEC investigation. As required by contract, the Company has a restricted cash balance of approximately \$10.2 million relating to this indemnity at September 30, 2008.

### *Revenue Recognition – AVINZA Royalties*

In accordance with the AVINZA Purchase Agreement (see Note 2), royalties are required to be reported and paid to the Company within 45 days of quarter-end during the 20 month period following the closing of the sale transaction. Beginning in October 2008, royalties will continue to be reported on a quarterly basis but paid on a calendar year basis. Royalties on sales of AVINZA due from King Pharmaceuticals, or King, are recognized in the quarter reported by King.

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### *Collaborative Research and Development and Other Revenues*

Collaborative research and development and other revenues are recognized as services are performed consistent with the performance requirements of the contract and collection is assured. Non-refundable contract fees for which no further performance obligation exists and where the Company has no continuing involvement are recognized upon the earlier of when payment is received or collection is assured. Revenue from non-refundable contract fees where the Company has continuing involvement through research and development collaborations or other contractual obligations is recognized ratably as services are performed over the development period or the period for which the Company continues to have a performance obligation. Revenue from performance milestones is recognized upon the achievement of the milestones as specified in the respective agreement. Payments received in advance of performance or delivery are recorded as deferred revenue and subsequently recognized over the period of performance or upon delivery.

### *Income Taxes*

The Company recognizes liabilities or assets for the deferred tax consequences of temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes* ("SFAS 109"). These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets or liabilities are recovered or settled. SFAS 109 requires that a valuation allowance be established when management determines that it is more likely than not that all or a portion of a deferred tax asset will not be realized. Management evaluates the realizability of its net deferred tax assets on a quarterly basis and valuation allowances are provided, as necessary. During this evaluation, management reviews its forecasts of income in conjunction with other positive and negative evidence surrounding the realizability of its deferred tax assets to determine if a valuation allowance is required. Adjustments to the valuation allowance will increase or decrease the Company's income tax provision or benefit. Management also applies the guidance of SFAS 109 to determine the amount of income tax expense or benefit to be allocated among continuing operations, discontinued operations, and items charged or credited directly to stockholders' equity.

The Company adopted the provisions of Financial Accounting Standard Board ("FASB") Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes," on January 1, 2007. FIN 48 clarifies the accounting for income taxes by prescribing a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined in FIN 48 as a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. There was no unrecognized tax benefit as of September 30, 2008 and 2007.

In accordance with SFAS No. 123 (revised 2004) Share-Based Payments ("SFAS 123(R)") effective January 1, 2006, the Company recognizes windfall tax benefits associated with the exercise of stock options directly to stockholders' equity only when realized in cash or as a reduction in income taxes payable. A windfall tax benefit occurs when the actual tax benefit realized by the Company upon an employee's disposition of a share-based award exceeds the deferred tax asset, if any, associated with the award that the Company had recorded. When assessing whether a tax benefit relating to share-based compensation has been realized, the Company follows the with-and-without method, excluding the indirect effects, under which current year share-based compensation deductions are assumed to be utilized after net operating loss carryforwards and other tax attributes.

### *Accounting for Stock-Based Compensation*

The Company applies the fair value recognition provisions of SFAS 123(R) using the modified prospective transition method to account for stock-based compensation. Under that transition method, compensation cost recognized in the three and nine months ended September 30, 2008 and 2007 includes: (a) compensation cost for all stock-based awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all stock-based awards granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R).

Stock-based compensation expense for awards to employees and non-employee directors is recognized on a straight-line basis over the vesting period until the last tranche vests. Compensation cost for consultant awards is recognized over each separate tranche's vesting period. The Company recognized compensation expense of \$0.9 million and \$0.9 million for the three months ended September 30, 2008 and 2007, respectively, and \$2.8 million and \$7.0 million for the nine months ended September 30, 2008 and 2007, respectively, associated with option awards, restricted stock and an equitable adjustment of employee stock options. Of the total



compensation expense associated with the option awards for the three and nine months ended September 30, 2007, \$0.01 million and \$1.8 million, respectively, related to the \$2.50 equitable adjustment of the exercise price for all options outstanding as of April 3, 2007 that was measured for financial reporting purposes effective March 28, 2007. There was no deferred tax benefit recognized in connection with these costs.

The fair-value for options that were awarded to employees and directors was estimated at the date of grant using the Black-Scholes option valuation model with the following weighted-average assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Risk-free interest rate	3.4%	4.4%	3.0%	4.9%
Dividend yield	—	—	—	—
Expected volatility	67%	65%	65%	66%
Expected term	6.0 years	6.0 years	6.0 years	6.0 years

The expected term of the employee and non-employee director options is the estimated weighted-average period until exercise or cancellation of vested options (forfeited unvested options are not considered). SAB 107 guidance permitted companies to use a “safe harbor” expected term assumption for grants up to December 31, 2007 based on the mid-point of the period between vesting date and contractual term, averaged on a tranche-by-tranche basis. Management used the safe harbor in selecting the expected term assumption in 2007. Management used SAB 110, which extends SAB 107 in the absence of adequate data for the year 2008. The expected term for consultant awards is the remaining period to contractual expiration.

Volatility is a measure of the expected amount of variability in the stock price over the expected life of an option expressed as a standard deviation. In selecting this assumption, management used the historical volatility of the Company’s stock price over a period approximating the expected term.

#### Stock Option Activity

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term in Years	Aggregate Intrinsic Value (in thousands)
Balance at December 31, 2007	2,223,032	\$ 8.87		
Granted	1,304,500	3.52		
Exercised	(4,438)	3.41		
Forfeited	(107,058)	6.88		
Cancelled	(360,343)	9.73		
Balance at September 30, 2008	<u>3,055,693</u>	<u>\$ 6.57</u>	<u>7.04</u>	<u>\$ 97</u>
Exercisable at September 30, 2008	<u>1,482,729</u>	<u>\$ 8.73</u>	<u>4.78</u>	<u>\$ 97</u>
Options expected to vest as of September 30, 2008	<u>2,811,229</u>	<u>\$ 6.73</u>	<u>6.84</u>	<u>\$ 97</u>

The weighted-average grant-date fair value of all stock options granted during the nine months ended September 30, 2008 was \$2.15 per share. The total intrinsic value of all options exercised during the nine months ended September 30, 2008 was \$3,000. As of September 30, 2008, there was \$3.8 million of total unrecognized compensation cost related to nonvested stock options. That cost is expected to be recognized over a weighted-average period of 2.88 years.

As of September 30, 2008, 2.1 million shares were available for future option grants or direct issuance under the Company’s 2002 stock incentive plan.

Cash received from options exercised for the nine months ended September 30, 2007 was \$4.2 million. There is no current tax benefit related to options exercised because of net operating losses (“NOLs”) for which a full valuation allowance has been established.

#### Restricted Stock Activity

Restricted stock activity for the nine months ended September 30, 2008 is as follows:

	<u>Shares</u>	<u>Weighted-Average Grant Date Stock Price</u>
Nonvested at December 31, 2007	295,600	\$ 9.90
Granted	414,000	3.42
Vested	(110,012)	10.92
Forfeited	(20,916)	6.59
Nonvested at September 30, 2008	<u>578,672</u>	<u>\$ 5.26</u>

The weighted-average grant-date fair value of restricted stock granted during the nine months ended September 30, 2008 was \$3.42 per share. As of September 30, 2008, there was \$1.5 million of total unrecognized compensation cost related to nonvested restricted stock. That cost is expected to be recognized over a weighted-average period of 1.47 years.

#### Employee Stock Purchase Plan

The Company has an employee stock purchase plan (as amended, the “2002 ESPP”). The 2002 ESPP allows employees to purchase a limited amount of common stock at the end of each three month period at a price equal to the lesser of 85% of fair market value on either the first trading day of the period or the last trading day of the period (the “Lookback Provision”). The 15% discount and the Lookback Provision make the 2002 ESPP compensatory under SFAS 123(R). There were 32,362 shares of common stock issued under the 2002 ESPP during the nine months ended September 30, 2008, resulting in a compensation expense of \$19,966. There were 20,110 shares of common stock issued under the 2002 ESPP during the nine months ended September 30, 2007, resulting in a compensation expense of \$31,427. As of September 30, 2008, 61,246 shares were available for future purchases under the 2002 ESPP.

#### Share Repurchases

In March 2007, the Company’s Board of Directors authorized up to \$100.0 million in share repurchases over the subsequent 12 months. During the nine months ended September 30, 2008, the Company repurchased a total of 0.3 million shares of its common stock totaling \$1.6 million. The Company has repurchased an aggregate of 6.5 million shares of its common stock totaling \$41.2 million prior to the expiration of the repurchase period on March 31, 2008.

### Cash, Cash Equivalents and Short-term Investments

Cash and cash equivalents consist of cash and highly liquid securities with maturities at the date of acquisition of three months or less. The following table summarizes the various investment categories at September 30, 2008 and December 31, 2007 (in thousands):

	<u>Cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Estimated fair value</u>
<b>September 30, 2008</b>				
U.S. government securities	\$56,909	\$ 108	\$ (11)	\$57,006
Corporate obligations	2,305	—	—	2,305
	59,214	108	(11)	59,311
Certificates of deposit - restricted	1,411	—	—	1,411
	<u>\$60,625</u>	<u>\$ 108</u>	<u>\$ (11)</u>	<u>\$60,722</u>
<b>December 31, 2007</b>				
U.S. government securities	\$ 7,509	\$ 4	\$ —	\$ 7,513
Corporate obligations	10,078	14	(9)	10,083
	17,587	18	(9)	17,596
Certificates of deposit - restricted	1,411	—	—	1,411
	<u>\$18,998</u>	<u>\$ 18</u>	<u>\$ (9)</u>	<u>\$19,007</u>

In July 2007, the Company purchased \$5.0 million of commercial paper issued by Golden Key Ltd. While the investment was highly-rated and within the Company's investment policy at the time of purchase, during the third quarter of 2007, large credit rating agencies downgraded the quality of this security. In addition, as a result of not meeting certain liquidity covenants, the assets of Golden Key Ltd. were assigned to a trustee who established a committee of the largest senior credit holders to determine the next steps. Subsequently, Golden Key Ltd. defaulted on its obligation to settle the security on the stated maturity date of October 10, 2007. Based on available information, management currently estimates that it will be able to recover approximately \$2.3 million on this investment. Management adjusted the carrying value by recording an impairment loss of \$0.1 million and \$1.4 million during the three and nine months ended September 30, 2008, respectively. As a result of ongoing volatility in the liquidity of the capital markets, the Company may be exposed to additional impairment for this investment until it is fully recovered or disposed of.

### Other Current Assets

Other current assets consist of the following (in thousands):

	<u>September 30, 2008</u>	<u>December 31, 2007</u>
Income taxes receivable	\$ 1,624	\$ 3,099
Prepaid expenses	1,427	1,076
Other receivables	504	738
Other	474	155
	<u>\$ 4,029</u>	<u>\$ 5,068</u>

### Property and Equipment

Property and equipment is stated at cost and consists of the following (in thousands):

	<u>September 30, 2008</u>	<u>December 31, 2007</u>
Equipment and leasehold improvements	\$ 13,353	\$ 40,577
Less accumulated depreciation and amortization	(11,666)	(37,712)
	<u>\$ 1,687</u>	<u>\$ 2,865</u>

Depreciation of equipment is computed using the straight-line method over the estimated useful lives of the assets, which range from three to ten years. Leasehold improvements are amortized using the straight-line method over their estimated useful lives or their related lease term, whichever is shorter. During the third quarter 2008, the Company conducted a physical count of its fixed assets that resulted in the write-off of gross fixed assets totaling \$23.8 million and related accumulated depreciation of \$23.7 million.

#### Impairment of Long-Lived Assets

Management reviews long-lived assets for impairment annually or whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair value for the Company's long-lived assets is determined using the expected cash flows discounted at a rate commensurate with the risk involved. During the nine months ended September 30, 2008, the Company recorded an impairment charge of \$0.7 million to general and administrative expense as a result of vacating a building in February 2008. For the same period in 2007, the Company recorded a net impairment charge of \$0.8 million, which included \$0.3 million of proceeds received from the sale of assets abandoned or disposed of and that were no longer used in the Company's ongoing operations following the sale of the Company's AVINZA product line and reduction in workforce. As of September 30, 2008, management believes that the future cash flows to be received from its long-lived assets will exceed the assets' carrying value.

#### Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	September 30, 2008	December 31, 2007
Allowances for loss on returns, rebates, chargebacks, and other discounts	\$ 15,292	\$ 17,275
Compensation	1,794	3,402
Current portion of lease termination obligation	1,068	—
Litigation settlement (see Note 6)	4,500	—
Legal expenses	3,771	110
Other	2,758	3,540
	<u>\$ 29,183</u>	<u>\$ 24,327</u>

The following summarizes the activity in the accrued liability accounts related to allowances for loss on returns, rebates, chargebacks, and other discounts for the nine months ended September 30, 2008 (in thousands):

	Charge-backs and		
	Rebates	Returns	Total
Balance at December 31, 2007	\$ 2,216	\$15,059	\$17,275
AVINZA Transaction Provision <sup>(1)</sup>	(717)	2,244	1,527
Oncology Transaction Provision <sup>(2)</sup>	(9)	(352)	(361)
Payments <sup>(3)</sup>	(801)	—	(801)
Charges <sup>(4)</sup>	—	(2,348)	(2,348)
Balance at September 30, 2008	<u>\$ 689</u>	<u>\$14,603</u>	<u>\$15,292</u>

(1) The AVINZA transaction provision amounts represent changes in the estimates of the accruals for rebates, chargebacks and returns recorded in connection with the sale of the AVINZA product line.

(2) The Oncology transaction provision amounts represent changes in the estimates of the accruals for rebates, chargebacks and returns recorded in connection with the sale of the Oncology product line.

(3) Represents actual cash payments affecting the reserve balance. Actual cash settlement of returns is reflected through accounts payable, which was \$0.8 million for the nine months ended September 30, 2008.

(4) Represents returns processed in the current reportable period.

### Comprehensive Income (loss)

Comprehensive income (loss) represents net income adjusted for the change during the periods presented in unrealized gains and losses on available-for-sale securities less reclassification adjustments for realized gains or losses included in net income, as well as foreign currency translation adjustments. The accumulated unrealized gains or losses and cumulative foreign currency translation adjustments are reported as accumulated other comprehensive income as a separate component of stockholders' equity. Comprehensive income (loss) is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income (loss) as reported	\$(18,125)	\$1,248	\$(28,487)	\$275,750
Unrealized net gain on available-for-sale securities	131	40	94	34
Foreign currency translation adjustments	—	5	—	337
Comprehensive income (loss)	<u>\$(17,994)</u>	<u>\$1,293</u>	<u>\$(28,393)</u>	<u>\$276,121</u>

### New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements and is effective for financial statements issued for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB FSP 157-2 which delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. These nonfinancial items include assets and liabilities such as reporting units measured at fair value in a goodwill impairment test and nonfinancial assets acquired and liabilities assumed in a business combination. Effective January 1, 2008, the Company adopted SFAS 157 for financial assets and liabilities recognized at fair value on a recurring basis. The adoption of SFAS 157 did not have a material impact on the Company's consolidated results of operations or financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115* ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS 159 apply only to entities that elect the fair value option; however, the amendment to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, applies to all entities with available-for-sale and trading securities. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company currently does not have any instruments eligible for election of the fair value option. Therefore, the adoption of SFAS 159 did not have a material impact on the Company's consolidated results of operations or financial position.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ("SFAS 141R"). SFAS 141R requires an acquirer to (i) recognize the assets acquired, liabilities assumed, contractual contingencies, and contingent consideration at fair value at the acquisition date, (ii) recognize acquisition-related costs separately from the acquisition, (iii) to recognize "negative goodwill" in earnings as a gain attributable to the acquisition, and (iv) to recognize changes in the amount of its deferred tax benefits that are recognizable because of the business combination either in earnings in the period of the combination or directly in contributed capital, depending on the circumstances. SFAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Management will assess the impact that SFAS 141R may have on its consolidated results of operations and financial position.

In December 2007, the FASB issued Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51* ("SFAS 160"). SFAS 160 requires entities to present ownership interests in subsidiaries held by parties

other than the parent entity within the equity section of the consolidated balance sheet, to present the amount of consolidated net income attributable to the parent and to the noncontrolling interest in the consolidated statement of operations, to recognize any changes in ownership interests as equity transactions, and to measure at fair value any retained noncontrolling equity investment upon deconsolidation of a subsidiary. The Company will adopt SFAS 160 in the first interim period of fiscal 2009, and management is evaluating the impact, if any, that the adoption of this statement will have on its consolidated results of operations and financial position.

In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities—amendment of FASB Statement No. 133* (“SFAS 161”). SFAS 161 requires entities to disclose the objectives for using derivative instruments in terms of underlying risk and accounting designation, to disclose the fair values of derivative instruments and their gains and losses in a tabular format, and to disclose information about credit-risk-related contingent features. The Company will adopt SFAS 161 in the first interim period of fiscal 2009, and management is evaluating the impact, if any, that the adoption of this statement will have on its consolidated results of operations and financial position.

## **2. Discontinued Operations**

### *Oncology Product Line*

On September 7, 2006, the Company, Eisai Inc., a Delaware corporation and Eisai Co., Ltd., a Japanese company (together with Eisai Inc., “Eisai”), entered into a purchase agreement (the “Oncology Purchase Agreement”) pursuant to which Eisai agreed to acquire all of the Company’s worldwide rights in and to the Company’s oncology products, including, among other things, all related inventory, equipment, records and intellectual property, and assume certain liabilities as set forth in the Oncology Purchase Agreement. The Oncology product line included the Company’s four marketed oncology drugs: ONTAK, Targretin capsules, Targretin gel and Panretin gel. For the three and nine months ended September 30, 2008, the Company recorded a \$12.8 million and \$12.6 million pre-tax loss, respectively, due to the recordation of the \$13.0 million litigation settlement with Salk (see Note 6) in addition to subsequent changes in certain estimates of assets and liabilities recorded as of the sale date.

Prior to the Oncology sale, the Company recorded accruals for rebates, chargebacks, and other discounts related to Oncology products when product sales were recognized as revenue under the sell-through method. Upon the Oncology sale, the Company accrued for rebates, chargebacks, and other discounts related to Oncology products in the distribution channel which had not sold-through at the time of the Oncology sale and for which the Company retained the liability subsequent to the Oncology sale. The Company’s accruals for Oncology rebates, chargebacks, and other discounts total \$0.5 million and \$1.2 million as of September 30, 2008 and December 31, 2007, respectively, and are included in accrued liabilities in the condensed consolidated balance sheets.

Additionally, and pursuant to the terms of the Oncology Purchase Agreement, the Company retained the liability for returns of products from wholesalers that had been sold by the Company prior to the close of the transaction. Accordingly, as part of the accounting for the sale of the Oncology product line, the Company recorded a reserve for Oncology product returns. Under the sell-through revenue recognition method, the Company previously did not record a reserve for returns from wholesalers. The Company’s reserve for Oncology returns was \$3.1 million and \$4.4 million as of September 30, 2008 and December 31, 2007, respectively, and are included in accrued liabilities in the condensed consolidated balance sheets.

### *AVINZA Product Line*

On September 6, 2006, the Company and King, entered into a purchase agreement (the “AVINZA Purchase Agreement”), pursuant to which King agreed to acquire all of the Company’s rights in and to AVINZA in the United States, its territories and Canada, including, among other things, all AVINZA inventory, records and related intellectual property, and assume certain liabilities as set forth in the AVINZA Purchase Agreement (collectively, the “Transaction”).

Pursuant to the AVINZA Purchase Agreement, at the closing on February 26, 2007 (the “Closing Date”), the Company received \$280.4 million in net cash proceeds, which is net of \$15.0 million that was funded into an escrow account to support any potential indemnification claims made by King following the closing.

In connection with the sale, the Company agreed to indemnify King in certain cases for a period of 30 months after the closing of the Transaction, including any breach of certain of the Company's representations, warranties or covenants contained in the asset purchase agreement. Under the Company's agreement with King, \$15.0 million of the total upfront cash payment was deposited into an escrow account to secure the Company's indemnification obligations to King following the closing of the Transaction. Of the escrowed amount, \$7.5 million was released to the Company in August 2007, and the remaining \$7.5 million, plus interest of \$0.6 million, was released to the Company in February 2008 and recorded as gain on sale of the AVINZA product line.

Prior to the AVINZA sale, the Company recorded accruals for rebates, chargebacks, and other discounts related to AVINZA products when product sales were recognized as revenue under the sell-through method. Upon the AVINZA sale, the Company accrued for rebates, chargebacks, and other discounts related to AVINZA products in the distribution channel which had not sold-through at the time of the AVINZA sale and for which the Company retained the liability subsequent to the sale. The Company's accruals for AVINZA rebates, chargebacks, and other discounts total \$0.2 million and \$1.0 million as of September 30, 2008 and December 31, 2007, respectively, and are included in accrued liabilities in the condensed consolidated balance sheets.

Additionally, and pursuant to the terms of the AVINZA Purchase Agreement, the Company retained the liability for returns of product from wholesalers that had been sold by the Company prior to the close of the Transaction. Accordingly, as part of the accounting for the gain on the sale of AVINZA, the Company recorded a reserve for AVINZA product returns. Under the sell-through revenue recognition method, the Company previously did not record a reserve for returns from wholesalers. The Company's reserve for AVINZA returns was \$11.5 million and \$10.7 million as of September 30, 2008 and December 31, 2007, respectively, and are included in accrued liabilities in the condensed consolidated balance sheets.

### 3. Financial Instruments

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including available-for-sale fixed income and equity securities and other equity securities. The fair value of these certain financial assets and liabilities was determined using the following inputs at September 30, 2008:

	Fair Value Measurements at Reporting Date Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
Fixed income available-for-sale securities <sup>(1)</sup>	\$59,311	\$ 57,006	\$ 2,305	\$ —
Equity available-for-sale securities <sup>(2)</sup>	—	—	—	—
<b>Total</b>	<b>\$59,311</b>	<b>\$ 57,006</b>	<b>\$ 2,305</b>	<b>\$ —</b>

<sup>(1)</sup> Included in cash and cash equivalents and short-term investments on our condensed consolidated balance sheet.

<sup>(2)</sup> Included in short-term investments on our condensed consolidated balance sheet.

Fixed income available-for-sale securities include U. S. Government Notes, and Corporate Discount Commercial Paper. Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase. The remaining balance of cash equivalents (not included in this table) of \$11.8 million at September 30, 2008, consists primarily of money market funds, for which the carrying amount is a reasonable estimate of fair value using level 2 inputs.

### 4. AVINZA Co-Promotion

In February 2003, the Company and Organon Pharmaceuticals USA Inc. ("Organon") announced that they had entered into an agreement for the co-promotion of AVINZA. Subsequently in January 2006, the Company signed an agreement with Organon that terminated the AVINZA co-promotion agreement between the two companies and returned AVINZA co-promotion rights to Ligand. In consideration of the early termination and return of rights under the terms of the agreement, the Company agreed to and paid Organon \$37.8 million in October 2006. The Company further agreed to and paid Organon \$10.0 million in January 2007, in

consideration of certain minimum sales calls during a Transition Period. In addition, following the Transition Period, the Company agreed to make royalty payments to Organon equal to 6.5% of AVINZA net sales through December 31, 2012 and thereafter 6.0% through patent expiration, currently anticipated to be November of 2017.

On February 26, 2007, the Company consummated its agreement with King pursuant to which King acquired all of the Company's rights in and to AVINZA, assumed certain liabilities, and reimbursed the Company the \$47.8 million previously paid to Organon (comprised of the \$37.8 million paid in October 2006 and the \$10.0 million that the Company paid in January 2007). King also assumed the Company's co-promote termination obligation to make payments to Organon based on net sales of AVINZA. In connection with King's purchase of AVINZA, Organon did not consent to the legal assignment of the co-promote termination obligation to King. Accordingly, the Company remains liable to Organon in the event of King's default of the obligation. Therefore, the Company recorded an asset as of February 26, 2007 to recognize King's assumption of the obligation, while continuing to carry the co-promote termination liability in the Company's consolidated financial statements to recognize the Company's legal obligation as primary obligor to Organon as required under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This asset represents a non-interest bearing receivable for future payments to be made by King and is recorded at its fair value based on management's estimate of future sales of AVINZA. As of September 30, 2008 and thereafter, the receivable and liability will remain equal and adjusted each quarter for changes in the estimated fair value of the obligation including for any changes in the estimate of future net AVINZA product sales. This receivable will be assessed on a quarterly basis for impairment (e.g., in the event King defaults on the assumed obligation to pay Organon). As of December 31, 2007 and September 30, 2008, the fair value of the co-promote termination liability (and the corresponding receivable) was determined using a discount rate of 15%.

On an annual basis, management reviews the carrying value of the co-promote termination liability. Due to assumptions and judgments inherent in determining the estimates of future net AVINZA sales through November 2017, the actual amount of net AVINZA sales used to determine the current fair value of the Company's co-promote termination asset and liability may be materially different from current estimates.

A summary of the co-promote termination liability as of September 30, 2008 is as follows (in thousands):

Net fair value of payments based on estimated future net AVINZA product sales as of December 31, 2007	\$ 59,456
Assumed payments made by King or assignee	(6,468)
September 30, 2008 fair value adjustment of estimated future payments based on estimated future net AVINZA product sales	<u>5,747</u>
Total co-promote termination liability as of September 30, 2008	58,735
Less: current portion of co-promote termination liability as of September 30, 2008	<u>(10,824)</u>
Long-term portion of co-promote termination liability as of September 30, 2008	<u>\$ 47,911</u>

## 5. Property Leases

The Company leases one of its office and research facilities under an operating lease arrangement through July 2015. The Company fully vacated this facility in February 2008. The operating lease agreement provides for increases in annual rents based on changes in the Consumer Price Index or fixed percentage increases ranging from 3% to 7%. Commencing January 2008, the Company sublet this facility through July 2015. The sublease agreement provides for a 3% increase in annual rents. As of September 30, 2008, the Company expects to receive aggregate future minimum lease payments totaling \$5.9 million (nondiscounted) over the remaining duration of the sublease agreement. In accordance with Statement of Financial Accounting Standards No. 146 (As Amended) *"Accounting for Costs Associated with Exit or Disposal Activities,"* the Company recorded a net charge to operating expenses of \$4.3 million for exit costs when it fully ceased use of this facility in the first quarter of 2008. The net charge consisted of a \$6.2 million charge for the net present value of future rent payments offset by a \$2.2 million reversal of deferred rent. As of September 30, 2008, \$6.2 million has been recorded as a liability for these exit costs on the condensed consolidated balance sheet with \$1.1 million classified as accrued liabilities and the balance included in other long-term liabilities.



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## 6. Litigation

The SEC issued a formal order of private investigation dated September 7, 2005, which was furnished to the Company's legal counsel on September 29, 2005, to investigate the circumstances surrounding the Company's restatement of its consolidated financial statements for the years ended December 31, 2002 and 2003, and for the first three quarters of 2004. The SEC's investigation is ongoing and the Company is cooperating with the investigation.

The Company and Seragen, Inc. were named parties to *Sergio M. Oliver, et al. v. Boston University, et al.*, a shareholder class action filed on December 17, 1998 in the Court of Chancery in the State of Delaware. The Company and Seragen were dismissed from the action, but such dismissal is subject to appeal and the Company and Seragen may have possible indemnification obligations with respect to certain defendants. On April 14, 2006, the court found for the plaintiffs on certain claims and awarded damages of approximately \$4.8 million plus interest. Judgment, however, has not been entered and the matter is subject to appeal. As of September 30, 2008, the Company has not accrued an indemnification obligation based on its assessment that its responsibility for any such obligation is not probable or estimable.

In July 2007, the Salk Institute for Biological Studies ("Salk") filed a demand for arbitration with the American Arbitration Association, seeking damages for alleged breach of contract based on Salk's theory that it is entitled to a portion of the money paid by Eisai to the Company for Targretin related assets. In September 2008, the Company reached a settlement with Salk, whereby the parties resolved all disputes that had arisen between them, including Salk's primary claim in arbitration relating to the sale of Targretin to Eisai in 2006. As part of the settlement, the parties executed mutual releases and agreed to jointly seek dismissal with prejudice of all claims and counterclaims asserted in the arbitration. The Company agreed to pay Salk \$9.5 million immediately upon settlement and \$3.5 million six months from the date of settlement in return for which Salk acknowledged that no additional payments would be due from Ligand or any sublicensee for any past, present or future conduct, including development of any compound in Ligand's internal or partnered pipeline, except for any future bazedoxifene related payments. Pursuant to the parties' agreement, the American Arbitration Association dismissed the proceeding. Accordingly, for the three month period ended September 30, 2008, the Company recorded a \$13.0 million charge to discontinued operations-loss on the sale of Oncology Product Line.

On March 4, 2008, Rockefeller University ("Rockefeller") filed suit, now proceeding in the United States District Court for the Southern District of New York against the Company alleging, among other things, a breach by the Company of its September 30, 1992 license agreement with Rockefeller, as well as other causes of action for unjust enrichment, quantum meruit, specific performance to perform an audit and declaratory relief. The complaint seeks damages of at least \$1.9 million, plus alleges that Rockefeller is entitled to 25% of payments to be received by the Company in the future related to Promacta and SB-559448 or from any third party in connection with certain products (which products, according to the complaint, include LGD-4665), and 5% of future net sales of certain of the Company's other products. The complaint requests a trial by jury, and also seeks to impose a constructive trust upon payments previously received by the Company to which Rockefeller claims it is owed a portion. The Company has filed an answer and counterclaims seeking, among other things, a judicial determination that (i) eltrombopag and the backup compound SB-559448 (including the use of such compounds) do not embody any invention(s) described or claimed in certain licensed patent rights under the September 30, 1992 license agreement between the Company and Rockefeller, (ii) Rockefeller technical information was not essential to the discovery or development of eltrombopag and the backup compound SB-559448, (iii) the Company is not liable for any additional payments under its September 30, 1992 license agreement with Rockefeller beyond any payments that the Company has already made, and (iv) the September 30, 1992 license agreement between the Company and Rockefeller was terminated in November 2007, and that subsequent to the termination of such agreement, the Company is not liable for future payments under such agreement. Discovery is scheduled to be completed in the second quarter of 2009, but delays are possible and management is unable to guarantee when a final decision will be rendered. Intellectual property license disputes are subject to inherent uncertainties and there can be no assurance this litigation will be resolved favorably to the Company or that it will not have a material adverse effect on the Company.

On October 10, 2008, the Company received notice that a putative class action complaint was filed in the Superior Court of New Jersey, Mercer County (Equity Division) by Allen Heilman, a stockholder of Pharmacoepia, Inc. ("Pharmacoepia"), against Pharmacoepia, the members of its Board of Directors, the Company and two of the Company's wholly owned subsidiaries. The complaint generally alleges that Pharmacoepia's Board of Directors' decision to enter into the proposed transaction with the

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Company on the terms contained in the proposed merger agreement constitutes a breach of fiduciary duty and gives rise to other unspecified state law claims. The complaint also alleges that the Company and two of its wholly owned subsidiaries aided and abetted Pharmacoepia's Board of Directors' breach of fiduciary duty. In addition, the complaint alleges that the named plaintiff will seek "equitable relief," including among other things, an order preliminarily and permanently enjoining the proposed transaction.

Based on management's assessment of available information, the Company has recorded a liability for estimated litigation settlement costs in the amount of \$1.0 million, which is included in research and development costs for the three and nine months ended September 30, 2008.

In addition, from time to time the Company is subject to various lawsuits and claims with respect to matters arising out of the normal course of its business. Due to the uncertainty of the ultimate outcome of these matters, the impact on future financial results is not subject to reasonable estimates.

## **7. Reductions in Workforce**

In December 2007, the Company entered into a plan to eliminate approximately 27 employee positions, across all functional areas, which were deemed to be no longer necessary in connection with the Company's ongoing efforts to be a highly-focused research and development and royalty-driven biotech company. The affected employees were informed of the plan in December 2007 with an effective termination date of December 31, 2007 for the majority of the affected employees. The Company completed the plan in the first quarter of 2008. In connection with the termination plan, the Company recognized expenses of \$1.1 million in the fourth quarter of 2007 which were paid in the first quarter of 2008.

## **8. Merger**

On September 24, 2008, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement"), with Pharmacoepia, Margaux Acquisition Corp, a direct wholly-owned subsidiary of the Company ("Merger Sub 1") and Latour Acquisition, LLC, a Delaware limited liability company ("Merger Sub 2"). Under the Merger Agreement, the Company will acquire Pharmacoepia pursuant to a two-step merger, whereby Merger Sub 1 will merge with and into Pharmacoepia, with Pharmacoepia as the surviving corporation, and Pharmacoepia will immediately thereafter merge with and into Merger Sub 2, with Merger Sub 2 as the surviving entity (collectively, the "Merger").

Under the terms of the Merger Agreement, the Company would issue approximately 0.58 of a share of common stock for each outstanding Pharmacoepia share of common stock, subject to certain adjustments for cancelled stock options, such that current stockholders of the Company would own approximately 84% of the combined company and Pharmacoepia stockholders would own approximately 16%. This exchange ratio is applicable if the average closing price of the Company's common stock falls in the range of \$3.00 and \$3.75 during a specified period prior to the closing date. If the prices are between \$3.75 and \$4.50, the value is fixed at \$66 million, and the exchange ratio would decrease as prices increase within that range. At prices above \$4.50, the exchange ratio would be fixed at 0.49 for one. At prices between \$3.00 and \$2.38, the value is fixed at \$52.8 million, and the exchange ratio would increase as prices decrease within the range, subject to limitations set forth in the Merger Agreement. Pharmacoepia stockholders would receive some cash consideration in addition to shares of the Company's common stock at prices below \$2.93 and above \$2.38. Below \$2.38, the consideration would be comprised of shares of the Company's common stock at a 0.60 for one exchange ratio plus the right to receive a proportionate share of \$10 million in cash. At prices below \$1.65, Pharmacoepia has the right to terminate the Merger Agreement. In addition, securityholders of Pharmacoepia will be entitled to receive contingent value rights, under which they could receive an aggregate of \$15 million cash payment upon the occurrence of a specified trigger event.

The Company and Pharmacoepia each made representations, warranties and covenants in the Merger Agreement that are similar to those made by parties in similar business combinations. The Merger is subject to customary closing conditions, including obtaining the approval of Pharmacoepia's stockholders and termination or expiration of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended. The Board of Directors of the Company and Pharmacoepia have approved the Merger and the Merger Agreement. Pharmacoepia has agreed, unless the Merger Agreement is terminated earlier, to cause a stockholders meeting to be held, for the purpose of considering approval of the Merger and the Merger Agreement. If the Merger

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Agreement is terminated under certain circumstances specified in the Merger Agreement, Pharmacoepia may be required to pay a termination fee of \$3.375 million and/or reimbursement of actual documented reasonable expenses up to a maximum of \$1.4 million.

Management expects to incur substantial additional costs in connection with the Merger, including costs associated with severance payments, repayment of outstanding debt, advisors' fees and other transaction-related expenses.

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

*Caution:* This discussion and analysis may contain predictions, estimates and other forward-looking statements that involve a number of risks and uncertainties, including those discussed in Item 1A "Risk Factors." This outlook represents our current judgment on the future direction of our business. These statements include those related to our AVINZA royalty revenues, product returns, and product development. Actual events or results may differ materially from our expectations. For example, there can be no assurance that our revenues or expenses will meet any expectations or follow any trend(s), that we will be able to retain our key employees or that we will be able to enter into any strategic partnerships or other transactions. We cannot assure you that we will receive expected AVINZA royalties to support our ongoing business or that our internal or partnered pipeline products will progress in their development, gain marketing approval or achieve success in the market. In addition, our ongoing SEC investigation, ongoing or future arbitration, or litigation or disputes with third parties may have a material adverse effect on us. Such risks and uncertainties, and others, could cause actual results to differ materially from any future performance suggested. We undertake no obligation to release publicly the results of any revisions to these forward-looking statements to reflect events or circumstances arising after the date of this quarterly report. This caution is made under the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended.

Our trademarks, trade names and service marks referenced herein include Ligand. Each other trademark, trade name or service mark appearing in this quarterly report belongs to its owner.

References to Ligand Pharmaceuticals Incorporated ("Ligand," the "Company," "we" or "our") include our wholly owned subsidiaries – Ligand Pharmaceuticals (Canada) Incorporated; Ligand Pharmaceuticals International, Inc.; Seragen, Inc. ("Seragen"); and Nexus Equity VI LLC ("Nexus").

### Overview

We are a biotechnology company that focuses on discovering and developing new drugs that address critical unmet medical needs in the areas of thrombocytopenia, anemia, cancer, hormone related diseases, osteoporosis and inflammatory diseases. We aim to develop drugs that are more effective and/or safer than existing therapies, that are more convenient to administer and that are cost effective. We plan to build a profitable company by generating income from research, milestone and royalty and co-promotion revenues resulting from our collaborations with pharmaceutical partners.

In September 2008, we announced that we had entered into a definitive merger agreement under which we will acquire Pharmacoepia, Inc., or Pharmacoepia, in a primarily stock-for-stock merger intended to be tax-free. Under the terms of the Merger Agreement, the Company would issue approximately 0.58 of a share of common stock for each outstanding Pharmacoepia share of common stock, subject to certain adjustments for cancelled stock options, such that current stockholders of the Company would own approximately 84% of the combined company and Pharmacoepia stockholders would own approximately 16%. This exchange ratio is applicable if the average closing price of the Company's common stock falls in the range of \$3.00 and \$3.75 during a specified period prior to the closing date. If the at prices are between \$3.75 and \$4.50, the value is fixed at \$66 million, and the exchange ratio would decrease as prices increase within that range. At prices above \$4.50, the exchange ratio would be fixed at 0.49 for one. At prices between \$3.00 and \$2.38, the value is fixed at \$52.8 million, and the exchange ratio would increase as prices decrease within the range, subject to limitations set forth in the Merger Agreement. Pharmacoepia stockholders would receive some cash consideration in addition to shares of the Company's common stock at prices below \$2.93 and above \$2.38. Below \$2.38, the consideration would be comprised of shares of the Company's common stock at a 0.60 for one exchange ratio plus the right to receive a proportionate share of \$10 million in cash. At prices below \$1.65, Pharmacoepia has the right to terminate the Merger Agreement. Securityholders of Pharmacoepia will also be entitled to receive contingent value rights, under which they could receive an aggregate \$15 million cash payment upon the occurrence of a specified trigger event. Pharmacoepia is a clinical development stage biopharmaceutical company dedicated to discovering and developing novel small molecule therapeutics to address significant medical needs. Pharmacoepia's strategy has been to retain the rights to product candidates at least to clinical validation, and to continue development on its own to New Drug Application (NDA) filing and commercialization for selected indications. Pharmacoepia has a broad portfolio of clinical and preclinical candidates under development internally or by partners. The Merger is subject to customary closing conditions, including obtaining the approval of Pharmacoepia's stockholders and termination or expiration of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

On September 7, 2006, we announced the sale of ONTAK, Targretin capsules, Targretin gel, and Panretin gel to Eisai, Inc., or Eisai, and the sale of AVINZA to King Pharmaceuticals, Inc., or King. The Eisai sales transaction subsequently closed on October 25, 2006. The AVINZA sale transaction subsequently closed on February 26, 2007. Accordingly, the results for the AVINZA product line have been presented in our condensed consolidated statements of operations for the three and nine months ended September 30, 2008 and 2007 as "Discontinued Operations."

We are a party to a number of collaboration arrangements that are in the development phase, including collaborations with GlaxoSmithKline, Pfizer, Abbott (formerly TAP), and Wyeth. We received funding during the research phase of the arrangements, and receive milestone and royalty payments as products are developed and marketed by our corporate partners. In addition, in connection with some of these collaborations, we received non-refundable up-front payments.

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We have been unprofitable since our inception on an annual basis and expect to incur net losses in the future. To be profitable, we, or our partners, must successfully develop, clinically test, market and sell our products. Even if we achieve profitability, we cannot predict the level of that profitability or whether we will be able to sustain profitability. We expect that our operating results will fluctuate from period to period as a result of differences in the timing and amounts of revenues, including royalties expected to be earned in the future from King on sales of AVINZA, expenses incurred, collaborative arrangements and other sources. Some of these fluctuations may be significant.

#### *Ligand Product Development Programs*

We are developing several proprietary products for which we have worldwide rights for a variety of cancers, thrombocytopenia and inflammation and hormonal disorders as discussed below.

#### *Thrombopoietin (TPO) Research Programs*

In our TPO program, we seek to develop our own drug candidates that mimic the activity of thrombopoietin for use in the treatment or prophylaxis of thrombocytopenia with indications in a variety of conditions including Idiopathic Thrombocytopenic Purpura (ITP), cancer, hepatitis C and other disorders of blood cell formation. These are large markets with unmet medical needs. For example, the U.S. prevalence of a few target diseases with thrombocytopenia is 200,000 patients with ITP, 1.3 million cancer patients receiving chemotherapy and 2.7 million patients with hepatitis C.

Thrombocytopenia can be caused by insufficient platelet production, splenic sequestration of platelets or increased destruction of platelets predominantly by a patient's own immune system. Thrombocytopenia in cancer patients can be treatment-related (chemotherapy) or cancer-related. Platelet transfusion is the standard of care for thrombocytopenia. However, repeated transfusions can result in the development of platelet alloantibodies that could significantly reduce the effectiveness of transfusions. In addition, patients are at increased risk of infections and allergic reactions. Currently, there is only one approved drug (Neumega) for the prevention of severe thrombocytopenia and the reduction of the need for platelet transfusions in patients with nonmyeloid malignancies. We believe that there is a substantial medical need for improved platelet enhancing agents for use in the treatment of thrombocytopenia due to the significant side effects seen with current therapies. Thus, a small molecule TPO mimetic with no apparent immunogenic potential and oral activity that may facilitate dosing may provide an attractive therapeutic profile for a major unmet medical need.

In February 2004, we began to research and then selected a TPO mimetic, LGD-4665, as a clinical candidate and completed preclinical studies in 2006. We completed single and multi-dose Phase I safety and efficacy studies in the fourth quarter of 2007. In 2008, we conducted an additional study evaluating once a week administration, for six weeks, to healthy volunteers. The results demonstrated that the molecule was safe and well tolerated at all dose levels and daily as well as weekly regimen and displayed reliable absorption with dose proportional pharmacokinetics. Phase I clinical results were presented at the American Society of Hematology meeting in December 2007 and at a meeting of the European Hematology Association in June 2008. We plan to present results of multiple Phase I pharmacology studies at ASH 2008.

Additional Phase I studies, evaluating drug-to-drug interaction, as well as liver impairment and food impact on absorption have also been completed. A Phase II clinical trial with LGD-4665 in ITP was initiated in April 2008. This 24-patient, double-blind placebo-controlled trial is designed to evaluate the safety and efficacy of LGD-4665 in adult patients. An IND for evaluation of LGD-4665 in MDS patients was filed to the FDA in September 2008.

We may pursue the therapeutic specialty applications emerging from our TPO mimetics internally, but may seek collaborations with major pharmaceutical companies to exploit broader clinical applications.

#### *Selective Androgen Receptor Modulators (SARM) Research and Development Programs*

We are pioneering the development of tissue selective SARMs, a novel class of non-steroidal, orally active molecules that selectively modulate the activity of the androgen receptor in different tissues, providing a wide range of opportunities for the treatment of many diseases and disorders in both men and women. Tissue-selective androgen receptor agonists may provide utility in the treatment of patients with frailty, cachexia, osteoporosis, sexual dysfunction and hypogonadism.

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We have assembled an extensive SARM compound library and, we believe, one of the most experienced androgen receptor drug discovery teams in the pharmaceutical industry. We may pursue the specialty applications emerging from SARMS internally, but may seek collaborations with major pharmaceutical companies to exploit broader clinical applications.

As part of our joint development and research alliance with TAP (now Abbott), we exercised an option to select for development one compound and a back-up, LGD-3303 and LGD-3129, respectively, out of a pool of compounds available for development. Preclinical studies we have conducted with LGD-3303 indicate that the compound may have utility for osteoporosis, sexual dysfunction, frailty and hypogonadism. *In vivo* studies in rodents indicate a favorable profile with anabolic effects on bone, but an absence of the prostatic hypertrophy that occurs with the currently marketed androgens.

After the conclusion of our research alliance with TAP, we discovered SARM compounds with androgen effects in bone and skeletal muscle, but with little or no activity in the prostate, oil-secreting glands in the skin, or female genitalia. Preclinical studies conducted on one of these compounds, LGD-4033, suggest that the compound may have favorable activity in the treatment of cachexia, frailty, osteoporosis, hypogonadism as well as other disorders. We expect to file an Investigational New Drug (IND) application for LGD-4033 in the fourth quarter of 2008.

#### *Erythropoiein (EPO) Research Program*

We are developing small molecule agonists for the EPO receptor. EPO stimulates the differentiation of bone marrow stem cells to form red blood cells. Various recombinant human EPO derivatives are marketed for the treatment of anemia due to renal failure or cancer chemotherapy (e.g., Aranesp, Epogen, Eprex, and Procrit). We believe that a small molecule agonist for the EPO receptor would provide additional benefit in the treatment of anemia and the convenience of oral administration compared to recombinant human protein therapeutics. EPO and TPO act on the same bone marrow hematopoietic stem cell to guide the development of blood cells. We expect that our prior experience in developing small molecule TPO mimetic drugs will lead to increased efficiency in discovering small molecule EPO mimetic drugs.

#### *Selective Glucocorticoid Receptor Modulators (SGRM) Research and Development Program*

We are developing SGRMs for inflammation, cancer indications and other therapeutic applications. We have a library of compounds that we are optimizing with the goal to identify one or more compounds to enter human trials. Our most advanced compound, LGD-5552, was on track to enter clinical trials in 2007; however Good Laboratory Practice studies failed to demonstrate the desired preclinical safety characteristics for a drug to treat rheumatoid arthritis. We decided in the first quarter of 2007 not to proceed with the development of LGD-5552. We have identified SGRM compounds that are chemically distinct from LGD-5552. Our studies of these compounds are in the research stage.

#### *Androgen-Independent Prostate Cancer (AiPC) program*

AIPC typically occurs within 2 years of initiation of hormonal therapy and no targeted treatment is currently available. Docetaxel is current standard of care which extends survival by approx. 6 months (from 12 to 18 months). Most prostate-derived tumors are initially androgen dependent and they regress in response to androgen ablation therapy. On average, regression lasts about 2 years, followed by break-through growth of androgen-independent tumors. There is experimental evidence that these androgen-independent tumors require the androgen receptor (AR) for continued proliferation (i.e. tumors are receptor dependent). The AIPC program goal is to identify compounds that specifically inhibit and degrade AR. Our studies of these compounds are in the research stage.

#### *Collaborative Research and Development Programs*

We may receive royalties on product candidates resulting from our research and development collaboration arrangements with third party pharmaceutical companies if and to the extent any such product candidate is ultimately approved by the FDA and successfully marketed. Our collaborations are discussed below.

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### GlaxoSmithKline Collaboration – Eltrombopag

Eltrombopag is an oral, small molecule drug that mimics the activity of thrombopoietin, a protein factor that promotes growth and production of blood platelets. Eltrombopag is a product candidate that resulted from our collaboration with SmithKline Beecham (now GlaxoSmithKline). At the European Hematology Association meeting on June 15, 2008, GlaxoSmithKline announced positive Phase III data from the ongoing, open label EXTEND (Eltrombopag eXTENDED Dosing) study. The results suggest that eltrombopag sustains increased platelet counts during long-term treatment for patients with Idiopathic Thrombocytopenia Purpura (ITP). GlaxoSmithKline also announced positive Phase II data from the ongoing REPEAT trial (Repeat ExPosure to Eltrombopag in Adults with Idiopathic Thrombocytopenic Purpura). A decrease in bleeding was observed in patients with chronic ITP, generating similar platelet counts with each subsequent cycle.

GlaxoSmithKline submitted a New Drug Application, or NDA, for approval to market eltrombopag (PROMACTA™/REVOLADE™) on December 18, 2007. Two pivotal trials, one Phase III trial and one Phase II trial, were submitted to support the NDA submission. On March 3, 2008, the FDA accepted for filing and review GlaxoSmithKline's NDA and granted a priority review status for PROMACTA® (eltrombopag) for treatment of chronic short-term ITP. Priority review is granted by the FDA for a treatment that addresses significant unmet medical needs or has the potential to provide a significant improvement compared to marketed products, and results in a review period of six months from the date of NDA submission. On May 30, 2008, the FDA's Oncology Drugs Advisory Committee (ODAC) panel unanimously voted (16-0) that PROMACTA demonstrated a favorable risk-benefit profile for the short-term treatment of patients with chronic ITP. The FDA has extended the priority review period for GlaxoSmithKline's NDA for PROMACTA for the short-term treatment of chronic ITP. The Prescription Drug User Fee Act action date was extended to September 19, 2008 and FDA action is pending.

If approved, PROMACTA would be the first oral thrombopoietin receptor agonist therapy for the short-term treatment of previously treated patients with chronic ITP to increase platelet counts and reduce or prevent bleeding. Eltrombopag is currently in a Phase III trial for the long-term treatment of ITP, and expects MAA and NDA submissions for the long-term treatment of ITP in 2008. GlaxoSmithKline reported positive Phase II data in patients with thrombocytopenia associated with hepatitis C and initiated two Phase III trials in patients with hepatitis C in the fourth quarter of 2007. A Phase II study in patients with chemotherapy-induced thrombocytopenia has been completed, a Phase III study is ongoing in chronic liver disease and a Phase I study is ongoing in patients with sarcoma receiving the adriamycin and ifosfamide regimen.

If annual net sales of eltrombopag are less than \$100.0 million, we will earn a royalty of 5% on such net sales. If eltrombopag's annual net sales are between \$100.0 million and \$200.0 million, we will earn a royalty of 7% on the portion of net sales between \$100.0 million and \$200.0 million, and if annual net sales are between \$200.0 million and \$400.0 million, we will earn a royalty of 8% on the portion of net sales between \$200.0 million and \$400.0 million. If annual sales exceed \$400.0 million, we will earn a royalty of 10% on the portion of net sales exceeding \$400.0 million. Our right to receive all of the royalty payments from GlaxoSmithKline will be subject to the outcome of the ongoing lawsuit between us and Rockefeller University, or Rockefeller. On March 4, 2008, Rockefeller filed suit against us alleging, among other things, that Rockefeller is entitled to 25% of payments to be received by us in the future related to Promacta. We have filed an answer and counterclaims seeking, among other things, a judicial determination that we are not liable for any additional payments under our September 30, 1992 license agreement with Rockefeller beyond any payments that we have already made. Intellectual property license disputes are subject to inherent uncertainties and there can be no assurance this litigation will be resolved favorably to us or that it will not have a material adverse effect on us.

### Wyeth Collaboration – bazedoxifene and bazedoxifene in combination with PREMARIN

Bazedoxifene (Viviant) is a product candidate that resulted from our collaboration with Wyeth. Bazedoxifene is a synthetic drug that was specifically designed to reduce the risk of osteoporotic fractures while at the same time protecting breast and uterine tissue. In June 2006, Wyeth submitted an NDA for bazedoxifene to the FDA for the prevention of postmenopausal osteoporosis. The FDA issued an approvable letter for bazedoxifene for this indication in April 2007. Wyeth received a second approvable letter in December 2007 and plans to have further discussions with the FDA to discuss the issues raised for the prevention indication. Wyeth also submitted a second NDA for bazedoxifene in the U.S. in July 2007 for the treatment of osteoporosis and an MAA to EMEA in September 2007 for the prevention and treatment of osteoporosis. Wyeth received a third approvable letter in the second quarter for Viviant for the treatment of osteoporosis. In the letter, the FDA requested information similar to that outlined in its approvable letter for bazedoxifene's NDA for the prevention of postmenopausal osteoporosis issued in December 2007. This included further analyses concerning the incidence of stroke and venous thrombotic events. Wyeth expects that an FDA Advisory Committee meeting will be scheduled following submission of its complete response to the approvable letters with respect to the prevention and treatment indications, which Wyeth plans to file in the first half of 2009.

Wyeth is also developing bazedoxifene in combination with PREMARIN (Aprela) as a progesterone-free treatment for menopausal symptoms. Two Phase III studies with bazedoxifene/conjugated estrogens (Aprela), showed reduced number and severity of hot flashes in symptomatic postmenopausal women by up to 80 percent, when compared with placebo. Wyeth expects to file an initial NDA no later than the second half of 2009.

We previously sold to Royalty Pharma AG, or Royalty Pharma, the rights to a total of 3.0% of net sales of bazedoxifene for a period of ten years following the first commercial sale of each product. After giving effect to the royalty sale, we will receive 0.5% of the first \$400.0 million in net annual sales. If net annual sales are between \$400.0 million and \$1.0 billion, we will receive a net royalty of 1.5% on the portion of net sales between \$400.0 million and \$1.0 billion, and if annual sales exceed \$1.0 billion, we will receive a net royalty of 2.5% on the portion of net sales exceeding \$1.0 billion. Additionally, the royalty owed to Royalty Pharma may be reduced by one third if net product sales exceed certain thresholds across all indications.

#### Pfizer Collaboration – Lasofoxifene

Lasofloxifene is a product candidate that resulted from our collaboration with Pfizer. In August 2004, Pfizer submitted an NDA to the FDA for lasofloxifene for the prevention of osteoporosis in postmenopausal women. In September 2005, Pfizer announced the receipt of a non-approvable letter from the FDA for the prevention of osteoporosis. In December 2004, Pfizer filed a supplemental NDA for the use of lasofloxifene for the treatment of vaginal atrophy. In February 2006, Pfizer announced the receipt of a non-approvable letter from the FDA for vaginal atrophy. Pfizer has also announced that lasofloxifene is being developed for the treatment of osteoporosis. In April 2007, Pfizer announced completion of the Postmenopausal Evaluation and Risk Reduction with lasofloxifene (PEARL) Phase III study with favorable efficacy and safety. Pfizer submitted an NDA and an MAA for osteoporosis treatment in December 2007 and January 2008, respectively. The FDA Advisory Committee in early September 2008 voted 9-3 in favor of this drug approved and the final FDA decision is pending. In October 2008, the FDA extended the review period through January 2009.

Under the terms of our agreement with Pfizer, we are entitled to receive royalty payments equal to 6% of net sales of lasofloxifene worldwide for any indication. We previously sold to Royalty Pharma the rights to a total of 3% of net sales of lasofloxifene for a period of ten years following the first commercial sale of lasofloxifene. Accordingly, we will receive approximately 3% of worldwide net annual sales of lasofloxifene.

#### Abbott (formerly TAP) Collaboration – LGD-2941

LGD-2941, a selective androgen receptor modulator, or SARM, was selected as a clinical candidate during our collaboration with TAP. TAP assigned the current SARM agreement to Abbott in the second quarter of 2008 upon the closing of the transaction between Takeda and Abbott to separate portions of the TAP business between the two parties. SARMS, such as LGD-2941, may contribute to the treatment of diseases including hypogonadism (low testosterone), sexual dysfunction, osteoporosis, frailty and cancer cachexia. Phase I clinical trials were completed in the fourth quarter of 2007. The agreement further provides for milestones moving through the development stage and royalties ranging from 6.0% to 12.0% on annual net sales of drugs resulting from the collaboration.

### **Results of Operations**

Total revenues for the three and nine months ended September 30, 2008 were \$5.2 million and \$14.9 million, respectively, compared to \$5.5 million and \$7.1 million for the same 2007 periods. Operating loss from continuing operations for the three and nine months ended September 30, 2008 was \$6.4 million and \$23.9 million, respectively, compared to \$8.7 million and \$52.1 million for the same 2007 periods.

#### *AVINZA Royalty Revenue*

In connection with the sale of AVINZA, King is required to pay us a royalty on net sales of AVINZA (see Note 2 to the condensed consolidated financial statements). In accordance with the AVINZA Purchase Agreement, royalties are required to be paid to us quarterly and beginning in October 2008, King is required to make royalty payments based upon calendar year net sales of AVINZA. Such royalties are recognized in the quarter reported. Since there is a one quarter lag from when King recognizes AVINZA



net sales to when King reports those sales and the corresponding royalties to us, we recognized AVINZA royalty revenues beginning in the second quarter of 2007. Royalty revenues were \$5.2 million and \$14.9 million for the three and nine months ended September 30, 2008 and \$5.2 million and \$6.6 million for the three and nine months ended September 30, 2007, respectively.

#### *Collaborative Research and Development and Other Revenues*

We recorded no collaborative research and development and other revenues for the three and nine months ended September 30, 2008. We recorded collaborative research and development and other revenues of \$0.3 million and \$0.5 million, respectively, for the three and nine months ended September 30, 2007, which were related to milestones earned from Wyeth.

#### *Research and Development Expenses*

The major components of research and development expenses are as follows (in thousands):

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Internal research programs	\$ 4,463	\$ 4,642	\$12,315	\$16,908
Development	<u>1,702</u>	<u>5,196</u>	<u>7,392</u>	<u>17,283</u>
Total research and development	<u>\$ 6,165</u>	<u>\$ 9,838</u>	<u>\$19,707</u>	<u>\$34,191</u>

Research and development expenses for the nine months ended September 30, 2007 include one-time severance benefits and stock compensation charges of \$5.9 million incurred in connection with our restructuring (see Note 7 to the condensed consolidated financial statements) and one-time stock compensation charges of \$0.8 million incurred in connection with the equitable adjustment of stock options (see Note 1 to the condensed consolidated financial statements). Research and development expenses for the three months ended September 30, 2008 decreased when compared to the same 2007 period due to lower headcount related expenses in connection with our restructuring and reduced research costs associated with our thrombopoietin (TPO) agonists program. Excluding the impact of one-time severance benefits and stock compensation charges, the decrease in research and development expenses for the nine months ended September 30, 2008 compared to the same 2007 period reflects reduced costs primarily due to lower headcount related expenses in connection with our restructuring and reduced research costs associated with our thrombopoietin (TPO) agonists program. The decreases for the three and nine months 2008 when compared to the same 2007 period were partially offset by \$1.0 million of estimated litigation settlement costs for the three months ended September 30, 2008.

A summary of our significant internal research and development programs as of September 30, 2008 is as follows:

<u>Program</u>	<u>Disease/Indication</u>	<u>Development Phase</u>
LGD-4665 (Thrombopoietin oral mimetic)	Idiopathic Thrombocytopenia Purpura, myelodysplastic syndrome, Hepatitis C, other thrombocytopenias	Phase II
Selective androgen receptor modulators (agonists)	Hypogonadism, osteoporosis, sexual dysfunction, frailty, cachexia	Pre-clinical
Small molecule EPO receptor agonists	Chemotherapy-induced anemia, anemia due to kidney failure	Research
Selective glucocorticoid receptor modulators	Inflammation, cancer	Research
Selective androgen receptor modulators (antagonists)	Prostate cancer	Research

We do not provide forward-looking estimates of costs and time to complete our ongoing research and development projects, as such estimates would involve a high degree of uncertainty. Uncertainties include our inability to predict the outcome of complex research, our inability to predict the results of clinical studies, regulatory requirements placed upon us by regulatory authorities such as the FDA and EMEA, our inability to predict the decisions of our collaborative partners, our ability to fund research and development programs, competition from other entities of which we may become aware in future periods, predictions of market potential from products that may be derived from our research and development efforts, and our ability to recruit and retain personnel or third-party research organizations with the necessary knowledge and skills to perform certain research. Refer to "Item 1A. Risk Factors" for additional discussion of the uncertainties surrounding our research and development initiatives.

#### *General and Administrative Expenses*

General and administrative expenses were \$5.9 million and \$20.6 million for the three and nine months ended September 30, 2008 compared to \$4.9 million and \$26.5 million, respectively, for the same 2007 periods. General and administrative costs for the three months ended September 30, 2008 increased when compared to the same 2007 period primarily due to increased legal expenses of \$1.9 million associated with the litigation settlement with Salk partially offset by lower headcount related expenses of \$0.3 million and reduced occupancy costs of \$0.3 million in connection with our restructuring and subleasing of an office and research facility in the first quarter of 2008. General and administrative costs for the nine months ended September 30, 2008 were lower when compared to the same 2007 period primarily due to lower headcount related expenses of \$6.6 million (which included a one-time severance benefits \$3.9 million in connection with our restructuring, and stock compensation charges \$1.0 million incurred in connection with the equitable adjustment of stock options), reduced outside consulting and audit fees of \$2.6 million and reduced occupancy cost of \$2.2 million. These reductions were partially offset by a \$4.3 million charge for exit costs when we fully ceased use of one of our leased facilities in the first quarter of 2008 and increased legal expenses of \$1.4 million primarily related to the settlement of the litigation with Salk.

#### *Accretion of Deferred Gain on Sale Leaseback*

On November 9, 2006, we sold real property located in San Diego, California for a sale price of \$47.6 million. This property includes our corporate headquarter building totaling approximately 82,500 square feet, the land on which the building is situated, and two adjacent vacant lots. As part of the sale transaction, we agreed to leaseback the building for a period of 15 years. In accordance with SFAS 13, *Accounting for Leases*, we recognized an immediate pre-tax gain on the sale transaction of \$3.1 million and deferred a gain of \$29.5 million on the sale of the building. The deferred gain is recognized on a straight-line basis over the 15 year term of the lease at a rate of approximately \$2.0 million per year. The amount of the deferred gain recognized for each of the three and nine months ended September 30, 2008 and 2007 was \$0.5 million and \$1.5 million, respectively.

#### *Interest Income*

Interest income was \$0.4 million and \$1.9 million for the three and nine months ended September 30, 2008, respectively, compared to \$1.5 million and \$7.4 million for the same 2007 periods. The decrease for the three and nine months ended September 30, 2008 is due to lower cash and investment balances as a result of the \$252.7 million cash dividend paid on April 19, 2007, as well as lower interest rates.

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### *Income Taxes*

We recorded income tax expense related to continuing operations of \$3.0 million and \$0.2 million for the three and nine months ended September 30, 2008, respectively, compared to a benefit of \$2.4 million and \$15.8 million, respectively, for the same 2007 periods. The income tax expense for the three months ended September 30, 2008 was recorded to offset income tax benefits recorded during the first half of 2008 as the Company no longer believes it will no longer have income from discontinued operations for 2008. The income tax expense for the nine months ended September 30, 2008 relates to the filing of amended state tax returns from previous years. The 2007 income tax benefit captured the deemed use of losses from continuing operations used to offset the income tax expense from discontinued operations.

### *Discontinued Operations*

#### *Oncology Product Line*

On September 7, 2006, we and Eisai Inc., a Delaware corporation and Eisai Co., Ltd., a Japanese company (which we collectively refer to as Eisai), entered into a purchase agreement, or the Oncology Purchase Agreement, pursuant to which Eisai agreed to acquire all of our worldwide rights in and to our oncology products, including, among other things, all related inventory, equipment, records and intellectual property, and assume certain liabilities as set forth in the Oncology Purchase Agreement. The Oncology product line included our four marketed oncology drugs: ONTAK, Targretin capsules, Targretin gel and Panretin gel.

Prior to the Oncology sale, we recorded accruals for rebates, chargebacks, and other discounts related to Oncology products when product sales were recognized as revenue under the sell-through method. Upon the Oncology sale, we accrued for rebates, chargebacks, and other discounts related to Oncology products in the distribution channel which had not sold-through at the time of the Oncology sale and for which we retained the liability subsequent to the Oncology sale. Our accruals for Oncology rebates, chargebacks, and other discounts total \$0.5 million as of September 30, 2008 and are included in accrued liabilities in the condensed consolidated balance sheet.

Additionally, and pursuant to the terms of the Oncology Purchase Agreement, we retained the liability for returns of product from wholesalers that had been sold by us prior to the close of the transaction. Accordingly, as part of the accounting for the gain on the sale of the Oncology product line, we recorded a reserve for Oncology product returns. Under the sell-through revenue recognition method, we previously did not record a reserve for returns from wholesalers. Our reserve for Oncology returns is \$3.1 million as of September 30, 2008 and is included in accrued liabilities in the condensed consolidated balance sheet.

In the three and nine months ended September 30, 2008, we recognized a \$12.8 million and \$12.6 million pre-tax loss, respectively, due to the \$13.0 million litigation settlement with Salk in addition to subsequent changes in certain estimates and liabilities recorded as of the sale date.

#### *AVINZA Product Line*

On September 6, 2006, we and King Pharmaceuticals, Inc., or King, entered into a purchase agreement, or the AVINZA Purchase Agreement, pursuant to which King agreed to acquire all of our rights in and to AVINZA in the United States, its territories and Canada, including, among other things, all AVINZA inventory, records and related intellectual property, and assume certain liabilities as set forth in the AVINZA Purchase Agreement, which we collectively refer to as the Transaction.

Pursuant to the AVINZA Purchase Agreement, at the closing on February 26, 2007, which we refer to as the Closing Date, we received \$280.4 million in net cash proceeds, which is net of \$15.0 million that was funded into an escrow account to support any potential indemnification claims made by King following the closing of the Transaction.

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In connection with the sale, we agreed to indemnify King in certain cases for a period of 30 months after the closing of the Transaction, including any breach of certain of our representations, warranties or covenants contained in the Avinza Purchase Agreement. Under our agreement with King, \$15.0 million of the total upfront cash payment was deposited into an escrow account to secure our indemnification obligations to King following the closing. Of the escrowed amount, \$7.5 million was released to us in August 2007, and the remaining \$7.5 million, plus interest of \$0.6 million, was released to us in February 2008 and recorded as gain on sale of our AVINZA product line.

Prior to the AVINZA sale, we recorded accruals for rebates, chargebacks, and other discounts related to AVINZA products when product sales were recognized as revenue under the sell-through method. Upon the AVINZA sale, we accrued for rebates, chargebacks, and other discounts related to AVINZA products in the distribution channel which had not sold-through at the time of the AVINZA sale and for which we retained the liability subsequent to the sale. Our accruals for AVINZA rebates, chargebacks, and other discounts total \$0.2 million as of September 30, 2008 and are included in accrued liabilities in the condensed consolidated balance sheet.

Additionally, and pursuant to the terms of the AVINZA Purchase Agreement, we retained the liability for returns of product from wholesalers that had been sold by us prior to the close of the Transaction. Accordingly, as part of the accounting for the gain on the sale of AVINZA, we recorded a reserve for AVINZA product returns. Under the sell-through revenue recognition method, we previously did not record a reserve for returns from wholesalers. Our reserve for AVINZA returns is \$11.5 million as of September 30, 2008 and is included in accrued liabilities in the condensed consolidated balance sheet.

In the three and nine months ended September 30, 2008, we recognized a \$0.1 million pre-tax and \$7.3 million pre-tax gain, respectively, due to subsequent changes in certain estimates and liabilities recorded as of the sale date as well as the release of \$8.1 million, including interest, of escrow funds.

#### *Income Taxes*

For the three and nine months ended September 30, 2008 we recorded an income tax benefit from discontinued operations of \$3.7 million and \$0.5 million, respectively. For the three months ended September 30, 2007 we recorded an income tax benefit from discontinued operations of \$1.4 million and an income tax expense of \$25.8 million for the nine months ended September 30, 2007. For the three and nine months ended September 30, 2008, we reversed tax expense recognized during the first six months of 2008 in accordance with SFAS No. 109, *Accounting for Income Taxes* as we no longer believe we will have income from discontinued operations for 2008. The income tax benefit of \$0.5 million for the nine months ended September 30, 2008 results primarily from the tax benefit derived from state income taxes expensed originally in 2007 and adjusted to agree to the corresponding state tax returns filed in the third quarter of 2008. The tax benefit for the three months ended September 30, 2007 primarily results from losses generated by changes in estimates of certain assets and liabilities recorded as of the sale date of our AVINZA and Oncology product lines. The tax expense for the nine months ended September 30, 2007 reflects the net tax due on taxable income that was generated by the gain on sale of our AVINZA and product line, changes in estimates of certain assets and liabilities recorded as of the sale date of our AVINZA and Oncology product lines, and the release of escrow funds from the sale of our AVINZA and Oncology product lines.

#### **Liquidity and Capital Resources**

We have financed our operations through private and public offerings of our equity securities, collaborative research and development and other revenues, issuance of convertible notes, product sales and the subsequent sales of our commercial assets, capital and operating lease transactions, accounts receivable factoring and equipment financing arrangements and investment income. In March 2007, we announced that our board of directors had authorized a stock repurchase program under Rule 10b-18 of the Securities Exchange Act of 1934, as amended, of up to \$100 million of shares of our common stock in the open market and negotiated purchases over a period of 12 months. During the nine months ended September 30, 2008, we repurchased a total of 0.3 million shares of our common stock totaling \$1.6 million. We have repurchased an aggregate of 6.5 million shares of our common stock totaling \$41.2 million prior to the close of the repurchase period on March 31, 2008.

Working capital was \$34.3 million at September 30, 2008 compared to \$59.0 million at December 31, 2007. Cash, cash equivalents, short-term investments and restricted investments totaled \$72.5 million as of September 30, 2008 compared to \$95.8 million as of December 31, 2007. We primarily invest our cash in United States government and investment grade corporate debt securities. Restricted investments as of September 30, 2008 consist of certificates of deposit held with a financial institution as collateral under equipment financing and third-party service provider arrangements.

On July 19, 2007, we purchased \$5.0 million of commercial paper issued by Golden Key Ltd. While the investment was highly-rated and within our investment policy at the time of purchase, during the third quarter of 2007, large credit rating agencies downgraded the quality of this security. In addition, as a result of not meeting certain liquidity covenants, the assets were assigned to a trustee who established a committee of the largest senior credit holders to determine the next steps. Subsequently, Golden Key defaulted on its obligation to settle the security on the stated maturity date of October 10, 2007. Based on available information, we estimate that we will be able to recover approximately \$2.3 million on this security. Accordingly, we adjusted the carrying value by recording an impairment loss of \$0.1 million and \$1.4 million during the three and nine months ended September 30, 2008, respectively. As a result of ongoing volatility in the liquidity of the capital markets, we may be exposed to additional impairment for this investment until it is fully recovered or disposed of.

Based on our revised business model, we believe our currently available cash, cash equivalents, and short-term investments as well as our current and future royalty revenues will be sufficient to satisfy our anticipated operating and capital requirements through at least the next twelve months. Our future operating and capital requirements will depend on many factors, including, but not limited to: the pace of scientific progress in our research and development programs; the magnitude of these programs; the scope and results of preclinical testing and clinical trials; the time and costs involved in obtaining regulatory approvals; the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims; competing technological and market developments; the amount of royalties on sales of AVINZA we receive from King; and the efforts of our collaborative partners. We will also consider additional equipment financing arrangements similar to arrangements currently in place.

#### *Operating Activities*

Operating activities used cash of \$26.8 million for the nine months ended September 30, 2008 compared to \$88.9 million for the same 2007 period. The use of cash for the nine months ended September 30, 2008 reflects a net loss of \$28.5 million adjusted for the \$7.3 million gain on the sale of our AVINZA and \$12.6 million loss on the sale of the Oncology product lines and the accretion of deferred gain on the sale leaseback of the building of \$1.5 million, offset by the recognition of contract termination costs of \$5.0 million, stock-based compensation expense of \$2.8 million, a \$0.8 million loss on write-off of fixed assets, \$1.4 million realized loss on investment and depreciation and amortization of assets of \$0.8 million. The use of cash for the nine months ended September 30, 2008 is further impacted by changes in operating assets and liabilities due primarily to decreases in accounts payable and accrued liabilities of \$13.2 million and other liabilities of \$0.6 million partially offset by a decrease in other current assets of \$1.0 million. The decrease in accounts payable and accrued liabilities is primarily due to the payment of severance related to the December 2007 reduction in workforce partially offset by \$1.0 million of estimated litigation settlement costs for the three months ended September 30, 2008.

The use of cash for the nine months ended September 30, 2007 reflects net income of \$275.8 million, adjusted by \$317.5 million in items to reconcile net income to net cash used in operations. These reconciling items primarily reflect the gain on the sale of our AVINZA product line of \$317.3 million, the adjustment to gain on the sale of our Oncology product line of \$7.7 million and the accretion of deferred gain on sale leaseback of building of \$1.5 million, and co-promote termination expense of \$1.4 million partially offset by the recognition of \$7.0 million of stock-based compensation expense, depreciation and amortization of assets of \$2.3 million and the write-off of assets of \$0.8 million.

Cash used in operating activities in 2008 includes \$5.3 million, net provided by discontinued operations. This compares to net cash used in discontinued operations of \$27.2 million for the same 2007 period.

#### *Investing Activities*

Investing activities used cash of \$35.4 million for the nine months ended September 30, 2008 compared to \$323.0 million of cash provided by investing activities for the same 2007 period.

Cash used for the nine months ended September 30, 2008 primarily reflects the net purchases of short term investments of \$43.1 million partially offset by the release from escrow of proceeds from the sale of our AVINZA product line in the amount of \$8.1 million.

Cash provided for the nine months ended September 30, 2007 primarily reflects proceeds from the sale of our AVINZA product line of \$289.4 million, the release of \$10.0 million of proceeds held in escrow from the sale of the Oncology product line, the decrease of restricted cash of \$39.2 million which was held in escrow as of December 31, 2006 and released in January 2007 to repay our loan with King, and net proceeds from sales of short-term investments of \$15.6 million.

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Cash provided by investing activities for the nine months ended September 30, 2008 includes \$8.1 million provided by discontinued operations from the release from escrow of proceeds from the sale of the AVINZA product line. Cash provided by investing activities for the same 2007 period includes \$299.4 million provided by discontinued operations from the sale of the AVINZA product line and release of the escrow from the sale of our Oncology product line.

#### *Financing Activities*

Financing activities used cash of \$2.8 million for the nine months ended September 30, 2008 compared to \$323.1 million for the same 2007 period.

Cash used for the nine months ended September 30, 2008 primarily reflects repurchases of our common stock of \$1.6 million and payments under equipment financing obligations of \$1.3 million. Cash used for the nine months ended September 30, 2007, primarily reflects the \$252.7 million cash dividend payment, \$35.5 million in repurchases of 5.4 million shares our common stock, the repayment of debt of \$37.8 million and payments under equipment financing obligations of \$1.6 million. These amounts are partially offset by \$4.3 million of proceeds from the issuance of common stock primarily related to the exercise of employee stock options.

On March 22, 2007, we announced a \$2.50 per share special cash dividend. The aggregate amount of \$252.7 million was paid on April 19, 2007 to shareholders of record as of April 5, 2007.

None of the cash used in financing activities for the nine months ended September 30, 2008 and 2007 relates to discontinued operations.

Certain of our property and equipment is pledged as collateral under various equipment financing arrangements. As of September 30, 2008, \$0.9 million was outstanding under such arrangements with \$0.7 million classified as current. Our equipment financing arrangements have terms of four years with interest ranging from 8.04% to 10.11%.

#### *Leases and Off-Balance Sheet Arrangements*

We lease our office and research facilities under operating lease arrangements with varying terms through November 2021. The agreements provide for increases in annual rents based on changes in the Consumer Price Index or fixed percentage increases ranging from 3% to 7%. Commencing January 2008, we also subleased a portion of our facilities through July 2015. The sublease agreement provides for a 3% increase in annual rents.

### Contractual Obligations

As of September 30, 2008, future minimum payments due under our contractual obligations are as follows (in thousands):

	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
Capital lease obligations <sup>(1)</sup>	\$ 941	\$ 762	\$ 179	\$ —	\$ —
Operating lease obligations <sup>(2)</sup>	63,536	5,039	10,536	11,178	36,783
Consulting agreements	380	380	—	—	—
Co-promote termination liability <sup>(3)</sup>	—	—	—	—	—
<b>Total contractual obligations</b>	<b>\$64,857</b>	<b>\$ 6,181</b>	<b>\$10,715</b>	<b>\$11,178</b>	<b>\$ 36,783</b>

<sup>(1)</sup> Includes interest payments as follows:

\$ 53	\$ 46	\$ 7	\$ —	\$ —
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<sup>(2)</sup> We lease an office and research facility under an operating lease arrangement through July 2015. Commencing January 2008, we sublet this facility through July 2015. The sublease agreement provides for a 3% increase in annual rents. As of September 30, 2008, we expect to receive aggregate future minimum lease payments totaling \$5.9 million (nondiscounted) over the duration of the sublease agreement as follows: less than one year, \$0.8 million; one to three years, \$1.7 million; three to five years, \$1.8 million; and after five years, \$1.6 million.

<sup>(3)</sup> Our co-promote termination obligation to Organon was assumed by King pursuant to the AVINZA Purchase Agreement. However, as Organon did not consent to the legal assignment of the obligation to King, we remain liable to Organon in the event of King's default of the obligation. We have excluded payments under the co-promote termination liability from the table as amounts are expected to be reimbursed by King. As of September 30, 2008, the total estimated amount of the obligation is \$107.5 million on an undiscounted basis.

As of September 30, 2008, we have net open purchase orders (defined as total open purchase orders at year end less any accruals or invoices charged to or amounts paid against such purchase orders) totaling approximately \$5.9 million. We plan to spend approximately \$0.1 million on capital expenditures during the remainder of 2008.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

At September 30, 2008, our investment portfolio included fixed-income securities of \$60.7 million. These securities are subject to interest rate risk and will decline in value if interest rates increase. However, due to the short duration of our investment portfolio, an immediate 10% change in interest rates is not expected to have a material impact on our financial condition, results of operations or cash flows. At September 30, 2008, we also have certain equipment financing arrangements with variable rates of interest. Due to the relative insignificance of such arrangements, however, an immediate 10% change in interest rates would have no material impact on our financial condition, results of operations, or cash flows. Declines in interest rates over time will, however, reduce our interest income, while increases in interest rates over time will increase our interest expense.

We do not have a significant level of transactions denominated in currencies other than U.S. dollars and as a result we have limited foreign currency exchange rate risk. The effect of an immediate 10% change in foreign exchange rates would have no material impact on our financial condition, results of operations or cash flows.



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**ITEM 4. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation 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, or the Exchange Act, as of the end of the period covered by this report, which we refer to as the Evaluation Date. Based on this evaluation, our principal executive officer and principal financial officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that the information relating to us, including our consolidated subsidiaries, required to be disclosed in our SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our most recently completed fiscal quarter. Based on that evaluation, our principal executive officer and principal financial officer concluded that there has not been any change in our internal control over financial reporting during that quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The SEC issued a formal order of private investigation dated September 7, 2005, to investigate the circumstances surrounding restatement of our consolidated financial statements for the years ended December 31, 2002 and 2003, and for the first three quarters of 2004. The SEC's investigation is ongoing and we are cooperating with the investigation.

We and Seragen, Inc., our subsidiary, were named parties to *Sergio M. Oliver, et al. v. Boston University, et al.*, a shareholder class action filed on December 17, 1998 in the Court of Chancery in the State of Delaware. We and Seragen were dismissed from the action, but such dismissal is subject to appeal and we and Seragen may have possible indemnification obligations with respect to certain defendants. On April 14, 2006, the court found for the plaintiffs on certain claims and awarded damages of approximately \$4.8 million plus interest. Judgment, however, has not been entered and the matter is subject to appeal. As of September 30, 2008, we have not accrued an indemnification obligation based on our assessment that our responsibility for any such obligation is not probable or estimable.

Salk filed a demand for arbitration in July 2007 with the American Arbitration Association, seeking damages for alleged breach of contract based on Salk's theory that it is entitled to a portion of the money paid by Eisai to us for Targretin related assets. In September 2008, we reached a settlement with Salk, whereby the parties resolved all disputes that had arisen between them, including Salk's primary claim in arbitration relating to the sale of Targretin to Eisai in 2006. As part of the settlement, the parties executed mutual releases and agreed to jointly seek dismissal with prejudice of all claims and counterclaims asserted in the arbitration. We agreed to pay Salk \$9.5 million immediately upon settlement and \$3.5 million six months from the date of settlement in return for which Salk acknowledged that no additional payments would be due from us or any sublicensee for any past, present or future conduct, including development of any compound in our internal or partnered pipeline, except for any future bazedoxifene related payments. Pursuant to the parties' agreement, the American Arbitration Association dismissed the proceeding.

On March 4, 2008, Rockefeller filed suit, now proceeding in the United States District Court for the Southern District of New York, against us alleging, among other things, a breach by us of our September 30, 1992 license agreement with Rockefeller, as well as other causes of action for unjust enrichment, quantum meruit, specific performance to perform an audit and declaratory relief. The complaint seeks damages of at least \$1.9 million, plus alleges that Rockefeller is entitled to 25% of payments to be received by us in the future related to Promacta and SB-559448 or from any third party in connection with certain products (which products, according to the complaint, include LGD-4665), and 5% of future net sales of certain of our other products. The complaint requests a trial by jury, and also seeks to impose a constructive trust upon payments previously received by us to which Rockefeller claims it is owed a portion. We have filed an answer and counterclaims seeking, among other things, a judicial determination that (i) eltrombopag and the backup compound SB-559448 (including the use of such compounds) do not embody any invention(s) described or claimed in certain licensed patent rights under the September 30, 1992 license agreement between us and Rockefeller, (ii) Rockefeller technical information was not essential to the discovery or development of eltrombopag and the backup compound SB-559448, (iii) we are not liable for any additional payments under our September 30, 1992 license agreement with Rockefeller beyond any payments that we have already made, and (iv) the September 30, 1992 license agreement between us and Rockefeller was terminated in November 2007, and that subsequent to the termination of such agreement, we are not liable for future payments under such agreement. Discovery is scheduled to be completed in the second quarter of 2009, but delays are possible and we are unable to guarantee when a final decision will be rendered. Intellectual property license disputes are subject to inherent uncertainties and there can be no assurance this litigation will be resolved favorably to us or that it will not have a material adverse effect on us.

On October 10, 2008, we received notice that a putative class action complaint was filed in the Superior Court of New Jersey, Mercer County (Equity Division) by Allen Heilman, one of Phamacopeia's stockholders, against Phamacopeia, the members of its Board of Directors, us and two of our wholly owned subsidiaries. The complaint generally alleges that Phamacopeia's Board of Directors' decision to enter into the proposed transaction with us on the terms contained in the proposed merger agreement constitutes a breach of fiduciary duty and gives rise to other unspecified state law claims. The complaint also alleges that we and two of our wholly owned subsidiaries aided and abetted Phamacopeia's Board of Directors' breach of fiduciary duty. In addition, the complaint alleges that the named plaintiff will seek "equitable relief," including among other things, an order preliminarily and permanently enjoining the proposed transaction.

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Based on management's assessment of available information, we have recorded a liability for estimated litigation settlement costs in the amount of \$1.0 million, which is included in research and development costs for the three and nine months ended September 30, 2008.

In addition, from time to time we are subject to various lawsuits and claims with respect to matters arising out of the normal course of our business. Due to the uncertainty of the ultimate outcome of these matters, the impact on future financial results is not subject to reasonable estimates.

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## ITEM 1A. RISK FACTORS

*The following is a summary description of some of the many risks we face in our business including any risk factors as to which there may have been a material change from those set forth in our Annual Report on Form 10-K for the year ended December 31, 2007. You should carefully review these risks in evaluating our business, including the businesses of our subsidiaries. You should also consider the other information described in this report.*

### ***Risks Related To Us and Our Business.***

***We rely heavily on collaborative relationships, and any disputes or litigation with our collaborative partners or termination or breach of any of the related agreements could reduce the financial resources available to us, including milestone payments and future royalty revenues.***

Our strategy for developing and commercializing many of our potential products, including products aimed at larger markets, includes entering into collaborations with corporate partners and others. These collaborations have provided us with funding and research and development resources for potential products for the treatment of a variety of diseases. These agreements also give our collaborative partners significant discretion when deciding whether or not to pursue any development program. Our existing collaborations may not continue or be successful, and we may be unable to enter into future collaborative arrangements to develop and commercialize our product candidates.

In addition, our collaborators may develop drugs, either alone or with others that compete with the types of drugs they are developing with us. This would result in increased competition for our programs. If products are approved for marketing under our collaborative programs, revenues we receive will depend on the manufacturing, marketing and sales efforts of our collaborative partners, who generally retain commercialization rights under the collaborative agreements. Generally, our current collaborative partners also have the right to terminate their collaborations under specified circumstances. If any of our collaborative partners breach or terminate their agreements with us or otherwise fail to conduct their collaborative activities successfully, our product development under these agreements will be delayed or terminated. Disputes or litigation may also arise with our collaborators, including disputes or litigation over ownership rights to intellectual property, know-how or technologies developed with our collaborators. Such disputes or litigation could adversely affect our rights to one or more of our product candidates, including our LGD-4665 and other small-molecule TPO mimetic compounds. Any such dispute or litigation could delay, interrupt or terminate the collaborative research, development and commercialization of certain potential products, create uncertainty as to ownership rights of intellectual property, or could result in litigation or arbitration. The occurrence of any of these problems could be time-consuming and expensive and could adversely affect our business.

### ***Our product candidates face significant regulatory hurdles prior to marketing which could delay or prevent sales.***

Before we obtain the approvals necessary to sell any of our potential products, we must show through preclinical studies and human testing that each product is safe and effective. We and our partners have a number of products moving toward or currently awaiting regulatory action, including eltrombopag, bazedoxifene and lasofoxifene. Failure to show any product's safety and effectiveness could delay or prevent regulatory approval of a product and could adversely affect our business. The clinical trials process is complex and uncertain. For example, the results of preclinical studies and initial clinical trials may not necessarily predict the results from later large-scale clinical trials. In addition, clinical trials may not demonstrate a product's safety and effectiveness to the satisfaction of the regulatory authorities. Recently, a number of companies have suffered significant setbacks in advanced clinical trials or in seeking regulatory approvals, despite promising results in earlier trials. The FDA may also require additional clinical trials after regulatory approvals are received. Such additional trials may be expensive and time-consuming, and failure to successfully conduct those trials could jeopardize continued commercialization of a product.

The rate at which we complete our clinical trials depends on many factors, including, but not limited to, our ability to obtain adequate supplies of the products to be tested and patient enrollment. Patient enrollment is a function of many factors, including the size of the patient population, the proximity of patients to clinical sites and the eligibility criteria for the trial. Delays in patient enrollment for our trials may result in increased costs and longer development times. In addition, our collaborative partners have rights to control product development and clinical programs for products developed under the collaborations. As a result, these collaborative partners may conduct these programs more slowly or in a different manner than expected. Moreover, even if clinical trials are completed, we or our collaborative partners still may not apply for FDA approval in a timely manner or the FDA still may not grant approval.

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***Third party intellectual property may prevent us or our partners from developing our potential products and we may owe a portion of any payments we receive from our collaborative partners to one or more third parties.***

Our success will depend on our ability and the ability of our collaborative partners to avoid infringing the proprietary rights of others, both in the United States and in foreign countries. In addition, disputes with licensors under our license agreements may arise which could result in additional financial liability or loss of important technology and potential products and related revenue, if any. Further, the manufacture, use or sale of our potential products or our collaborative partners' products or potential products may infringe the patent rights of others. This could impact AVINZA, eltrombopag, bazedoxifene, lasofoxifene, LGD-4665 and any other products or potential products.

Several drug companies and research and academic institutions have developed technologies, filed patent applications or received patents for technologies that may be related to our business. Others have filed patent applications and received patents that conflict with patents or patent applications we have licensed for our use, either by claiming the same methods or compounds or by claiming methods or compounds that could dominate those licensed to us. In addition, we may not be aware of all patents or patent applications that may impact our ability to make, use or sell any of our potential products. For example, US patent applications may be kept confidential while pending in the United States Patent and Trademark Office and patent applications filed in foreign countries are often first published six months or more after filing.

In July 2007, the Salk Institute for Biological Studies, or Salk, filed a demand for arbitration with the American Arbitration Association, seeking damages for alleged breach of contract based on Salk's theory that it was entitled to a portion of the money paid by, the purchaser of our oncology product line, to us for Targretin-related assets. In September 2008, we reached a settlement with Salk, whereby the parties resolved all disputes that had arisen between them, including Salk's primary claim in arbitration relating to the sale of Targretin to Eisai in 2006. As part of the settlement, the parties executed mutual releases and agreed to jointly seek dismissal with prejudice of all claims and counterclaims asserted in the arbitration. We agreed to pay Salk \$9.5 million immediately upon settlement and \$3.5 million six months from the date of settlement in return for which Salk acknowledged that no additional payments would be due from us or any sublicensee for any past, present or future conduct, including development of any compound in our internal or partnered pipeline, except for any future bazedoxifene related payments. Pursuant to the parties' agreement, the American Arbitration Association dismissed the proceeding.

On March 4, 2008, Rockefeller University, or Rockefeller, filed suit, now proceeding in the United States District Court for the Southern District of New York, against us alleging, among other things, a breach by us of our September 30, 1992 license agreement with Rockefeller, as well as other causes of action for unjust enrichment, quantum meruit, specific performance to perform an audit and declaratory relief. The complaint seeks damages of at least \$1.9 million, plus alleges that Rockefeller is entitled to 25% of payments to be received by us in the future related to Promacta and SB-559448 or from any third party in connection with certain products (which products, according to the complaint, include LGD-4665), and 5% of future net sales of certain of our other products. The complaint requests a trial by jury, and also seeks to impose a constructive trust upon payments previously received by us to which Rockefeller claims it is owed a portion. We have filed an answer and counterclaims seeking, among other things, a judicial determination that (i) eltrombopag and the backup compound SB-559448 (including the use of such compounds) do not embody any invention(s) described or claimed in certain licensed patent rights under the September 30, 1992 license agreement between us and Rockefeller, (ii) Rockefeller technical information was not essential to the discovery or development of eltrombopag and the backup compound SB-559448, (iii) we are not liable for any additional payments under our September 30, 1992 license agreement with Rockefeller beyond any payments that we have already made, and (iv) the September 30, 1992 license agreement between us and Rockefeller was terminated in November 2007, and that subsequent to the termination of such agreement, we are not liable for future payments under such agreement. Discovery is scheduled to be completed in the second quarter of 2009, but delays are possible and we are unable to guarantee when a final decision will be rendered. Intellectual property license disputes are subject to inherent uncertainties and there can be no assurance this litigation will be resolved favorably to us or that it will not have a material adverse effect on us.

Further, these and other possible disagreements or litigation with our collaborative partners could delay our ability and the ability of our collaborative partners to achieve milestones or our receipt of other payments. In addition, these and any other possible disagreements or litigation could delay, interrupt or terminate the research, development and commercialization of certain potential products being developed by either our collaborative partners or by us. Moreover, if we are unable to resolve the current dispute with Rockefeller or any other possible disagreements with licensors or collaborative partners, protracted litigation or arbitration could result. The occurrence of any of the foregoing problems could be time-consuming and expensive and could adversely affect our business.

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As noted above, Rockefeller has filed a lawsuit against us claiming, among other things, that it is owed and will be owed certain payments under our agreement with them. Other third parties have not directly threatened an action or claim against us, although we do periodically receive other communications or have other conversations with the owners of other patents or other intellectual property. If others obtain patents with conflicting claims, we may be required to obtain licenses to those patents or to develop or obtain alternative technology. We may not be able to obtain any such licenses on acceptable terms, or at all. Any failure to obtain such licenses could delay or prevent us from pursuing the development or commercialization of our potential products.

In general, litigation claims can be expensive and time consuming to bring or defend against and could result in settlements or damages that could significantly impact our results of operations and financial condition. We cannot predict or determine the outcome of these matters or reasonably estimate the amount or range of amounts of any fines or penalties that might result from a settlement or an adverse outcome. However, a settlement or an adverse outcome could have a material adverse effect on our financial position, liquidity and results of operations.

***We are substantially dependent on AVINZA royalties for our revenues.***

King is obligated to pay us royalties in the future based on sales of AVINZA by King. Specifically, beginning in October 2008, King is required to make royalty payments based upon calendar year net sales of AVINZA. If calendar year net sales are less than \$200.0 million, the royalty payment will be 5% of all net sales. If calendar year net sales are greater than \$200.0 million, the royalty payment will be 10% of all net sales less than \$250.0 million, plus 15% of net sales greater than \$250.0 million. In addition, beginning in 2009, we will no longer be entitled to receive royalties on a quarterly basis, but will collect royalties on an annual basis, which may adversely impact our cash flows. These royalties represent and will for some time represent substantially all of our ongoing revenue. Although we may also receive royalties and milestones from our partners in various past and future collaborations, the amount of revenue from these royalties and milestones is unknown and highly uncertain.

As a result, any setback that may occur with respect to AVINZA could significantly impair our operating results and/or reduce the market price for our stock. Setbacks could include problems with shipping, distribution, manufacturing, product safety, marketing, government licenses and approvals, intellectual property rights, competition with existing or new products and physician or patient acceptance of the products, as well as higher than expected total rebates, returns or discounts.

On September 10, 2007, King reported that Actavis, a manufacturer of generic pharmaceutical products headquartered in Iceland, had filed with the FDA an Abbreviated New Drug Application, or ANDA, with a Paragraph IV Certification pertaining to AVINZA, the rights to which were acquired by King from us in February 2007. According to the report, Actavis's Paragraph IV Certification sets forth allegations that U.S. Patent No. 6,066,339, or the 339 patent, which pertains to AVINZA, and which is listed in the FDA's Approved Drug Products With Therapeutic Equivalence Evaluations, will not be infringed by Actavis's manufacture, use, or sale of the product for which the ANDA was submitted. The expiration date for this patent is November 2017. King, King Pharmaceuticals Research and Development, Inc., Elan Corporation, plc and Elan Pharma International Ltd. jointly filed suit in federal district court in New Jersey on October 18, 2007 against Actavis, Inc. and Actavis Elizabeth LLC for patent infringement under the 339 patent. The lawsuit seeks a judgment that would, among other things, prevent Actavis from commercializing its proposed morphine product until after expiration of the 339 patent.

AVINZA was licensed from Elan Corporation which is its sole manufacturer. Any problems with Elan's manufacturing operations or capacity could reduce sales of AVINZA, as could any licensing or other contract disputes with Elan, raw materials suppliers, or others. Similarly, King's AVINZA sales efforts could be affected by a number of factors and decisions regarding its organization, operations, and activities as well as events both related and unrelated to AVINZA, including sales force reorganizations and lower than expected sales call and prescription volumes. AVINZA could also face stiffer competition from existing or future pain products. The negative impact on the AVINZA's sales growth in turn may negatively affect our royalties, revenues and earnings.

AVINZA sales may also be negatively impacted by higher than expected discounts (especially pharmacy benefit management/group purchasing organization rebates and Medicaid rebates, which can be substantial), returns and chargebacks and/or slower than expected market penetration. Other setbacks that AVINZA could face in the sustained-release opioid market include product safety and abuse issues, regulatory action, and the inability to obtain sufficient quotas of morphine from the Drug Enforcement Agency to support production requirements.

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With respect to regulatory action and product safety issues, the FDA previously requested expanded warnings on the AVINZA label to alert doctors and patients to the dangers of using AVINZA with alcohol. Changes were made to the label. The FDA also requested clinical studies to investigate the risks associated with taking AVINZA with alcohol. Any additional warnings, studies and any further regulatory action could have significant adverse effects on AVINZA sales.

***We may not be able to hire and/or retain key employees.***

If we are unable to hire and/or retain key employees, we may not have sufficient resources to successfully manage our assets or our business, and we may not be able to perform our obligations under various contracts and commitments. Either of these could have substantial negative impacts on our business and our stock price.

***Our stock price has been volatile and could experience a sudden decline in value.***

Our common stock has experienced significant price and volume fluctuations and may continue to experience volatility in the future. As a result, you may not be able to sell your shares quickly or at the latest market price if trading in our stock is not active or the volume is low. Many factors may have a significant impact on the market price of our common stock, including, but not limited to, the following factors: results of or delays in our preclinical studies and clinical trials; the success of our collaboration agreements; publicity regarding actual or potential medical results relating to products under development by us or others; announcements of technological innovations or new commercial products by us or others; developments in patent or other proprietary rights by us or others; comments or opinions by securities analysts or major stockholders; future sales of our common stock by existing stockholders; regulatory developments or changes in regulatory guidance; litigation or threats of litigation; economic and other external factors or other disaster or crises; the departure of any of our officers, directors or key employees; period-to-period fluctuations in financial results; and limited daily trading volume.

The Financial Industry Regulatory Authority, or FINRA, (formerly the National Association of Securities Dealers, Inc.) and the Securities and Exchange Commission, or SEC, have adopted certain new rules. If we were unable to continue to comply with the new rules, we could be delisted from trading on the NASDAQ Global Market, or Nasdaq, and thereafter trading in our common stock, if any, would be conducted through the over-the-counter market or on the Electronic Bulletin Board of FINRA. As a consequence of such delisting, an investor would likely find it more difficult to dispose of, or to obtain quotations as to the price of, our common stock. Delisting of our common stock could also result in lower prices per share of our common stock than would otherwise prevail.

***Our product development involves a number of uncertainties, and we may never generate sufficient collaborative payments and royalties from the development of products to become profitable.***

We were founded in 1987. We have incurred significant losses since our inception. As of September 30, 2008, our accumulated deficit was \$610.0 million.

Most of our products in development will require extensive additional development, including preclinical testing and human studies, as well as regulatory approvals, before they can be marketed. We cannot predict if or when any of the products we are developing or those being developed with our partners will be approved for marketing. There are many reasons why we or our collaborative partners may fail in our efforts to develop our potential products, including the possibility that: preclinical testing or human studies may show that our potential products are ineffective or cause harmful side effects; the products may fail to receive necessary regulatory approvals from the FDA or foreign authorities in a timely manner, or at all; the products, if approved, may not be produced in commercial quantities or at reasonable costs; the products, if approved, may not achieve commercial acceptance; regulatory or governmental authorities may apply restrictions to our products, which could adversely affect their commercial success; or the proprietary rights of other parties may prevent us or our partners from marketing the products.

Any product development failures for these or other reasons, whether with our products or our partners' products, may reduce our expected revenues, profits, and stock price.

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***The past restatement of our consolidated financial statements increased the possibility of legal or administrative proceedings. Any future material weaknesses or deficiencies in our internal control over financial reporting could harm stockholder and business confidence on our financial reporting, our ability to obtain financing and other aspects of our business.***

We determined that our consolidated financial statements for the years ended December 31, 2002 and 2003, and for the first three quarters of 2004, as described in more detail in our 2004 Annual Report on Form 10-K, should be restated. As a result of these events, we have become subject to a number of additional risks and uncertainties. We expect to continue to incur unanticipated accounting and legal costs as noted below. In addition, the SEC has instituted a formal investigation into our restated consolidated financial statements identified above. This investigation will likely continue to divert more of our management's time and attention and cause us to continue to incur substantial costs. Such investigations can also lead to fines or injunctions or orders with respect to future activities, as well as further substantial costs and diversion of management time and attention.

While no material weaknesses were identified as of December 31, 2007, we cannot assure you that material weaknesses will not be identified in future periods. The existence of one or more material weakness or significant deficiency could result in errors in our consolidated financial statements. Substantial costs and resources may be required to rectify any internal control deficiencies. If we fail to achieve and maintain the adequacy of our internal controls in accordance with applicable standards, we may be unable to conclude on an ongoing basis that we have effective internal controls over financial reporting. If we cannot produce reliable financial reports, our business and financial condition could be harmed, investors could lose confidence in our reported financial information, or the market price of our stock could decline significantly. In addition, our ability to obtain additional financing to operate and expand our business, or obtain additional financing on favorable terms, could be materially and adversely affected, which, in turn, could materially and adversely affect our business, our financial condition and the market value of our securities. Moreover, our reputation with customers, lenders, investors, securities analysts and others may be adversely affected.

***Challenges to or failure to secure patents and other proprietary rights may significantly hurt our business.***

Our success will depend on our ability and the ability of our licensors to obtain and maintain patents and proprietary rights for our potential products both in the United States and in foreign countries. Patents may not be issued from any of these applications currently on file, or, if issued, may not provide sufficient protection. Our patent position, like that of many biotechnology and pharmaceutical companies, is uncertain and involves complex legal and technical questions for which important legal principles are unresolved. We may not develop or obtain rights to products or processes that are patentable. Even if we do obtain patents, such patents may not adequately protect the technology we own or have licensed. In addition, others may challenge, seek to invalidate, infringe or circumvent any patents we own or license and rights we receive under those patents may not provide competitive advantages to us.

Any conflicts resulting from the patent rights of others could significantly reduce the coverage of our patents and limit our ability to obtain meaningful patent protection. We have had and will continue to have discussions with our current and potential collaborative partners regarding the scope and validity of our patents and other proprietary rights. If a collaborative partner or other party successfully establishes that our patent rights are invalid, we may not be able to continue our existing collaborations beyond their expiration. Any determination that our patent rights are invalid also could encourage our collaborative partners to seek early termination of our agreements. Such invalidation could adversely affect our ability to enter into new collaborations.

We may also need to initiate litigation, which could be time-consuming and expensive, to enforce our proprietary rights or to determine the scope and validity of others' rights. If litigation occurs, a court may find our patents or those of our licensors invalid or may find that we have infringed on a competitor's rights. In addition, if any of our competitors have filed patent applications in the United States which claim technology we also have invented, the United States Patent and Trademark Office may require us to participate in expensive interference proceedings to determine who has the right to a patent for the technology.

We also rely on unpatented trade secrets and know-how to protect and maintain our competitive position. We require our employees, consultants, collaborative partners and others to sign confidentiality agreements when they begin their relationship with us. These agreements may be breached, and we may not have adequate remedies for any breach. In addition, our competitors may independently discover our trade secrets.

***Our legacy commercial product lines expose us to product liability risks and we may not have sufficient insurance to cover any claims.***

We completed the sale of our commercial product lines in February 2007. Nevertheless, products we sold prior to divesting these product lines expose us to potential product liability risks. For example, such products may need to be recalled to address regulatory issues. A successful product liability claim or series of claims brought against us could result in payment of significant amounts of money and divert management's attention from running our business.



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In addition, some of the compounds we are investigating may be harmful to humans. We believe that we carry reasonably adequate insurance for product liability claims. However, we may not be able to maintain our insurance on commercially reasonable terms, or our insurance may not provide adequate protection in the case of a product liability claim. To the extent that product liability insurance, if available, does not cover potential claims, we will be required to self-insure the risks associated with such claims.

***We will have continuing obligations to indemnify the buyers of our commercial product lines, and may be subject to other liabilities related to the sale of our commercial product lines.***

In connection with the sale of our AVINZA product line, we have agreed to indemnify King in certain cases for a period of 30 months after the closing of the sale of the AVINZA product line in February 2007, including any breach of certain representations, warranties or covenants contained in the asset purchase agreement. In addition, we have agreed to indemnify Eisai, the purchaser of our Oncology product line, for damages suffered by Eisai arising from any breach of our representations, warranties, covenants or obligations in the asset purchase agreement. Our obligation to indemnify Eisai extends beyond the closing of the sale of our Oncology product line in October 2006 up to, in some cases, 36 months and, in other cases, until the expiration of the applicable statute of limitations. In a few instances, our obligation to indemnify Eisai survives in perpetuity. Under our agreement with King, \$15.0 million of the total upfront cash payment was deposited into an escrow account to secure our indemnification obligations to King. As of March 31, 2008, all amounts in the King escrow account had been released to us. Similarly, our agreement with Eisai required that \$20.0 million of the total upfront cash payment be deposited into an escrow account to secure our indemnification obligations to Eisai. As of September 30, 2008, all amounts in the Eisai escrow account had been released to us.

Under certain circumstances, the asset purchase agreement for the AVINZA product line also allows King to set off indemnification claims against the royalty payments payable to us, including AVINZA royalty payments. Under the asset purchase agreements, our exposure for any indemnification claim brought by King or Eisai is limited to \$40.0 million and \$30.0 million, respectively. However, in certain matters, our indemnification obligation is not subject to the foregoing limits on liability. For example, we are obligated to indemnify King, without limitation, for all liabilities arising under certain agreements with Catalent Pharma Solutions related to the manufacture of AVINZA. Similarly, we are obligated to indemnify Eisai, without limitation, for all liabilities related to certain claims regarding promotional materials for the ONTAK and Targretin drug products. We cannot predict the liabilities that may arise as a result of these matters. Any claims related to our indemnification obligations to King or Eisai could materially and adversely affect our financial condition.

As previously disclosed, in connection with the AVINZA sale transaction, King assumed our obligation to make payments to Organon based on net sales of AVINZA (the fair value of which was \$58.7 million as of September 30, 2008). As Organon did not consent to the legal assignment of the co-promote termination obligation from us to King, we remain liable to Organon in the event King defaults on this obligation. Any successful claim brought against us by Salk or others, or any requirement to pay a material amount to Organon, could adversely affect our business and the price of our securities.

***If we do not reach the market with our products before our competitors offer products for the same or similar uses, or if we are not effective in marketing our products, our revenues from product sales, if any, will be reduced.***

We face intense competition in our development activities. Many of our competitors are fully integrated pharmaceutical companies and more established biotechnology companies, which have substantially greater financial, technical, sales and marketing and human resources than we do. These companies might succeed in obtaining regulatory approval for competitive products more rapidly than we can for our products. In addition, competitors might develop technologies and products that are less expensive and perceived to be safer or more effective than those being developed by us, which could impair our product development and render our technology obsolete.

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***We use hazardous materials, which requires us to incur substantial costs to comply with environmental regulations.***

In connection with our research and development activities, we handle hazardous materials, chemicals and various radioactive compounds. To properly dispose of these hazardous materials in compliance with environmental regulations, we are required to contract with third parties at a substantial cost. Our annual cost of compliance with these regulations is approximately \$0.7 million. In addition, we believe that we carry reasonably adequate insurance for toxic tort claims. However, we cannot eliminate the risk or predict the exposure of accidental contamination or injury from the handling and disposing of hazardous materials, whether by us or our third-party contractors. Any accident in the handling and disposing of hazardous materials may expose us to significant liability.

***Our shareholder rights plan and charter documents may hinder or prevent change of control transactions.***

Our shareholder rights plan and provisions contained in our certificate of incorporation and bylaws may discourage transactions involving an actual or potential change in our ownership. In addition, our Board of Directors may issue shares of preferred stock without any further action by the stockholders. Such restrictions and issuances may have the effect of delaying or preventing a change in our ownership. If changes in our ownership are discouraged, delayed or prevented, it would be more difficult for our current Board of Directors to be removed and replaced, even if you or our other stockholders believe that such actions are in the best interests of us and our stockholders.

***Return from any dividend is speculative; you may not receive a return on your securities.***

In general, we intend to retain any earnings to support the expansion of our business. We have previously paid a special dividend of a substantial portion of the net proceeds from our product line asset sales. However, other than this special dividend, we do not anticipate paying cash dividends on any of our securities in the foreseeable future. Any returns you receive from our stock will be highly dependent on increases in the market price for our securities, if any. The price for our common stock has been highly volatile and may decrease.

***We may lose some or all of the value of some of our short term investments.***

We engage one or more third parties to manage some of our cash consistent with an investment policy that allows a range of investments and maturities. The investments are intended to maintain safety of principal while providing liquidity adequate to meet projected cash requirements. Risks of principal loss are to be minimized through diversified short and medium term investments of high quality, but the investments are not in every case guaranteed or fully insured. In light of the recent changes in the credit market, one of our short term investments in commercial paper is now in default. We intend to pursue collection efforts, but we might not recoup some or all of our investment in the commercial paper. In addition, from time to time we may suffer other losses on our short term investment portfolio.

***We may require additional money to run our business and may be required to raise this money on terms which are not favorable to us or which reduce our stock price.***

We may need to complete additional equity or debt financings to fund our operations. Our inability to obtain additional financing could adversely affect our business. Financings may not be available at all or on terms favorable to us. In addition, these financings, if completed, may not meet our capital needs and could result in substantial dilution to our stockholders.

If adequate funds are not available, we may be required to delay, reduce the scope of or eliminate one or more of our research or drug development programs. We may also be required to liquidate our business or file for bankruptcy protection. Alternatively, we may be forced to attempt to continue development by entering into arrangements with collaborative partners or others that require us to relinquish some or all of our rights to technologies or drug candidates that we would not otherwise relinquish.

***Our drug development programs will require substantial additional future funding which could hurt our operational and financial condition.***

Our drug development programs require substantial additional capital to successfully complete them, arising from costs to: conduct research, preclinical testing and human studies; establish pilot scale and commercial scale manufacturing processes and facilities; and establish and develop quality control, regulatory, marketing, sales and administrative capabilities to support these programs.

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Our future operating and capital needs will depend on many factors, including: the pace of scientific progress in our research and development programs and the magnitude of these programs; the scope and results of preclinical testing and human studies; the time and costs involved in obtaining regulatory approvals; the time and costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims; competing technological and market developments; our ability to establish additional collaborations; changes in our existing collaborations; the cost of manufacturing scale-up; and the effectiveness of our commercialization activities.

We expect our research and development expenditures over the next three years to continue to be significant. However, we base our outlook regarding the need for funds on many uncertain variables. Such uncertainties include regulatory approvals, the timing of events outside our direct control such as product launches by partners and the success of such product launches, negotiations with potential strategic partners, possible sale of assets or other transactions and other factors. Any of these uncertain events can significantly change our cash requirements.

While we expect to fund our research and development activities primarily from cash generated from AVINZA royalties to the extent possible, if we are unable to do so, we may need to complete additional equity or debt financings or seek other external means of financing. These financings could depress our stock price. If additional funds are required to support our operations and we are unable to obtain them on terms favorable to us, we may be required to cease or reduce further development or commercialization of our products, to sell some or all of our technology or assets or to merge with another entity.

***Significant returns of products we sold prior to selling our commercial businesses could harm our operating results.***

Under our agreements to sell our commercial businesses, we remain financially responsible for returns of our products sold before those businesses were transferred to their respective buyers. Consequently, if returns of those products are higher than expected, we could incur substantial expenses for processing and issuing refunds for those returns which, in turn, could negatively impact our financial results. The amount of returns could be affected by a number of factors including, but not limited to, ongoing product demand, product rotation at distributors and wholesalers, and product stability issues.

***There are numerous risks associated with our recent entry into a definitive merger agreement to acquire Pharmacopeia.***

On September 24, 2008, we entered into a definitive merger agreement to acquire all of the outstanding voting stock of Pharmacopeia, a clinical development stage biopharmaceutical company dedicated to discovering and developing novel small molecule therapeutics to address significant medical needs. There are numerous risks associated with our having entered into this agreement, including the following:

We cannot assure you that all conditions to the proposed merger will be completed and the proposed merger consummated. The proposed merger is subject to the satisfaction of closing conditions, including obtaining the approval of the stockholders of Pharmacopeia. In the event that the proposed merger is not completed, we may be subject to risks, including the costs related to the proposed merger, such as legal, accounting, and advisory fees, which must be paid even if the merger is not completed. If the proposed merger is not completed, the market price of our common stock could decline. In addition, a putative class action complaint was filed in the Superior Court of New Jersey, Mercer County (Equity Division) by Allen Heilman, one of Pharmacopeia's stockholders, against Pharmacopeia, the members of its board of directors, Ligand and two of our subsidiaries. The complaint generally alleges that Pharmacopeia's board of directors' decision to enter into the proposed transaction with us on the terms contained in the merger agreement constitutes a breach of fiduciary duty and gives rise to other unspecified state law claims. The complaint also alleges that we and two of our subsidiaries aided and abetted Pharmacopeia's board of directors' breach of fiduciary duty. In addition, the complaint alleges that the named plaintiff will seek "equitable relief," including among other things, an order preliminarily and permanently enjoining the proposed transaction. This lawsuit could prevent or delay the completion of the proposed merger. We can provide no assurances as to the outcome of the foregoing legal proceeding and its potential effect on the completion of the merger. The defense of this or any future legal proceeding could divert our management's attention and resources from the needs of our business. We may be required to make substantial payments or incur other adverse effects in the event of adverse judgments or settlements of any such proceedings.

We may not achieve successful integration of the Pharmacopeia assets in a timely manner, or at all, and we may not realize the benefits and synergies of the merger to the extent, or in the timeframe, anticipated. We and Pharmacopeia entered into the merger agreement with the expectation that the merger will result in benefits arising out of the combination of the companies. The successful integration of us and Pharmacopeia will require, among other things, integration of Pharmacopeia's assets into Ligand. It is possible that the integration process could result in the loss of key employees, diversion of each company's management's attention, the disruption or interruption of, or the loss of momentum in, each company's ongoing business or inconsistencies in standards, controls, procedures and policies, any of which could adversely affect either company's ability to maintain relationships with licensors, collaborators, partners, suppliers and employees or our ability to achieve the anticipated benefits of the merger, or could reduce our earnings or otherwise adversely affect the business and financial results of the combined company and, as a result, adversely affect the market price of our common stock. We expect to incur significant costs and commit significant management time integrating Pharmacopeia's business operations, technology, development programs, products and personnel with those of Ligand's. If we do not successfully integrate the business of Pharmacopeia, the expenditure of these costs will reduce our cash position.

Costs associated with the proposed merger are difficult to estimate, may be higher than expected, and may harm the financial results of the combined company. We have incurred substantial direct transaction costs associated with the proposed merger and we expect to continue to incur substantial costs for these purposes. If the total costs of the proposed merger exceed estimates or the benefits of the proposed merger do not exceed the total costs of the proposed merger, our financial results could be adversely affected.

**ITEM 6. EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
2.1(1)	Agreement and Plan of Merger, by and among the Company, Pharmacoepia, Inc., Margaux Acquisition Corp. and Latour Acquisition, LLC, dated as of September 24, 2008.
3.1(2)	Amended and Restated Certificate of Incorporation of the Company (Filed as Exhibit 3.1).
3.2(2)	Bylaws of the Company, as amended (Filed as Exhibit 3.3).
3.3(3)	Amended Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of the Company.
3.4(4)	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Company dated June 14, 2000 (Filed as Exhibit 3.5).
3.5(5)	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Company dated June 30, 2004 (Filed as Exhibit 3.6).
3.6(6)	Amendment of the Bylaws of the Company dated November 8, 2005 (Filed as Exhibit 3.1).
3.7(7)	Amendment of Bylaws of the Company dated December 4, 2007 (Filed as Exhibit 3.1).
4.1(8)	Specimen stock certificate for shares of Common Stock of the Company.
4.2(9)	Indenture dated November 26, 2002, between the Company and J.P. Morgan Trust Company, National Association, as trustee, with respect to the 6% convertible subordinated notes due 2007 (Filed as Exhibit 4.3).
4.3(9)	Form of 6% Convertible Subordinated Note due 2007 (Filed as Exhibit 4.4).
4.4(9)	Pledge Agreement dated November 26, 2002, between the Company and J.P. Morgan Trust Company, National Association (Filed as Exhibit 4.5).
4.5(9)	Control Agreement dated November 26, 2002, among the Company, J.P. Morgan Trust Company, National Association and JP Morgan Chase Bank (Filed as Exhibit 4.6).
4.6(10)	2006 Preferred Shares Rights Agreement, by and between the Company and Mellon Investor Services LLC, dated as of October 13, 2006 (Filed as Exhibit 4.1).
10.316†	Settlement Agreement and Mutual Release of all Claims, by and between the Company and The Salk Institute for Biological Studies, dated as of September 2, 2008.
10.317(1)	Form of Contingent Value Rights Agreement.
31.1	Certification by Principal Executive Officer, Pursuant to Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Principal Financial Officer, Pursuant to Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by Principal Executive Officer, Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by Principal Financial Officer, Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

† Confidential treatment has been requested for portions of this exhibit. These portions have been omitted from this quarterly report and submitted separately to the Securities and Exchange Commission.

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- (1) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on September 26, 2008.
  - (2) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Registration Statement on Form S-4 (No. 333-58823) filed on July 9, 1998.
  - (3) This exhibit was previously filed as part of and is hereby incorporated by reference to same numbered exhibit filed with the Company's Quarterly Report on Form 10-Q for the period ended March 31, 1999.
  - (4) This exhibit was previously filed as part of, and are hereby incorporated by reference to the numbered exhibit filed with the Company's Annual Report on Form 10-K for the year ended December 31, 2000.
  - (5) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2004.
  - (6) This exhibit was previously filed as part of, and is being incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on November 14, 2005.
  - (7) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on December 6, 2007.
  - (8) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company's Registration Statement on Form S-1 (No. 33-47257) filed on April 16, 1992 as amended.
  - (9) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Registration Statement on Form S-3 (No. 333-102483) filed on January 13, 2003, as amended.
  - (10) This exhibit was previously filed as part of, and is being incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on October 17, 2006.

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**LIGAND PHARMACEUTICALS INCORPORATED**

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.

Date: November 7, 2008

By: /s/ John P. Sharp

John P. Sharp

Vice President, Finance and Chief Financial Officer

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- 
- (1) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on September 26, 2008.
  - (2) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Registration Statement on Form S-4 (No. 333-58823) filed on July 9, 1998.
  - (3) This exhibit was previously filed as part of and is hereby incorporated by reference to same numbered exhibit filed with the Company's Quarterly Report on Form 10-Q for the period ended March 31, 1999.
  - (4) This exhibit was previously filed as part of, and are hereby incorporated by reference to the numbered exhibit filed with the Company's Annual Report on Form 10-K for the year ended December 31, 2000.
  - (5) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2004.
  - (6) This exhibit was previously filed as part of, and is being incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on November 14, 2005.
  - (7) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on December 6, 2007.
  - (8) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company's Registration Statement on Form S-1 (No. 33-47257) filed on April 16, 1992 as amended.
  - (9) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Registration Statement on Form S-3 (No. 333-102483) filed on January 13, 2003, as amended.
  - (10) This exhibit was previously filed as part of, and is being incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on October 17, 2006.



**CERTAIN MATERIAL (INDICATED BY AN ASTERISK) HAS BEEN OMITTED FROM THIS DOCUMENT PURSUANT TO A REQUEST FOR CONFIDENTIAL TREATMENT. THE OMITTED MATERIAL HAS BEEN FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION.**

SETTLEMENT AGREEMENT AND MUTUAL RELEASE OF ALL CLAIMS

This Settlement Agreement and Mutual Release of All Claims (“Settlement Agreement”) is entered into by and between Ligand Pharmaceuticals Incorporated (“Ligand”) and The Salk Institute for Biological Studies (“Salk”).

RECITALS:

A. Salk and Ligand entered into a license agreement, effective as of October 20, 1988 (the “Original Agreement”), pursuant to which Salk exclusively licensed to Ligand rights to certain intellectual property. Effective as of September 15, 1989, December 1, 1989 and October 20, 1990, Salk and Ligand entered into amendments to the Original Agreement (the Original Agreement, as so amended, the “1988 Agreement”).

B. Salk and Ligand entered into an Amended and Restated License Agreement effective as of April 12, 2002, pursuant to which they restated the 1988 Agreement and agreed to additional amendments to the 1988 Agreement, all as set forth in the Amended and Restated License Agreement, which was later amended in part on February 13, 2003 (as so amended, the “2002 ALA”).

C. Salk and Ligand entered into a license agreement, effective January 28, 1997, pursuant to which Salk licensed to Ligand rights to certain intellectual property, which was later amended in part on February 13, 2003 (as so amended, the “PPAR Agreement”).

D. A dispute has arisen between Ligand and Salk concerning their respective rights and obligations under the 2002 ALA. Following a mediation during June 2007, Salk filed a formal demand for arbitration, filed a Statement of Claim and Ligand asserted various counterclaims in the Arbitration. The parties are scheduled to commence an arbitration hearing on September 29, 2008 before the American Arbitration Association, Case No. 73 193Y 00344 07 TNM, captioned, The Salk Institute for Biological Studies Claimant and Counterclaim Respondent versus Ligand Pharmaceuticals, Inc. , Respondent and Counterclaimant (the “Arbitration”).

E. In accordance with the provisions of this Settlement Agreement, Ligand and Salk have reached a settlement and resolution of all disputes that have arisen between them, including all disputes concerning the 2002 ALA, and wish to terminate the 2002 ALA and the PPAR Agreement as set forth in Section 4 below.

AGREEMENT:

1. Materiality. Salk and Ligand acknowledge and agree that each provision of this Settlement Agreement is material to their respective decisions to settle said legal action and all disputes that have arisen between them concerning the 2002 ALA and to terminate the 2002 ALA subject to Section 4.5 herein regarding bazedoxifene and to terminate the PPAR Agreement as set forth in Section 4 below. Salk and Ligand further acknowledge and agree that neither of them would have entered into this Settlement Agreement in the absence of any of its provisions.

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2. Investigation. Each party acknowledges and agrees that it as made an acceptable investigation of the facts pertaining to this settlement, this Settlement Agreement and the matters pertaining thereto.

3. Payments.

3.1 Payments. Ligand will pay to Salk an aggregate amount of Thirteen Million Dollars (\$13,000,000), payable as follows by wire transfer: (a) one (1) business day following the later of receipt by Ligand of written wire transfer instructions from Salk or the Effective Date, Ligand will pay to Salk Nine Million Five Hundred Thousand Dollars (\$9,500,000) (the "Initial Payment"); and (b) on the six-month anniversary of the Effective Date, Ligand will pay to Salk Three Million Five Hundred Thousand Dollars (\$3,500,000) (the "Additional Payment", and together with the Initial Payment, the "Payments").

3.2 Patent Costs. Within [\*\*\*] ([\*\*\*)] days of receipt of an invoice accompanied by reasonable supporting documentation, Ligand shall reimburse Salk for its actual Patent Costs incurred through the Effective Date (as defined in Article 4.12 of the 2002 ALA and/or Section 7.2 (a) of the PPAR Agreement, as applicable), not to exceed [\*\*\*] (\$[\*\*\*]).

4. Termination of Agreements; Covenant Not to Sue.

4.1 Termination of Agreements. In partial consideration of the Payments made by Ligand hereunder, Salk and Ligand agree that, as of the Effective Date, and except as set forth in Sections 4.2 and 4.5 below, (a) the 2002 ALA shall be terminated; however, the provisions of Article 15 concerning confidentiality and Article 17 concerning disclaimer of liability and indemnification shall survive the termination of the 2002 ALA, Article 15 for a period of [\*\*\*] ([\*\*\*)] [\*\*\*], and Article 17 [\*\*\*]; and (b) notwithstanding Section 9.3 of the PPAR Agreement, the PPAR Agreement shall be terminated; however [\*\*\*] and [\*\*\*] shall survive the termination of the PPAR Agreement.

4.2 Continuation of Certain Sublicensed or Assigned Rights. Salk acknowledges that Ligand has previously conveyed, or granted irrevocable and/or perpetual sublicenses of, certain of the rights granted to Ligand under the 2002 ALA and/or the PPAR Agreement including, without limitation, pursuant to (a) that certain Purchase Agreement dated September 7, 2006 among Ligand, Seragen, Inc., Eisai Inc. and Eisai Co., Ltd, (b) that certain License Agreement effective June 30, 1999 between Ligand and X-Ceptor Therapeutics, Inc. (as amended) and (c) that certain Amended and Restated Technology Cross License Agreement dated September 24, 1997 among Allergan, Inc., Ligand and Allergan Ligand Retinoid Therapeutics, Inc. The prior conveyance and/or grant of such sublicense rights shall continue in full force and effect subject to the terms and conditions of this Settlement Agreement, including without limitation, Section 4.3, and shall be deemed assigned to Salk pursuant to Section 2.3 of the PPAR Agreement and consistent with Article 11.5 of the 2002 ALA, as applicable.

\*\*\* Certain information on this page has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

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Subject to the aforementioned rights granted by Ligand to third parties, all rights granted to Ligand by Salk under the 2002 ALA and the PPAR Agreement shall revert as of the Effective Date to Salk for the benefit of Salk.

4.3 No Additional Payments. Salk acknowledges that no additional payments other than the Payments shall be due to Salk from and after the Effective Date from Ligand or any sublicensee or assignee for any past, present or future conduct that may have been subject to the 2002 ALA or the PPAR Agreement, including, without limitation, for Promacta, lasofoxifene, LGD-4665, LGD-4033, any EPO modulator or any other compound developed by Ligand alone or with a third party, whether in the past, present or future that may have been subject to the 2002 ALA or the PPAR Agreement (other than payments with respect to bazedoxifene as to which the parties have agreed as set forth in Section 4.5).

4.4 Covenant Not to Sue. In partial consideration of the Payments made by Ligand hereunder, only subject to Section 4.5 below and the obligations of this Settlement Agreement, Salk hereby grants to Ligand and its sublicensees, only to the extent that they received rights from Ligand, a covenant not to sue Ligand or its sublicensees under any patents or know-how owned or controlled by Salk that was the subject to the 2002 ALA or the PPAR Agreement for any past, present or future use of such patents and know-how and acknowledges Ligand's and its sublicensees' right to use such technology for uses reasonably related to submission of information to the FDA or other regulatory authorities.

4.5 Bazedoxifene. Notwithstanding Section 4.1 of this Settlement Agreement regarding Termination of Agreements and Section 4.4 of this Settlement Agreement regarding Covenant Not to Sue, [\*\*\*] of the 2002 ALA shall remain in force solely related to bazedoxifene until the earlier of (a) March 29, 2011 (the expiration of U.S. Patent No. 5,298,429) or (b) the mutual agreement of the parties to the termination of the surviving sections of the 2002 ALA related to bazedoxifene. For the avoidance of doubt, any payments made by Ligand to acquire a paid-up license pursuant to Section 4.8 shall be calculated consistent with payments made by Ligand prior to the Effective Date under Section 4.8 related to bazedoxifene.

5. Warranties and Representations by Each Party. Each Party represents and warrants to the other Party that, as of the Effective Date:
- (a) it is a corporation or entity duly organized and validly existing under the laws of the jurisdiction in which it is incorporated;
  - (b) it has full corporate or institutional power and authority, and has obtained all approvals, permits and consents necessary, to enter into this Agreement and to perform its obligations hereunder;
  - (c) this Agreement is legally binding upon it and enforceable in accordance with its terms; and

\*\*\* Certain information on this page has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

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(d) the execution, delivery and performance of this Agreement does not conflict with any agreement, instrument or understanding, oral or written, to which it is a party or by which it may be bound, nor violate any material law or regulation of any governmental or regulatory authority having jurisdiction over it.

6. Publicity Regarding Settlement: News Release.

6.1 Characterization of Settlement. Ligand and Salk agree that in characterizing or describing the settlement and resolution of said legal action or the terms and conditions of this Settlement Agreement, neither party will make any statements that such party has been successful, attained a victory, or prevailed in the Arbitration. Salk and Ligand acknowledge that this Settlement Agreement is the product of a compromise and that neither of them has attained a victory, prevailed, or succeeded in the Arbitration.

6.2 Press Release; SEC Filings. Salk and Ligand shall, within four (4) business days after the Effective Date of this Settlement Agreement, issue a mutually agreed upon joint press release in the form to be proposed by Ligand and subject to Salk's prior written approval, not to be unreasonably withheld. In the event Salk does not provide its written approval within one (1) business day after receipt from Ligand of the draft joint press release, Ligand may issue a press release in its own name in furtherance of its disclosure obligations as a publicly traded company. The parties acknowledge that Ligand is obligated to file a Current Report on Form 8-K in connection with the execution of this Settlement Agreement.

7. Mutual Release of Claims. In consideration of the obligations, warranties and representations of each of the parties to this Settlement Agreement, and excluding claims arising out of, based upon or relating to bazedoxifene after the Effective Date and contingent upon each party's timely performance of them, Salk and Ligand each hereby releases and forever discharges the other, and each of their stockholders, predecessors, successors, affiliated corporations, subsidiary corporations, parent corporations, agents, directors, officers, employees, representatives, lawyers, and all persons acting by, through, under, or in concert with them, or any of them, from any and all liability whatever, including all claims, demands and causes of action, of every nature, including, without limitation, any claims for breach of contract, declaratory relief, misrepresentation, or any other form of damage or theory of recovery whatsoever arising out of, based upon or relating to (a) the disputes, claims and counterclaims in the Arbitration, as well as any claims which could have been properly plead and tried in the Arbitration, (b) the 2002 ALA, (c) the PPAR Agreement, (d) Promacta, lasofoxifene, LGD-4665, LGD-4033, any EPO modulator or any other compound developed by Ligand alone or with a third party, that may have been subject to the 2002 ALA or the PPAR Agreement (other than bazedoxifene as to which the parties have agreed as set forth in Section 4.5) and (e) all payments "made under protest" by Ligand to Salk pursuant to Article 4.4 of the 2002 ALA. Salk and Ligand shall each bear their own attorneys' fees and costs incurred in this action.

Salk and Ligand each acknowledge that they have been advised by legal counsel and are familiar with the provisions of California Civil Code Section 1542, which provides as follows:

"A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR."

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Each of the parties recognizes and understands that this section applies to and covers the aforementioned claims and hereby expressly waives any rights it may have under this section as well as under any other statutes or common law principles of similar effect.

8. Dismissal of Arbitration. Within five business days after Effective Date of this Settlement Agreement, the parties shall file a Stipulation and Proposed Order with the American Arbitration Association, in the form attached hereto as Exhibit A, to effect a dismissal of the Arbitration with prejudice, including, without limitation, a dismissal of all claims and counterclaims asserted in the Arbitration. Each party shall bear its own costs and attorneys' fees.
9. Confidentiality. All confidential scientific, technical, and business information communicated by one party hereto to the other, including information contained in patent applications, shall be kept confidential by the recipient, which shall take all reasonable steps to ensure that such confidential information does not pass negligently or otherwise into the hands of those unauthorized to receive it. Notwithstanding the foregoing, a party hereto shall be relieved of such confidentiality obligations and not be prevented from disclosing any information received by it from the disclosing party if (a) the information was previously known to the recipient; (b) the information is or becomes generally available to the public through no fault of the recipient, including as a result of publications and/or laying open to inspection of any patent applications that the disclosing party may file; (c) the information is acquired in good faith in the future by the recipient from a third party who is not under an obligation of confidence to the disclosing party in respect to such information; (d) the information is required to be disclosed by the recipient to a third party by law or legal process, provided that should the receiving party be required to make such disclosure, they will take all reasonable steps to inform the disclosing party of such disclosure in sufficient time for the disclosing party to oppose such disclosure before it takes place; or (e) the information is approved by the disclosing party for disclosure by the recipient. The obligations imposed in this Section 9 will run for a period of [\*\*\*] ([\*\*\*)] years commencing from the Effective Date of this Settlement Agreement.
10. Governing Law. This Settlement Agreement and its effect are subject to and shall be construed and enforced in accordance with the laws of the State of California, United States of America, as applied to contracts executed and performed entirely within the State of California, without regard to conflicts of laws rules.
11. Written Notices. All written notices, payments, and reports, except as otherwise set forth in this Settlement Agreement, shall be deemed to be effective when mailed, postage prepaid, by first class, registered or certified mail to:

(if to Salk)

The Salk Institute for Biological Studies  
Attention: General Counsel  
P. O. Box 85800  
San Diego, California 92138

Copy to: Business Manager, Office of Technology Management

\*\*\* Certain information on this page has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

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And

(if to Ligand)

Ligand Pharmaceuticals Incorporated  
Attn: General Counsel  
10275 Science Center Drive  
San Diego, CA 92121

or to such other person or by such other means to which the parties may from time to time have agreed.

12. Successors and Assigns. The terms of this Settlement Agreement shall inure to the benefit of and be binding upon the respective successors and assigns of each party. An ownership change for Ligand or a planned dissolution of assets by Ligand shall not relieve the obligation to make any Payments to Salk.
13. Entire Agreement: Integration. The terms and conditions of this Settlement Agreement and the attached Exhibit constitute the entire agreement between Salk and Ligand and supersede all prior negotiations, representations, letters of intent, agreements and understandings, either or in writing, between Salk and Ligand. This Settlement Agreement shall not be amended, supplemented or abrogated other than by a written instrument signed by the authorized representative of each party.
14. No Waiver. The failure of either party to enforce at any time any of the provisions of this Settlement Agreement, or any rights in respect of it, or to exercise any election provided in it, shall in no way be considered to be a waiver of such provisions, rights or elections, and shall in no way affect the validity of this Settlement Agreement.
15. Compromise And Settlement. This Settlement Agreement is entered into solely by way of compromise and settlement of the Arbitration and the dispute between Ligand and Salk and is not and shall not be construed as an admission of liability, responsibility or fault by either party.
16. Counterparts. This Settlement Agreement may be executed in one or more counterparts by each party and their attorneys, each of which shall be deemed to be an original and all of which taken together shall constitute one and the same agreement.
17. Effective Date. The effective date of this Settlement Agreement shall be the last date on which this Agreement has been signed by both parties.

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18. Headings. The headings used in this Settlement Agreement are inserted for reference only and shall not be deemed to be a part of the text.
  19. Additional Assurances. Ligand and Salk agree to execute, acknowledge and deliver such further instruments, and to do such other acts, as may be reasonably necessary in order to carry out the intent and purposes of this Settlement Agreement.
  20. Severability of Provisions. The invalidity or unenforceability of any provision of this Settlement Agreement shall in no way affect the validity or enforceability of any other provision of this Settlement Agreement.
  21. Drafting. Each party acknowledges and affirms that the parties have cooperated in drafting and preparation of this Agreement. Hence, in any construction of this Agreement, the same shall not be construed against any party.

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Dated: September 2, 2008

LIGAND PHARMACEUTICALS  
INCORPORATED

By: /s/ Charles S. Berkman

Its: Vice President, General Counsel & Secretary

APPROVED AS TO FORM AND CONTENT  
THIS 2nd DAY OF SEPTEMBER, 2008

LATHAM & WATKINS LLP

By: /s/ Stephen P. Swinton

Stephen P. Swinton

Attorneys for Ligand Pharmaceuticals Incorporated



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Dated: September 2, 2008

THE SALK INSTITUTE FOR BIOLOGICAL STUDIES

By: /s/ Gary H. Silverstein

Its: General Counsel, Assistant Secretary

APPROVED AS TO FORM AND CONTENT  
THIS 2nd DAY OF SEPTEMBER, 2008

COOLEY GODWARD KRONISH LLP

By: /s/ Anthony M. Stiegler

Anthony M. Stiegler

Attorneys for The Salk Institute for Biological Studies

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO EXCHANGE ACT RULE 13a-14(a)/15d-14(a)  
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, John L. Higgins, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Ligand 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: November 7, 2008

/s/ John L. Higgins

John L. Higgins  
President, Chief Executive Officer and Director  
(Principal Executive Officer)

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO EXCHANGE ACT RULE 13a-14(a)/15d-14(a)  
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, John P. Sharp, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Ligand 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: November 7, 2008

/s/ John P. Sharp

John P. Sharp  
Vice President, Finance and Chief Financial Officer  
(Principal Financial Officer)

**CERTIFICATION BY PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the accompanying Quarterly Report on Form 10-Q of Ligand Pharmaceuticals Incorporated (the "Company") for the quarter ended September 30, 2008, I, John L. Higgins, President, Chief Executive Officer and Director of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

(1) such Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) the information contained in such Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, fairly presents, in all material respects, the financial condition and results of operations of the Company.

The foregoing certification is being furnished solely to accompany such Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, pursuant to 18 U.S.C. § 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

Date: November 7, 2008

/s/ John L. Higgins

John L. Higgins

*President, Chief Executive Officer and Director  
(Principal Executive Officer)*

**CERTIFICATION BY PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the accompanying Quarterly Report on Form 10-Q of Ligand Pharmaceuticals Incorporated (the "Company") for the quarter ended September 30, 2008, I, John P. Sharp, Vice President, Finance and Chief Financial Officer of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

(1) such Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) the information contained in such Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, fairly presents, in all material respects, the financial condition and results of operations of the Company.

The foregoing certification is being furnished solely to accompany such Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, pursuant to 18 U.S.C. § 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

Date: November 7, 2008

/s/ John P. Sharp

John P. Sharp

*Vice President, Finance and Chief Financial Officer  
(Principal Financial Officer)*