LIGAND PHARMACEUTICALS INC
Form S-1/A
February 10, 2006

Table of Contents

As filed with the Securities and Exchange Commission on February 10, 2006
Registration No. 333-131029

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

Amendment No. 1
to
FORM S-1
REGISTRATION STATEMENT
Under
The Securities Act of 1933
LIGAND PHARMACEUTICALS INCORPORATED
(Exact name of Registrant as specified in its charter)

Delaware	**2834**	**77-0160744**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification Number)**

10275 Science Center Drive
San Diego, CA 92121
(858) 550-7500
(Address, including zip code, and telephone number, including area code, of Registrant s principal executive offices)

David E. Robinson
President and Chief Executive Officer
Ligand Pharmaceuticals Incorporated
10275 Science Center Drive
San Diego, CA 92121
(858) 550-7500
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Faye H. Russell, Esq.	**Warner R. Broaddus, Esq.**
Latham & Watkins LLP	**Ligand Pharmaceuticals Incorporated**
12636 High Bluff Drive, Suite 400	10275 Science Center Drive
San Diego, CA 92130	San Diego, CA 92121
(858) 523-5400	(858) 550-7500

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. þ

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

Table of Contents

7,988,793 SHARES OF COMMON STOCK

This prospectus relates to the offer and sale of up to 7,791,855 shares to be issued pursuant to awards granted or to be granted under our 2002 Stock Incentive Plan, or our 2002 Plan, and up to 147,510 shares to be issued pursuant to our 2002 Employee Stock Purchase Plan, or our 2002 ESPP.

This prospectus also relates to the offer and sale of up to 49,428 shares of our common stock which may be offered from time to time by the selling stockholders identified on page 120 of this prospectus for their own accounts. Each of the selling stockholders named in the prospectus acquired the shares of common stock upon exercise of options previously granted to them as an employee, director or consultant of Ligand or as restricted stock granted to them as a director of Ligand, in each case under the terms of our 2002 Plan.

It is anticipated that the selling stockholders will offer shares for sale at prevailing prices on the date of sale or in negotiated transactions. We will not receive any of the proceeds from the sale of the shares of our common stock by the selling stockholders under this prospectus. We are paying the expenses incurred in registering the shares, but all selling and other expenses incurred by each of the selling stockholders will be borne by that selling stockholder.

Among the shares of common stock there are shares which are restricted securities under the Securities Act before their sale under this prospectus. This prospectus has been prepared in part for the purpose of registering the shares of common stock under the Securities Act to allow for future sales by the selling stockholders, on a continuous or delayed basis, to the public without restriction. Each selling stockholder and any participating broker or dealer may be deemed to be an underwriter within the meaning of the Securities Act, in which event any profit on the sale of shares by the selling stockholder and any commissions or discounts received by those brokers or dealers may be deemed to be underwriting compensation under the Securities Act.

Our common stock is quoted on The Pink Sheets LLC under the symbol LGND. On February 9, 2006, the last reported sale price of our common stock was $12.85 per share.

AN INVESTMENT IN THE SHARES OFFERED BY THIS PROSPECTUS IS SPECULATIVE AND SUBJECT TO RISK OF LOSS. SEE RISK FACTORS BEGINNING ON PAGE 7 AND THE TABLE OF CONTENTS ON PAGE i.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THE DATE OF THIS PROSPECTUS IS _____ _____, 2006.

TABLE OF CONTENTS

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our common stock.

Table of Contents

PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus and does not contain all of the information that you should consider in making your investment decision. Before investing in our common stock, you should carefully read this entire prospectus, including our consolidated financial statements and the related notes included in this prospectus and the information set forth under the headings Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations.

The Company

Our goal is to build a profitable pharmaceutical company that discovers, develops and markets new drugs that address critical unmet medical needs in the areas of cancer, men s and women s health, skin diseases, osteoporosis, and metabolic, cardiovascular and inflammatory diseases. We strive to develop drugs that are more effective and/or safer than existing therapies, that are more convenient (taken orally or topically administered) and that are cost effective. We plan to build a profitable pharmaceutical company by generating income from the specialty pharmaceutical products we develop and market, and from research, milestone and royalty revenues resulting from our collaborations with large pharmaceutical partners, which develop and market products in large markets that are beyond our strategic focus or resources.

We currently market four oncology products in the United States: Panretin® gel (alitretinoin) 0.1%, ONTAK® (denileukin diftitox) and Targretin® (bexarotene) capsules, each of which was approved by the Food and Drug Administration, or FDA, in 1999; and Targretin® (bexarotene) gel 1%, which was approved by the FDA in 2000. Our fifth and newest product, AVINZA®, is a treatment for chronic, moderate-to-severe pain that was approved by the FDA in March 2002. In Europe, the European Commission, or EC, granted a Marketing Authorization, or MA, for Panretin gel in October 2000 and an MA for Targretin capsules in March 2001. We also continue efforts to acquire or in-license other products, like ONTAK and AVINZA, which have near-term prospects of FDA approval and which can be marketed by our specialty sales forces. We are developing additional products through our internal development programs and currently have various products in clinical development, including marketed products that we are testing for larger market indications such as non-small cell lung cancer, or NSCLC, chronic lymphocytic leukemia, or CLL, non-Hodgkin s lymphoma, or NHL, and hand dermatitis.

We have formed research and development collaborations with numerous global pharmaceutical companies, including Abbott Laboratories, Allergan, Inc., Bristol-Myers Squibb, Eli Lilly & Company, GlaxoSmithKline, Organon (Akzo Nobel), Parke-Davis, Pfizer Inc., TAP Pharmaceutical Products, Inc. (TAP), and Wyeth. As of August 31, 2005, our corporate partners had 13 Ligand products in human development and numerous compounds on an Investigational New Drug Application, or IND, track or in preclinical and research stages. These corporate partner products are being studied for the treatment of large market indications such as osteoporosis, diabetes, contraception and cardiovascular disease. One of these partner products, lasofoxifene, is being developed by Pfizer for osteoporosis and other indications. Pfizer filed a New Drug Application, or NDA, with the FDA in August 2004 for the use of lasofoxifene in the prevention of osteoporosis and then filed a supplemental NDA in December 2004 for the use of lasofoxifene in the treatment of vaginal atrophy. Two of these partner products are in pivotal Phase III clinical trials: bazedoxifene, which is being developed by Wyeth as monotherapy for osteoporosis and in combination with Wyeth s PREMARIN for osteoporosis prevention, and vasomotor symptoms of menopause. A fourth partner product, LY519818, is being developed by Eli Lilly & Company for the treatment of type 2 diabetes. Lilly has announced plans to advance this product into Phase III registration studies after completion of two-year carcinogenicity studies and appropriate consultation with the FDA. Another Lilly product, LY674 has recently advanced into Phase II development for atherosclerosis and LY929 is in Phase I development for type 2 diabetes. Two additional partner products being developed by GlaxoSmithKline are in Phase II: GSK516 for cardiovascular disease and dislipidemia and SB497115 for thrombocytopenia. Other partner products in Phase II include pipendoxifene (formerly ERA-923) being developed by Wyeth for breast cancer and NSP-989 for contraception and NSP-989 combo for contraception in Phase I. In February 2005, GlaxoSmithKline commenced Phase I studies of SB-449448, a second product for thrombocytopenia and TAP commenced Phase I studies for LGD 2941 for the treatment of osteoporosis and frailty. Additionally, in September 2005, Pfizer announced the receipt of a non-

Table of Contents

approvable letter from the FDA for the prevention of osteoporosis. However, lasofoxifene continues in Phase III clinical trials by Pfizer for the treatment of osteoporosis.

Internal and collaborative research and development programs are built around our proprietary science technology, which is based on our leadership position in gene transcription technology. Panretin gel, Targretin capsules, and Targretin gel as well as our corporate partner products currently on human development track are modulators of gene transcription, working through key cellular or intracellular receptor targets discovered using our Intracellular Receptor, or IR, technology.

On January 17, 2006, we signed an agreement with Organon USA, Inc. that terminates the AVINZA® co-promotion agreement between the two companies and returns AVINZA rights to us. The effective date of the termination agreement is January 1, 2006, however the parties have agreed to continue to cooperate during a transition period ending September 30, 2006 to promote the product. See Management s Discussion and Analysis of Financial Condition and Results of Operations Overview ; Business Overview; and Business Overview-Ligand Marketed Products AVINZA Co-Promotion Agreement with Organon.

Corporate Information

We were incorporated in Delaware in 1987. Our principal executive offices are located at 10275 Science Center Drive, San Diego, California 92121, and our telephone number is (858) 550-7500. Our website address is http://www.ligand.com. The information on, or accessible through, our website is not part of this prospectus. Unless the context requires otherwise, references in this prospectus to the Company, Ligand, we, us and our refer to Lig Pharmaceuticals Incorporated.

Our trademarks, trade names and service marks referenced in this prospectus include Ligand, ONTAK, Panretin, Targretin, and AVINZA. Each other trademark, trade name or service mark appearing in this prospectus belongs to its owner.

Table of Contents

THE OFFERING

Common stock offered.	Up to 7,988,793 shares, assuming the issuance of all shares of common stock reserved for issuance under the 2002 Plan and the 2002 ESPP. The amount also includes 49,428 shares previously issued under the 2002 Plan which may be offered from time to time by the selling stockholders.
Common stock to be outstanding after this offering	Up to 82,088,839 shares, assuming the issuance of all shares of common stock reserved for issuance under the 2002 Plan and 2002 ESPP. The amount also includes 49,428 shares previously issued under the 2002 Plan which may be offered from time to time by the selling stockholders.
Use of proceeds.	We will not receive any of the proceeds from the sale of the shares of our common stock by the selling stockholders under this prospectus. We will receive proceeds in connection with option exercises under the 2002 Plan and shares issued under the 2002 ESPP which will be based upon each granted option exercise price or purchase price, as applicable. The exercise price under our 2002 Plan is generally based upon the fair market value of our shares at the option grant date. The purchase price of the common stock acquired under our 2002 ESPP is equal to 85% of the lower of the fair market value per share of common stock on the start date of the offering period in which the individual is enrolled or the fair market value on the quarterly purchase date. Any proceeds received by us will be used for working capital and general corporate purposes. See Use of Proceeds and Capitalization.

The number of shares of common stock that will be outstanding after this offering is based on shares outstanding as of December 31, 2005.

Table of Contents

SELECTED CONSOLIDATED FINANCIAL DATA

Set forth below are highlights from Ligand s unaudited consolidated financial data as of and for the three and nine months ended September 30, 2005 and 2004 and Ligand s consolidated financial data as of and for the years ended December 31, 2000 through 2004. The unaudited consolidated financial statements for September 30, 2005 and 2004 have been prepared on a basis consistent with our audited consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments, we consider necessary for the fair statement of the information. The results of operations for the three and nine months ended September 30, 2005 and 2004 are not necessarily indicative of the results that may be expected for the full year or any other future period. Consolidated balance sheet data as of December 31, 2003, 2002, 2001, and 2000, and consolidated statements of operations data for the years then ended have been restated with respect to the matters described in Management s Discussion and Analysis of Financial Condition and Results of Operations and in Note 2 to our accompanying consolidated financial statements appearing elsewhere in this prospectus. As noted below, the consolidated balance sheet data as of December 31, 2000 through 2002 and the consolidated statement of operations data for the years ended 2000 and 2001 are unaudited.

The selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our interim and annual consolidated financial statements and related notes included elsewhere in this prospectus.

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,		Year Ended December 31,				
	2005	2004	2005	2004	2004	2003	2002	2001	20
	(Restated) (Unaudited)		(Restated) (Unaudited)			(Restated)	(Restated)	(Restated) (Unaudited)	(Res (Una
	(in thousands, except share and loss per share data)								
idated ent of ions									
sales (1)	$ 42,584	$ 31,934	$ 119,364	$ 86,172	$ 120,335	$ 55,324	$ 30,326	$ 32,038	$
royalty net (2)		67		67	31,342	11,786	17,600		
rative n and ment er s	2,172	4,771	8,176	10,222	11,835	14,008	23,843	30,718	
products	9,807	9,819	31,539	27,082	39,804	26,557	14,738	11,582	
h and ment es	12,911	16,747	42,170	50,830	65,204	66,678	59,060	49,427	
general trative es	17,787	17,311	57,151	50,132	65,798	52,540	41,825	35,072	
motion (3)	7,766	8,501	22,472	22,232	30,077	9,360			
om ons fore tive f changes unting es tive n prior g of tion (4) tive f g of ing for	(3,515)	(15,606)	(25,792)	(53,815)	(37,371)	(74,017)	(43,854)	(33,325)	(
	(6,281)	(18,498)	(33,677)	(62,475)	(45,141)	(94,466)	(52,257)	(53,305)	(
						(2,005)			(

e interest 5)									
s	(6,281)	(18,498)	(33,677)	(62,475)	(45,141)	(96,471)	(52,257)	(53,305)	(
nd per share s: fore tive f changes unting es	$ (0.08)	$ (0.25)	$ (0.46)	$ (0.85)	$ (0.61)	$ (1.33)	$ (0.76)	$ (0.90)	$
tive n prior g of tion (4) tive f g of ing for e interest 5)						(0.03)			
s	$ (0.08)	$ (0.25)	$ (0.46)	$ (0.85)	$ (0.61)	$ (1.36)	$ (0.76)	$ (0.90)	$
ed number mon	74,041,204	73,845,613	73,998,594	73,635,562	73,692,987	70,685,234	69,118,976	59,413,270	55,6
ma s g the d method unting able entity is									
ively(5): s nd net loss e						$ (94,352)	$ (52,456)	$ (53,600)	$ (
						$ (1.34)	$ (0.76)	$ (0.90)	$

Table of Contents

	At September 30,		At December 31,				
	2005	2004 (Restated) (Unaudited)	2004	2003 (Restated)	2002 (Restated) (Unaudited)	2001 (Restated) (Unaudited)	2000 (Restated) (Unaudited)
				(in thousands)			
Consolidated Balance Sheet Data:							
Cash, cash equivalents, short-term investments and restricted investments	$ 75,616	$ 82,063	$ 114,870	$ 100,690	$ 74,894	$ 40,058	$ 25,097
Working capital (deficit) (6)	(106,887)	(69,998)	(48,505)	(19,776)	18,370	2,375	8,372
Total assets	306,047	303,773	332,466	314,046	287,709	126,898	117,484
Current portion of deferred revenue, net	158,224	141,545	152,528	105,719	48,609	27,152	13,713
Long-term obligations (excludes long-term portion of deferred revenues, net)	173,242	174,431	174,214	173,851	162,329	138,837	133,575
Long-term portion of deferred revenue, net	4,279	3,216	4,512	3,448	3,595	4,164	5,727
Common stock subject to conditional redemption/repurchase	12,345	12,345	12,345	14,595	34,595	14,595	14,595
Accumulated deficit	(828,337)	(811,994)	(794,660)	(749,519)	(653,048)	(600,791)	(547,486)
Total stockholders equity (deficit) (7)	(108,414)	(93,404)	(75,317)	(37,554)	8,925	(86,849)	(72,405)

(1) We began selling ONTAK and Panretin gel in 1999 and Targretin capsules and Targretin gel in 2000. AVINZA was approved by the FDA in March 2002 and subsequently launched in the U.S. in June 2002.

(2) Represents the sale of rights to royalties. See Note 11 to our annual consolidated financial statements included elsewhere in this prospectus.

(3) Represents expense related to our AVINZA co-promotion agreement with Organon Pharmaceuticals USA, Inc. entered into in February 2003. See Note 8 to our annual consolidated financial statements included elsewhere in this prospectus and Note 6 to our interim consolidated financial statements included elsewhere in this prospectus. On January 17, 2006, we signed an agreement with Organon USA, Inc. that terminates the AVINZA® co-promotion agreement between the two companies and returns AVINZA rights to us. The effective date of the termination agreement is January 1, 2006, however the parties have agreed to continue to cooperate during a transition period ending September 30, 2006 to promote the product. See Management s Discussion and Analysis of Financial Condition and Results of Operations Overview ; Business Overview; and Business Overview-Ligand Marketed Products AVINZA Co-Promotion Agreement with Organon.

(4) In 2000, we changed our policy for the recognition of revenue related to up-front fees in accordance with Staff Accounting Bulletin (SAB) No. 101 Revenue Recognition, as amended by SAB 104 (hereinafter referred to as SAB 104).

(5) In December 2003, we adopted FIN 46(R), *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51*. Under FIN 46(R), we were required to consolidate the variable interest entity from which we leased our corporate headquarters. Accordingly, as of December 31, 2003, we consolidated assets with a carrying value of $13.6 million, debt of $12.5 million, and a non-controlling interest of $0.6 million. In connection with the adoption of FIN 46(R), we recorded a charge of $2.0 million as a cumulative effect of the accounting change on December 31, 2003. In April 2004, we acquired the portion of the variable interest entity that we did not previously own. The acquisition resulted in Ligand assuming the existing loan against the property and making a payment of approximately $0.6 million to the entity s other shareholder. See Note 3 to our annual consolidated financial statements included elsewhere in this prospectus.

(6) Working capital (deficit) includes deferred product revenue recorded under the sell-through revenue recognition method.

(7) The cumulative effect of the restatement at January 1, 2000 was approximately $(13.2) million, which represents the effect of the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(1.0) million; royalties $0.1 million; $(1.6) million regarding rent expense for annual rent increases; $(14.6) million regarding the reclassification from equity of the Company s issuance of common stock subject to conditional redemption to Pfizer in accordance with EITF D-98; $3.4 million regarding the capitalization of the X-Ceptor purchase right in October 1999; and $0.5 million regarding the reversal of X-Ceptor warrant amortization.

Table of Contents

RISK FACTORS

The following is a summary description of some of the many risks we face in our business. You should carefully review these risks in evaluating an investment in our common stock.

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

The restatement of our consolidated financial statements has had a material adverse impact on us, including increased costs, and the increased possibility of legal or administrative proceedings.

We determined that our consolidated financial statements for the years ended December 31, 2002 and 2003, and as of and for the quarters of 2003, and for the first three quarters of 2004, as described in more detail in Note 2 to our accompanying interim and annual consolidated financial statements appearing elsewhere in this prospectus, should be restated. As a result of these events, we have become subject to a number of additional risks and uncertainties, including:

We have incurred substantial unanticipated costs for accounting and legal fees in 2005 in connection with the restatement. Although the restatement is complete, we expect to continue to incur such costs as noted below.

We have been named in a number of lawsuits that began in August 2004 claiming to be class actions and shareholder derivative actions. Additionally, in October 2005, we, our directors, and certain of our officers were named in a shareholder derivative action which was filed in the United States District Court for the Southern District of California. As a result of our restatement the plaintiffs in these lawsuits may make additional claims, expand existing claims and/or expand the time periods covered by the complaints. Other plaintiffs may bring additional actions with other claims, based on the restatement. If such events occur, we may incur additional substantial defense costs regardless of their outcome. Likewise, such events might cause a diversion of our management s time and attention. If we do not prevail in any such actions, we could be required to pay substantial damages or settlement costs.

The Securities and Exchange Commission (SEC) has instituted a formal investigation of the Company s consolidated financial statements. This investigation will likely divert more of our management s time and attention and cause us 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.

The need to reconsider our accounting treatment and the restatement of our consolidated financial statements caused us to be late in filing our required reports on Form 10-K for December 31, 2004 and Forms 10-Q for the quarters ended March 31, 2005 and June 30, 2005, respectively, which caused us to be delisted from NASDAQ National Market. See Our common stock was delisted from the NASDAQ National Market which may reduce the price of our common stock and the levels of liquidity available to our stockholders and cause confusion among investors for additional discussion regarding the NASDAQ delisting.

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.

Maintaining an effective system of internal control over financial reporting is necessary for us to provide reliable financial reports. In November 2005, we restated our consolidated financial statements for the years ended 2002 and 2003, and the 2003 quarterly periods and first three quarters of 2004. We also identified and reported a number of material weaknesses in our internal control over financial reporting, as described below.

As a result of these material weaknesses, management s assessment concluded that the Company s internal control over financial reporting is ineffective. Some of the identified material weaknesses have not been fully

Table of Contents

addressed. It is also possible that additional material weaknesses will be identified in the future. Until we remediate the remaining material weaknesses we have the risk of another restatement.

The material weaknesses in our internal control over financial reporting related to the lack of controls and procedures to ensure that revenues are recognized in accordance with generally accepted accounting principles, the lack of controls and procedures to prevent shipping of short-dated products, the lack of adequate manpower and insufficient qualified accounting personnel to identify and resolve complex accounting issues, the lack of adequate record keeping and documentation of past transactional accounting decisions, the lack of controls over accruals and cut-offs, and the lack of controls surrounding financial reporting and close procedures.

Because we have concluded that our internal control over financial reporting is not effective and our independent registered public accountants issued an adverse opinion on the effectiveness of our internal controls, and to the extent we identify future weaknesses or deficiencies, there could be material misstatements in our consolidated financial statements and we could fail to meet our financial reporting obligations. As a result, our ability to obtain additional financing, 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. In addition, perceptions of us could also be adversely affected among customers, lenders, investors, securities analysts and others. Current material weaknesses or any future weaknesses or deficiencies could also hurt confidence in our business and consolidated financial statements and our ability to do business with these groups.

Our revenue recognition policy has changed to the sell-through method which is currently not used by most companies in the pharmaceutical industry which will make it more difficult to compare our results to the results of our competitors.

Because our revenue recognition policy has changed to the sell-through method which reflects products sold through the distribution channel, we do not recognize revenue for the domestic product shipments of AVINZA, ONTAK, Targretin capsules and Targretin gel. Under our previous method of accounting, product sales were recognized at time of shipment.

Under the sell-through revenue recognition method, future product sales and gross margins may be affected by the timing of certain gross to net sales adjustments including the cost of certain services provided by wholesalers under distribution service agreements, and the impact of price increases. Cost of products sold and therefore gross margins for our products may also be further impacted by changes in the timing of revenue recognition. Additionally, our revenue recognition models incorporate a significant amount of third party data from our wholesalers and IMS. Such data is subject to estimates and as such, any changes or corrections to these estimates identified in later periods, such as changes or corrections occurring as a result of natural disasters or other disruptions, including Hurricane Katrina, could affect the revenue that we report in future periods.

As a result of our change in revenue recognition policy and the fact that the sell-through method is not widely used by our competitors, it may be difficult for potential and current stockholders to assess our financial results and compare these results to others in our industry. This may have an adverse effect on our stock price.

Our new revenue recognition models under the sell-through method are extremely complex and depend upon the accuracy and consistency of third party data as well as dependence upon key finance and accounting personnel to maintain and implement the controls surrounding such models.

We have developed revenue recognition models under the sell-through method that are unique to the Company s business and therefore are highly complex and not widely used in the pharmaceutical industry. The revenue recognition models incorporate a significant amount of third-party data from our wholesalers and IMS. To effectively maintain the revenue recognition models, we depend to a considerable degree upon the timely and accurate reporting to us of such data from these third parties and our key accounting and finance personnel to accurately interpolate such data into the models. If the third-party data is not calculated on a consistent basis and reported to us on an accurate or timely basis or we lose any of our key accounting and finance personnel, the accuracy of our consolidated financial statements could be materially affected. This could cause future delays in our earnings announcements, regulatory filings with the SEC, and potential delays in relisting or delisting with the NASDAQ.

Table of Contents

Our common stock was delisted from the NASDAQ National Market which may reduce the price of our common stock and the levels of liquidity available to our stockholders and cause confusion among investors.

Our common stock was delisted from the NASDAQ National Market on September 7, 2005. Unless and until the Company s common stock is relisted on NASDAQ, its common stock is expected to be quoted on the Pink Sheets. The quotation of our common stock on the Pink Sheets may reduce the price of our common stock and the levels of liquidity available to our stockholders. In addition, the quotation of our common stock on the Pink Sheets may materially adversely affect our access to the capital markets, and any limitation on liquidity or reduction in the price of our common stock could materially adversely affect our ability to raise capital through alternative financing sources on terms acceptable to us or at all. Stocks that are quoted on the Pink Sheets are no longer eligible for margin loans, and a company quoted on the Pink Sheets cannot avail itself of federal preemption of state securities or blue sky laws, which adds substantial compliance costs to securities issuances, including pursuant to employee option plans, stock purchase plans and private or public offerings of securities. Our delisting from the NASDAQ National Market and quotation on the Pink Sheets may also result in other negative implications, including the potential loss of confidence by suppliers, customers and employees, the loss of institutional investor interest and fewer business development opportunities.

While we have applied to have our common stock relisted on the NASDAQ National Market, we may not be successful in that effort. Even if we are successful in getting our common stock relisted on NASDAQ, the relisting may cause confusion among investors who have become accustomed to our being quoted on the Pink Sheets as they seek to determine our stock price or trade in our stock.

Our small number of products and our dependence on partners and other third parties means our results are vulnerable to setbacks with respect to any one product.

We currently have only five products approved for marketing and a handful of other products/indications that have made significant progress through development. Because these numbers are small, especially the number of marketed products, any significant setback with respect to any one of them could significantly impair our operating results and/or reduce the market prices for our securities. Setbacks could include problems with shipping, distribution, manufacturing, product safety, marketing, government licenses and approvals, intellectual property rights and physician or patient acceptance of the product, as well as higher than expected total rebates, returns or discounts.

In particular, AVINZA, our pain product, now accounts for a majority of our product revenues and we expect AVINZA revenues will continue to grow over the next several years. Thus any setback with respect to AVINZA could significantly impact our financial results and our share price. AVINZA was licensed from Elan Corporation which is currently its sole manufacturer. We have contracted with Cardinal to provide additional manufacturing capacity and second source back-up, however we expect Elan will be a significant supplier over the next several years. Any problems with Elan s or Cardinal s manufacturing operations or capacity could reduce sales of AVINZA, as could any licensing or other contract disputes with these suppliers.

Similarly, our co-promotion partner executes a large part of the marketing and sales efforts for AVINZA and those efforts may be affected by our partner s organization, operations, activities and events both related and unrelated to AVINZA. Our co-promotion efforts have encountered and continue to encounter a number of difficulties, uncertainties and challenges, including sales force reorganizations and lower than expected sales call and prescription volumes, which have hurt and could continue to hurt AVINZA sales growth. The negative impact on the product s sales growth in turn has caused and may continue to cause our revenues and earnings to be disappointing. Any failure to fully optimize this co-promotion arrangement and the AVINZA brand, by either partner, could also cause AVINZA sales and our financial results to be disappointing and hurt our stock price. Any disputes with our co-promotion partner over these or other issues could harm the promotion and sales of AVINZA and could result in substantial costs to us. In addition, in January 2006 we announced that we were terminating the co-promotion arrangement with a nine-month transition period. Failure to successfully transition our partner s efforts and functions back to Ligand and/or failure to repartner or otherwise replace our partner s sales activities for AVINZA after the transition could adversely affect the sales of the product.

Table of Contents

AVINZA is a relatively new product and therefore the predictability of its commercial results is relatively low. Higher than expected discounts (especially PBM/GPO rebates and Medicaid rebates, which can be substantial), returns and chargebacks and/or slower than expected market penetration could reduce sales. Other setbacks that AVINZA could face in the sustained-release opioid market include product safety and abuse issues, regulatory action, intellectual property disputes and the inability to obtain sufficient quotas of morphine from the Drug Enforcement Agency (DEA) to support our production requirements.

In particular, with respect to regulatory action and product safety issues, the FDA recently requested that we expand the warnings on the AVINZA label to alert doctors and patients to the dangers of using AVINZA with alcohol. We are in the process of making appropriate changes to the label. The FDA also requested clinical studies to investigate the risks associated with taking AVINZA with alcohol. We are in discussions with the FDA regarding the design of those studies. These additional warnings, studies and any further regulatory action could have significant adverse affects on AVINZA sales.

Our product development and commercialization involves a number of uncertainties, and we may never generate sufficient revenues from the sale of products to become profitable.

We were founded in 1987. We have incurred significant losses since our inception. At September 30, 2005, our accumulated deficit was approximately $828.3 million. We began receiving revenues from the sale of pharmaceutical products in 1999. We achieved quarterly net income of $17.3 million during the fourth quarter of 2004, which was primarily the result of recognizing approximately $31.3 million from the sale of royalty rights to Royalty Pharma. However, for the three and nine months ended September 30, 2005, we incurred a net loss of $6.3 million and $33.7 million, respectively, and expect to incur net losses in future quarters. To consistently be profitable, we must successfully develop, clinically test, market and sell our products. Even if we consistently 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 when we incur expenses and receive revenues from product sales, collaborative arrangements and other sources. Some of these fluctuations may be significant.

Most of our products in development will require extensive additional development, including preclinical testing and human studies, as well as regulatory approvals, before we can market them. 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. For example, lasofoxifene (Oporia), a partner product being developed by Pfizer recently received a non-approvable decision from the FDA and trials of our market product Targretin failed to meet endpoints in Phase III trials in which we were studying its use in non small cell lung cancer. There are many reasons that we or our collaborative partners may fail in our efforts to develop our other 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, once 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.

Third-party reimbursement and health care reform policies may reduce our future sales.

Sales of prescription drugs depend significantly on access to the formularies, or lists of approved prescription drugs, of third-party payers such as government and private insurance plans, as well as the availability of reimbursement to the consumer from these third-party payers. These third party payers frequently require drug

Table of Contents

companies to provide predetermined discounts from list prices, and they are increasingly challenging the prices charged for medical products and services. Our current and potential products may not be considered cost-effective, may not be added to formularies and reimbursement to the consumer may not be available or sufficient to allow us to sell our products on a competitive basis. For example, we have current and recurring discussions with insurers regarding formulary access, discounts and reimbursement rates for our drugs, including AVINZA. We may not be able to negotiate favorable reimbursement rates and formulary status for our products or may have to pay significant discounts to obtain favorable rates and access. Only one of our products, ONTAK, is currently eligible to be reimbursed by Medicare (reimbursement for Targretin is being provided to a small group of patients by Medicare through December 2005 as part of the Medicare Replacement Drug Demonstration Project). Recently enacted changes by Medicare to the hospital outpatient payment reimbursement system may adversely affect reimbursement rates for ONTAK. Beginning in 2004, we have also experienced a significant increase in ONTAK units that are sold through Disproportionate Share Hospitals or DSHs. These hospitals are part of the federal government s procurement system and thus receive significantly higher rebates than non-government purchasers of our products. As a result, our net revenues for ONTAK could be substantially reduced if this trend continues.

In addition, the efforts of governments and third-party payers to contain or reduce the cost of health care will continue to affect the business and financial condition of drug companies such as us. A number of legislative and regulatory proposals to change the health care system have been discussed in recent years, including price caps and controls for pharmaceuticals. These proposals could reduce and/or cap the prices for our products or reduce government reimbursement rates for products such as ONTAK. In addition, an increasing emphasis on managed care in the United States has and will continue to increase pressure on drug pricing. We cannot predict whether legislative or regulatory proposals will be adopted or what effect those proposals or managed care efforts may have on our business. The announcement and/or adoption of such proposals or efforts could adversely affect our profit margins and business.

We are building marketing and sales capabilities in the United States and Europe which is an expensive and time-consuming process and may increase our operating losses.

Developing the sales force to market and sell products is a difficult, expensive and time-consuming process. We have developed a US sales force of approximately 130 people. We also rely on third-party distributors to distribute our products. The distributors are responsible for providing many marketing support services, including customer service, order entry, shipping and billing and customer reimbursement assistance. In Europe, we currently rely on other companies to distribute and market our products. We have entered into agreements for the marketing and distribution of our products in territories such as the United Kingdom, Germany, France, Spain, Portugal, Greece, Italy and Central and South America and have established a subsidiary, Ligand Pharmaceuticals International, Inc., with a branch in London, England, to coordinate our European marketing and operations. Our reliance on these third parties means our results may suffer if any of them are unsuccessful or fail to perform as expected. We may not be able to continue to expand our sales and marketing capabilities sufficiently to successfully commercialize our products in the territories where they receive marketing approval. With respect to our co-promotion or licensing arrangements, for example our co-promotion agreement for AVINZA, which is currently in transition, any revenues we receive will depend substantially on the marketing and sales efforts of others, which may or may not be successful.

The cash flows from our product shipments may significantly fluctuate each period based on the nature of our products.

Excluding AVINZA, our products are small-volume specialty pharmaceutical products that address the needs of cancer patients in relatively small niche markets with substantial geographical fluctuations in demand. To ensure patient access to our drugs, we maintain broad distribution capabilities with inventories held at approximately 150 locations throughout the United States. The purchasing and stocking patterns of our wholesaler customers for all our products are influenced by a number of factors that vary from product to product, including but not limited to overall level of demand, periodic promotions, required minimum shipping quantities and wholesaler competitive initiatives. As a result, the overall level of product in the distribution channel may average from two to six months worth of projected inventory usage. Although we have distribution services contracts in place to maintain stable inventories at our major wholesalers, if any of them were to substantially reduce the inventory they carry in a given

11

Table of Contents

period, e.g. due to circumstances beyond their reasonable control, or contract termination or expiration, our shipments and cash flow for that period could be substantially lower than historical levels.

In the second half of 2004, we entered into new fee-for-service or distributor services agreements for each of our products with the majority of our wholesaler customers. Under these agreements, in exchange for a set fee, the wholesalers have agreed to provide us with certain services. Concurrent with the implementation of these agreements we will no longer routinely offer these wholesalers promotional discounts or incentives. The agreements typically have a one-year initial term and are renewable.

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.

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 currently estimate our research and development expenditures over the next 3 years to range between $200 million and $275 million. 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 and other factors. Any of these uncertain events can significantly change our cash requirements as they determine such one-time events as the receipt of major milestones and other payments.

While we expect to fund our research and development activities from cash generated from internal operations 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. 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.

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

We have incurred losses since our inception and may not generate positive cash flow to fund our operations for one or more years. As a result, 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 favorable terms. In addition, these financings, if completed, still may not meet our capital needs and could result in substantial dilution to our stockholders. For instance, in April 2002 and September 2003 we issued an aggregate of 7.7 million shares of our common stock in a private placement. In addition, in November 2002 we

Table of Contents

issued in a private placement $155.3 million in aggregate principal amount of our 6% Convertible Subordinated Notes due 2007, which could be converted into 25,149,025 shares of our common stock.

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, or our marketing and sales initiatives. 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 products 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 in clinical trials, the most significant of which are our Phase III trials for Targretin capsules in NSCLC, lasofoxifene which is under NDA review and two products in Phase III trials by one of our partners involving bazedoxifene. Failure to show any product s safety and effectiveness would delay or prevent regulatory approval of the product and could adversely affect our business. The clinical trials process is complex and uncertain. 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. 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, which could be expensive and time-consuming, and failure to successfully conduct those trials could jeopardize continued commercialization.

In particular, we announced top-line data, or a summary of significant findings from our Phase III trials for Targretin capsules in NSCLC in late March of 2005. The data analysis showed that the trials did not meet their endpoints of improved overall survival and projected two-year survival. However, in both trials, additional subset analysis completed after the initial intent to treat results are being analyzed. We have been evaluating data from current and prior Phase II studies to see if they show a similar correlation between hypertriglyceridemia and increased survival. The data will further shape our future plans for Targretin. If further studies are justified they will be conducted on our own or with a partner or cooperative group. These analyses may not be favorable and may not be completed or demonstrate any hypothesis or endpoint. If these analyses or subsequent data fails to show safety or effectiveness, our stock price could be harmed. In addition, subsequent data may be inconclusive or mixed and could be delayed. The FDA may not approve Targretin for this new indication, or may delay approval, even if the data appears to be favorable. Any of these events could depress our stock price.

The rate at which we complete our clinical trials depends on many factors, including 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. For example, each of our Phase III Targretin clinical trials involved approximately 600 patients and required significant time and investment to complete enrollments. Delays in patient enrollment for our other 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 collaborators may conduct these programs more slowly or in a different manner than we had expected. 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.

We face substantial competition which may limit our revenues.

Some of the drugs that we are developing and marketing will compete with existing treatments. In addition, several companies are developing new drugs that target the same diseases that we are targeting and are taking IR-related and STAT-related approaches to drug development. The principal products competing with our products targeted at the cutaneous t-cell lymphoma market are Supergen/Abbott s Nipent and interferon, which is marketed by a number of companies, including Schering-Plough s Intron A. Products that compete with AVINZA include Purdue Pharma L.P. s OxyContin and MS Contin and potentially Palladone (launched in early 2005 and subsequently withdrawn from the market), Janssen Pharmaceutica Products, L.P. s Duragesic, aai Pharma s Oramorph SR, Alpharma s Kadian, and generic sustained release morphine sulfate, oxycodone and fentanyl. New

13

Table of Contents

generic, A/B substitutable or other competitive products may also come to market and compete with our products, reducing our market share and revenues. Many of our existing or potential competitors, particularly large drug companies, have greater financial, technical and human resources than us and may be better equipped to develop, manufacture and market products. Many of these companies also have extensive experience in preclinical testing and human clinical trials, obtaining FDA and other regulatory approvals and manufacturing and marketing pharmaceutical products. In addition, academic institutions, governmental agencies and other public and private research organizations are developing products that may compete with the products we are developing. These institutions are becoming more aware of the commercial value of their findings and are seeking patent protection and licensing arrangements to collect payments for the use of their technologies. These institutions also may market competitive products on their own or through joint ventures and will compete with us in recruiting highly qualified scientific personnel.

We rely heavily on collaborative relationships and termination of any of these programs could reduce the financial resources available to us, including research funding and milestone payments.

Our strategy for developing and commercializing many of our potential products, including products aimed at larger markets, includes entering into collaborations with corporate partners, licensors, licensees and others. These collaborations provide us with funding and research and development resources for potential products for the treatment or control of metabolic diseases, hematopoiesis, women s health disorders, inflammation, cardiovascular disease, cancer and skin disease, and osteoporosis. These agreements also give our collaborative partners significant discretion when deciding whether or not to pursue any development program. Our collaborations may not continue or be successful.

In addition, our collaborators may develop drugs, either alone or with others, that compete with the types of drugs they currently are developing with us. This would result in less support and increased competition for our programs. If products are approved for marketing under our collaborative programs, any revenues we receive will depend on the manufacturing, marketing and sales efforts of our collaborators, who generally retain commercialization rights under the collaborative agreements. Our current collaborators also generally 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.

We may have disputes in the future with our collaborators, including disputes concerning which of us owns the rights to any technology developed. For instance, we were involved in litigation with Pfizer, which we settled in April 1996, concerning our right to milestones and royalties based on the development and commercialization of droloxifene. These and other possible disagreements between us and our collaborators could delay our ability and the ability of our collaborators to achieve milestones or our receipt of other payments. In addition, any disagreements could delay, interrupt or terminate the collaborative research, development and commercialization of certain potential products, 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.

Some of our key technologies have not been used to produce marketed products and may not be capable of producing such products.

To date, we have dedicated most of our resources to the research and development of potential drugs based upon our expertise in our IR technology. Even though there are marketed drugs that act through IRs, some aspects of our IR technologies have not been used to produce marketed products. Much remains to be learned about the function of IRs. If we are unable to apply our IR and Signal Transducer and Activator of Transcription, or STAT, technologies to the development of our potential products, we may not be successful in discovering or developing new products.

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 and to avoid infringing the proprietary rights of others, 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. In addition, disputes with licensors under our license agreements

Table of Contents

may arise which could result in additional financial liability or loss of important technology and potential products and related revenue, if any.

Our patent position, like that of many 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, they 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. Further, the manufacture, use or sale of our products may infringe the patent rights of others.

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 Patent and Trademark Office and patent applications filed in foreign countries are often first published six months or more after filing. 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. While we routinely receive communications or have conversations with the owners of other patents, none of these third parties have directly threatened an action or claim against us. If other companies 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.

We have had and will continue to have discussions with our current and potential collaborators regarding the scope and validity of our patents and other proprietary rights. If a collaborator 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 collaborators to terminate their agreements where contractually permitted. Such a determination could also 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 results, a court may find our patents or those of our licensors invalid or may find that we have infringed on a competitor s rights. If any of our competitors have filed patent applications in the United States which claim technology we also have invented, the 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.

Hoffmann-La Roche Inc. has received a US patent, has made patent filings and has issued patents in foreign countries that relate to our Panretin gel products. While we were unsuccessful in having certain claims of the US patent awarded to Ligand in interference proceedings, we continue to believe that any relevant claims in these Hoffman-La Roche patents in relevant jurisdictions are invalid and that our current commercial activities and plans relating to Panretin are not covered by these Hoffman-La Roche patents in the US or elsewhere. In addition, we have our own portfolio of issued and pending patents in this area which cover our commercial activities, as well as other uses of 9-*cis* retinoic acid, in the US, Europe and elsewhere. However, if the claims in these Hoffman-La Roche patents are not invalid and/or unenforceable, they might block the use of Panretin gel in specified cancers, not currently under active development or commercialization by us.

Novartis AG has filed an opposition to our European patent that covers the principal active ingredient of our ONTAK drug. We have received a favorable preliminary opinion from the European Patent Office, however this is not a final determination and Novartis has filed a response to the preliminary opinion that argues our patent is invalid. If the opposition is successful, we could lose our ONTAK patent protection in Europe which could substantially reduce our future ONTAK sales in that region. We could also incur substantial costs in asserting our rights in this opposition proceeding, as well as in other possible future proceedings in the United States.

15

Table of Contents

We also rely on unpatented trade secrets and know-how to protect and maintain our competitive position. We require our employees, consultants, collaborators 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.

Reliance on third-party manufacturers to supply our products risks supply interruption or contamination and difficulty controlling costs.

We currently have no manufacturing facilities, and we rely on others for clinical or commercial production of our marketed and potential products. In addition, some raw materials necessary for the commercial manufacturing of our products are custom and must be obtained from a specific sole source. Elan manufactures AVINZA for us, Cambrex manufactures ONTAK active pharmaceutical ingredient for us, Raylo manufacture Targretin active pharmaceutical ingredient for us, and Cardinal Health manufactures Targretin capsules for us. We also recently entered into contracts with Cardinal Health to manufacture and package AVINZA and with Hollister-Stier for the filling and finishing of ONTAK. Each of these recent contracts calls for manufacturing and packaging the product at a new facility. Qualification and regulatory approval for these facilities are required prior to starting commercial manufacturing and was recently received in 2005 for both facilities. Any delays or failures of the manufacturing or packaging process could cause inventory problems or product shortages.

To be successful, we will need to ensure continuity of the manufacture of our products, either directly or through others, in commercial quantities, in compliance with regulatory requirements at acceptable cost and in sufficient quantities to meet product growth demands. Any extended or unplanned manufacturing shutdowns, shortfalls or delays could be expensive and could result in inventory and product shortages. If we are unable to reliably manufacture our products our revenues could be adversely affected. In addition, if we are unable to supply products in development, our ability to conduct preclinical testing and human clinical trials will be adversely affected. This in turn could also delay our submission of products for regulatory approval and our initiation of new development programs. In addition, although other companies have manufactured drugs acting through IRs and STATs on a commercial scale, we may not be able to translate our core technologies or other technologies into drugs that can be manufactured at costs or in quantities to make marketable products.

The manufacturing process also may be susceptible to contamination, which could cause the affected manufacturing facility to close until the contamination is identified and fixed. In addition, problems with equipment failure or operator error also could cause delays in filling our customers orders.

Our business exposes us to product liability risks or our products may need to be recalled, and we may not have sufficient insurance to cover any claims.

Our business exposes us to potential product liability risks. Our products also 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 the business. Some of the compounds we are investigating may be harmful to humans. For example, retinoids as a class are known to contain compounds which can cause birth defects. We may not be able to maintain our insurance on acceptable 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 believe that we carry reasonably adequate insurance for product liability claims.

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 substantial cost to us. Our annual cost of compliance with these regulations is approximately $700,000. We cannot completely eliminate the risk of accidental contamination or injury from the handling and disposing of hazardous materials, whether by us or by our third-party contractors. In the event of any accident, we could be held liable for any damages that result, which could be significant. We believe that we carry reasonably adequate insurance for toxic tort claims.

Table of Contents

Future sales of our securities may depress the price of our securities.

Sales of substantial amounts of our securities in the public market could seriously harm prevailing market prices for our securities. These sales might make it difficult or impossible for us to sell additional securities when we need to raise capital.

You may not receive a return on your securities other than through the sale of your securities.

We have not paid any cash dividends on our common stock to date. We intend to retain any earnings to support the expansion of our business, and we do not anticipate paying cash dividends on any of our securities in the foreseeable future.

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 you. Such 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.

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements, including statements regarding the demand for our marketed products, the diligence of our corporate partners in continuing development of product candidates for which they are responsible, the progress and timing of clinical trials, whether conducted by us or by our corporate partners, the safety and efficacy of our products and product candidates, the goals of our development activities, estimates of the potential markets for our product candidates, the success of our previously announced strategic alternatives evaluation, our operations and expenditures and projected cash needs. The forward-looking statements are contained principally in the sections entitled Prospectus Summary, Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and Business. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that could cause our actual results, levels of activity, performance or achievement to differ materially from those expressed or implied by these forward-looking statements. These risks and uncertainties include, among others:

- our ability to successfully complete clinical development of our product candidates on expected timetables, or at all, which includes enrolling sufficient patients in our clinical trials and demonstrating the safety and efficacy of our product candidates in such trials;
- our ability to ensure continued supply of sufficient quantities of our products and product candidates to support market demand and for clinical trials;
- our ability to obtain, maintain and successfully enforce adequate patent and other intellectual property protection of our currently marketed products and product candidates that may be approved for sale;
- the content and timing of submissions to and decisions made by the FDA and other regulatory agencies, including demonstrating to the satisfaction of the FDA the safety and efficacy of product candidates we or our corporate partners are developing;
- our ability to develop a sufficient sales and marketing force or enter into agreements with third parties to sell and market any of our products or product candidates that may be approved for sale;
- the success of our competitors;
- our ability to obtain reimbursement for any of our products or product candidates that may be approved for sale from third-party payors, and the extent of such coverage;
- our ability to successfully complete our previously announced strategic alternatives evaluation; and
- our ability to raise additional funds in the capital markets, through arrangements with corporate partners or from other sources.

Forward-looking statements include all statements that are not historical facts. In some cases, you can identify forward-looking statements by terms such as may, will, should, could, would, expects, plans, anticipates, estimates, projects, predicts, potential, or the negative of those terms, and similar expressions and comparable terminology intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and subject to risks and uncertainties. Given these uncertainties, you should not place undue reliance on these forward-looking statements. These forward-looking statements represent our estimates and assumptions only as of the date of this prospectus and, except as required by law, we undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this prospectus. The forward-looking statements contained in this prospectus are excluded from the safe harbor protection provided by the Private Securities Litigation Reform Act of 1995 and Section 27A of the Securities Act of 1933, as amended.

Table of Contents

USE OF PROCEEDS

We will not receive any of the proceeds from the sale of the shares of our common stock by the selling stockholders under this prospectus. We will receive proceeds in connection with option exercises under the 2002 Plan and shares issued under the 2002 ESPP which will be based upon each granted option exercise price or purchase price, as applicable. The exercise price under our 2002 Plan is generally based upon the fair market value of our shares at the option grant date. The purchase price of the common stock acquired under our 2002 ESPP is equal to 85% of the lower of the fair market value per share of common stock on the start date of the offering period in which the individual is enrolled or the fair market value on the quarterly purchase date. Any proceeds received by us will be used for working capital and general corporate purposes. See Use of Proceeds and Capitalization.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our capital stock and do not intend to pay any cash dividends in the foreseeable future. We currently intend to retain our earnings, if any, to finance future growth.

Table of Contents

CAPITALIZATION

The following table sets forth our cash, cash equivalents and short-term investments and our capitalization as of September 30, 2005:

on an actual basis; and

on a pro forma as adjusted basis to reflect the proceeds from (a) the exercise of all currently outstanding options and (b) the future grant and exercise of all options/shares currently reserved for future issuance under the 2002 ESPP and 2002 Plan as follows:

- 6,917,755 shares of common stock issuable upon the exercise of options outstanding as of September 30, 2005 at a weighted average exercise price of $11.78 per share.

- The addition of 234,667 shares of common stock issuable upon the exercise of options that were granted in December 2005 under the 2002 Plan at an exercise price of $11.35 per share.

- The reduction of 147,290 shares of common stock that were previously issuable upon the exercise of options that were granted under the 2002 Plan and were cancelled in the fourth quarter of 2005. The stock value is based upon an average exercise price of $12.08 per share.

- The addition of 789,348 shares of our common stock reserved for future issuance under our 2002 Plan (including the 750,000 share increase in the authorized shares under the 2002 Plan approved by our stockholders at the Company s annual stockholders meeting held on January 31, 2006) at an estimated exercise price of $12.25 per share. The estimated per share price is based upon the current market value of our common stock on January 10, 2006.

- The addition of 147,510 shares of common stock reserved for issuance under our 2002 ESPP at an estimated purchase price of $10.41 per share. The estimated purchase per share price is based upon 85% of the purchase price of our common stock on January 10, 2006.

The addition of 15,566 shares of restricted stock awarded on January 4, 2006 under the 2002 Plan to certain outside directors. The stock value is based upon the fair market value on January 4, 2006, the award date, which was $11.56 per share. We received no proceeds from the issuances of such shares of restricted stock. See Selling Stockholders. You should read this table together with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the related notes appearing elsewhere in this prospectus. As described above, the pro forma capitalization assumes that all of the stock options or shares previously granted or reserved for future issuance will be exercised or issued. However, not all of such options or shares may be issued, exercised or granted.

Table of Contents

	September 30, 2005 (Unaudited)	
	Actual	Pro Forma As Adjusted
	(in thousands, except share and par value data)	
Cash, cash equivalents, short-term investments and restricted investments	$ 75,616	$ 169,173
Common stock subject to conditional redemption; 997,568 shares issued and outstanding at September 30, 2005	$ 12,345	$ 12,345
Stockholders deficit:		
Convertible preferred stock, $0.001 par value; 5,000,000 shares authorized; no shares issued or outstanding pro forma as adjusted	$	$
Common stock, $0.001 par value; 200,000,000 shares authorized; 73,133,715 and 81,091,271shares issued and outstanding pro forma as adjusted	73	81
Additional paid-in capital	720,943	814,672
Accumulated other comprehensive (loss) income	(182)	(182)
Accumulated deficit	(828,337)	(828,517)
Treasury stock, at cost; 73,842 shares	(911)	(911)
Total stockholders deficit	$ (108,414)	$ (14,857)

Table of Contents

SELECTED CONSOLIDATED FINANCIAL DATA

Set forth below are highlights from Ligand s unaudited consolidated financial data as of and for the three and nine months ended September 30, 2005 and 2004 and Ligand s consolidated financial data as of and for the years ended December 31, 2000 through 2004. The unaudited consolidated financial statements for September 30, 2005 and 2004 have been prepared on a basis consistent with our audited consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments, we consider necessary for the fair statement of the information. The results of operations for the three and nine months ended September 30, 2005 and 2004 are not necessarily indicative of the results that may be expected for the full year or any other future period. Consolidated balance sheet data as of December 31, 2003, 2002, 2001, and 2000, and consolidated statements of operations data for the years then ended have been restated with respect to the matters described in Management s Discussion and Analysis of Financial Condition and Results of Operations and in Note 2 to our accompanying consolidated financial statements appearing elsewhere in this prospectus. As noted below, the consolidated balance sheet data as of December 31, 2000 through 2002 and the consolidated statement of operations data for the years ended 2000 and 2001 are unaudited.

The selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our interim and annual consolidated financial statements and related notes included elsewhere in this prospectus.

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,		Year Ended December 31,				
	2005	2004	2005	2004	2004	2003	2002	2001	20
	(Restated) (Unaudited)		(Restated) (Unaudited)		(Restated)	(Restated)	(Restated)	(Restated) (Unaudited)	(Res (Una
	(in thousands, except share and loss per share data)								
idated ent of ions									
sales (1)	$ 42,584	$ 31,934	$ 119,364	$ 86,172	$ 120,335	$ 55,324	$ 30,326	$ 32,038	$
royalty net (2)		67		67	31,342	11,786	17,600		
rative n and ment er s	2,172	4,771	8,176	10,222	11,835	14,008	23,843	30,718	
products	9,807	9,819	31,539	27,082	39,804	26,557	14,738	11,582	
h and ment es	12,911	16,747	42,170	50,830	65,204	66,678	59,060	49,427	
general trative es	17,787	17,311	57,151	50,132	65,798	52,540	41,825	35,072	
motion (3)	7,766	8,501	22,472	22,232	30,077	9,360			
om ons fore tive f changes unting es tive n prior g of tion (4) tive f g of ing for	(3,515)	(15,606)	(25,792)	(53,815)	(37,371)	(74,017)	(43,854)	(33,325)	(
	(6,281)	(18,498)	(33,677)	(62,475)	(45,141)	(94,466)	(52,257)	(53,305)	(
						(2,005)			(

e interest 5)									
s	(6,281)	(18,498)	(33,677)	(62,475)	(45,141)	(96,471)	(52,257)	(53,305)	(
nd per share s: fore tive f changes unting es	$ (0.08)	$ (0.25)	$ (0.46)	$ (0.85)	$ (0.61)	$ (1.33)	$ (0.76)	$ (0.90)	$
tive n prior g of									
tion (4) tive f g of ing for e interest 5)						(0.03)			
s	$ (0.08)	$ (0.25)	$ (0.46)	$ (0.85)	$ (0.61)	$ (1.36)	$ (0.76)	$ (0.90)	$
ed number mon	74,041,204	73,845,613	73,998,594	73,635,562	73,692,987	70,685,234	69,118,976	59,413,270	55,6
ma s g the d method unting able entity is									
ively(5): s nd net loss e						$ (94,352)	$ (52,456)	$ (53,600)	$ (
						$ (1.34)	$ (0.76)	$ (0.90)	$

Table of Contents

	At September 30,		At December 31,				
	2005	2004 (Restated) (Unaudited)	2004	2003 (Restated)	2002 (Restated) (Unaudited)	2001 (Restated) (Unaudited)	2000 (Restated) (Unaudited)
				(in thousands)			
Consolidated Balance Sheet Data:							
Cash, cash equivalents, short-term investments and restricted investments	$ 75,616	$ 82,063	$ 114,870	$ 100,690	$ 74,894	$ 40,058	$ 25,097
Working capital (deficit) (6)	(106,887)	(69,998)	(48,505)	(19,776)	18,370	2,375	8,372
Total assets	306,047	303,773	332,466	314,046	287,709	126,898	117,484
Current portion of deferred revenue, net	158,224	141,545	152,528	105,719	48,609	27,152	13,713
Long-term obligations (excludes long-term portion of deferred revenues, net)	173,242	174,431	174,214	173,851	162,329	138,837	133,575
Long-term portion of deferred revenue, net	4,279	3,216	4,512	3,448	3,595	4,164	5,727
Common stock subject to conditional redemption/repurchase	12,345	12,345	12,345	14,595	34,595	14,595	14,595
Accumulated deficit	(828,337)	(811,994)	(794,660)	(749,519)	(653,048)	(600,791)	(547,486)
Total stockholders equity (deficit) (7)	(108,414)	(93,404)	(75,317)	(37,554)	8,925	(86,849)	(72,405)

(1) We began selling ONTAK and Panretin gel in 1999 and Targretin capsules and Targretin gel in 2000. AVINZA was approved by the FDA in March 2002 and subsequently launched in the U.S. in June 2002.

(2) Represents the sale of rights to royalties. See Note 11 to our annual consolidated financial statements included elsewhere in this prospectus.

(3) Represents expense related to our AVINZA co-promotion agreement with Organon Pharmaceuticals USA, Inc. entered into in February 2003. See Note 8 to our annual consolidated financial statements included elsewhere in this prospectus and Note 6 to our interim consolidated financial statements included elsewhere in this prospectus. On January 17, 2006, we signed an agreement with Organon USA, Inc. that terminates the AVINZA® co-promotion agreement between the two companies and returns AVINZA rights to us. The effective date of the termination agreement is January 1, 2006, however the parties have agreed to continue to cooperate during a transition period ending September 30, 2006 to promote the product. See Management s Discussion and Analysis of Financial Condition and Results of Operations Overview ; Business Overview; and Business Overview-Ligand Marketed Products AVINZA Co-Promotion Agreement with Organon.

(4) In 2000, we changed our policy for the recognition of revenue related to up-front fees in accordance with Staff Accounting Bulletin (SAB) No. 101 Revenue Recognition, as amended by SAB 104 (hereinafter referred to as SAB 104).

(5) In December 2003, we adopted FIN 46(R), *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51*. Under FIN 46(R), we were required to consolidate the variable interest entity from which we leased our corporate headquarters. Accordingly, as of December 31, 2003, we consolidated assets with a carrying value of $13.6 million, debt of $12.5 million, and a non-controlling interest of $0.6 million. In connection with the adoption of FIN 46(R), we recorded a charge of $2.0 million as a cumulative effect of the accounting change on December 31, 2003. In April 2004, we acquired the portion of the variable interest entity that we did not previously own. The acquisition resulted in Ligand assuming the existing loan against the property and making a payment of approximately $0.6 million to the entity s other shareholder. See Note 3 to our annual consolidated financial statements included elsewhere in this prospectus.

(6) Working capital (deficit) includes deferred product revenue recorded under the sell-through revenue recognition method.

(7) The cumulative effect of the restatement at January 1, 2000 was approximately $(13.2) million, which represents the effect of the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(1.0) million; royalties $0.1 million; $(1.6) million regarding rent expense for annual rent increases; $(14.6) million regarding the reclassification from equity of the Company s issuance of common stock subject to conditional redemption to Pfizer in accordance with EITF D-98; $3.4 million regarding the capitalization of the X-Ceptor purchase right in October 1999; and $0.5 million regarding the reversal of X-Ceptor warrant amortization.

Table of Contents

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 under the heading Risk Factors. This outlook represents our current judgment on the future direction of our business. These statements include those related to management s trend analyses and expectations, Organon discussions, product and corporate partner pipeline, litigation,, the SEC enforcement investigation, the potential relisting of the Company s securities on the NASDAQ National Market, and material weaknesses and remediation. Actual events or results may differ materially from Ligand s expectations. For example, there can be no assurance of that the Company s subsequent processes and initiatives such as the Company achieving relisting on the NASDAQ Stock Market and if so, when relisting will occur, that the Company s currently ongoing or future litigation (including private litigation and the SEC investigation) will not have an adverse effect on the Company, that corporate or partner pipeline products will gain approval or success in the market, that the Company will remediate any identified material weaknesses, or that the sell-through revenue recognition models will not require adjustment and not result in a subsequent restatement. In addition, the Company s financial results and stock price may suffer as a result of the previously announced restatement and delisting action by NASDAQ or as a result of any failure to remediate material weaknesses and its relationships with its vendors, stockholders or other creditors may suffer. Such risks and uncertainties 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 prospectus. This caution is made under the safe harbor provisions of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended.

Background of the Restatement

On March 17, 2005, the Company announced that in connection with the preparation of its consolidated financial statements for 2004 and the audit of those consolidated financial statements, the Audit Committee of the Board of Directors would conduct a review, with the assistance of management, of the Company s revenue recognition policies and accounting for product sales, including its estimates of product returns under SFAS 48 Revenue When Right of Return Exists (SFAS 48) and Staff Accounting Bulletin (SAB) No. 101 Revenue Recognition, as amended by SAB 104 (hereinafter referred to as SAB 104). The review included the Company s revenue recognition policies and practices for current and past periods as well as the Company s internal control over financial reporting as it related to those items. The Company also reviewed the accounting and classification of its sales of royalty rights in its consolidated statements of operations. The Audit Committee retained Dorsey & Whitney LLP as independent counsel. The Audit Committee and independent counsel subsequently retained PricewaterhouseCoopers as their independent accounting consultants to assist in the review. In addition, the Company, through its counsel, Latham & Watkins LLP, retained FTI Ten Eyck to provide an independent accounting perspective in connection with the accounting issues under review.

On May 20, 2005, the Company announced that the Audit Committee had completed its accounting review and that the Company would restate its consolidated financial statements as of December 31, 2003 and for the years ended December 31, 2003 and 2002, and as of and for the first three quarters of 2004 and for the quarters of 2003. The Audit Committee and management independently reviewed the Company s revenue recognition practices and policies for product sales for 2003 and 2002 and each of the three quarters in the period ended September 30, 2004. These reviews focused on whether the Company had properly recognized revenue on product shipments to distributors under SFAS 48 and SAB 104. Based on these reviews, the Company determined that it had not met all of the criteria under SFAS 48 and SAB 104 to recognize revenue upon shipment. As a result of this error, the Company determined to restate its financial results and to report financial results under the sell-through revenue recognition method for the domestic product shipments of AVINZA, ONTAK, Targretin capsules and Targretin gel. The Company also announced that it was continuing its work to review the accounting and classification of its sales of royalty rights in its consolidated statements of operations and that the Audit Committee review found no evidence of improper or fraudulent actions or practices by any member of management or that management acted in bad faith in adopting and administering the Company s historical revenue recognition policies.

25

Table of Contents

Subsequent to the Company s announcement that it would restate its consolidated financial statements, the Company s previous auditors declined to be re-engaged to audit the restatement. As a result, the Audit Committee engaged BDO Seidman, LLP (BDO), the Company s current independent registered public accounting firm, to re-audit the consolidated financial statements for the fiscal years ended December 31, 2003 and 2002. During the course of the re-audits other errors were identified that affected the restated consolidated financial statements.

In connection with the restatement, the SEC instituted a formal investigation concerning the Company s consolidated financial statements. These matters were previously the subject of an informal SEC inquiry. Ligand has been cooperating fully with the SEC and will continue to do so in order to bring the investigation to a conclusion as promptly as possible.

The Restatement and Other Related Matters

In November 2005, the Company filed its annual report on Form 10-K for the year ended December 31, 2004 which also restated its consolidated financial statements for the years ended 2002 and 2003, and the 2003 quarterly periods and the first three quarters of 2004. Set forth below is a summary of the significant determinations regarding the restatement and additional matters addressed in the course of the restatement.

Revenue Recognition. The restatement corrects the recognition of revenue for transactions involving each of the Company s products that did not satisfy all of the conditions for revenue recognition contained in SFAS 48 and SAB 104. The Company s products impacted by this restatement are the domestic product shipments of AVINZA, ONTAK, Targretin Capsules, and Targretin Gel. Specifically, although the Company believed it had met each of the criteria for recognizing revenue upon shipment of each of its products, management subsequently determined that based upon SFAS 48 and SAB 104 it did not have the ability to make reasonable estimates of future returns because there was (i) a lack of sufficient visibility into the wholesaler and retail distribution channels; (ii) an absence of historical experience with similar products; (iii) increasing levels of inventory in the wholesale and retail distribution channels as a result of increasing demand of the Company s new products among other factors; and (iv) a concentration of a few large distributors. As a result, the Company could not make reliable and reasonable estimates of returns which precluded it from recognizing revenue at the time of product shipment, and therefore such transactions were restated using the sell-through method. The restatement of product revenue under the sell-through method required the correction of other accounts whose balances are largely based upon the prior accounting policy. Such accounts include gross to net sales adjustments and cost of goods (products) sold. Gross to net sales adjustments include allowances for returns, rebates, chargebacks, discounts, and promotions, among others. Cost of product sold includes manufacturing costs and royalties.

The restatement did not affect the revenue recognition of Panretin or the Company s international product sales. For Panretin, the Company s wholesalers only stock minimal amounts of product, if any. As such, wholesaler orders are considered to approximate end-customer demand for the product. For international sales, the Company s products are sold to third-party distributors for which the Company has had minimal returns. For these sales, the Company believes that it has met the SFAS 48 and SAB 104 criteria for recognizing revenue.

Specific models were developed for: AVINZA, including a separate model for each dosage strength (a retail-stocked product for which the sell-through revenue recognition event is prescriptions as reported by a third party data provider, IMS Health Incorporated, or IMS); Targretin capsules and gel (for which revenue recognition is based on wholesaler out-movement as reported by IMS); and ONTAK (for which revenue recognition is based on wholesaler out-movement as reported to the Company by its wholesalers as the product is generally not stocked in pharmacies). Separate models were also required for each of the adjustments associated with the gross to net sales adjustments and cost of goods sold. The Company also developed separate demand reconciliations for each product to assess the reasonableness of the third party information described above.

Under the sell-through method used in the restatement and on a going-forward basis, the Company does not recognize revenue upon shipment of product to the wholesaler. For these shipments, the Company invoices the wholesaler, records deferred revenue at gross invoice sales price less estimated cash discounts and, for ONTAK, end-customer returns, and classifies the inventory held by the wholesaler as deferred cost of goods sold within other current assets. Additionally, for royalties paid to technology partners based on product shipments to wholesalers, the Company records the cost of such royalties as deferred royalty expense within other current

26

Table of Contents

assets. Royalties paid to technology partners are deferred as the Company has the right to offset royalties paid for product that are later returned against subsequent royalty obligations. Royalties for which the Company does not have the ability to offset (for example, at the end of the contracted royalty period) are expensed in the period the royalty obligation becomes due. The Company recognizes revenue when inventory is sold through (as discussed below), on a first-in first-out (FIFO) basis. Sell-through for AVINZA is considered to be at the prescription level or at the time of end user consumption for non-retail prescriptions. Thus, changes in wholesaler or retail pharmacy inventories of AVINZA do not affect the Company s product revenues. Sell-through for ONTAK, Targretin capsules, and Targretin gel is considered to be at the time the product moves from the wholesaler to the wholesaler s customer. Changes in wholesaler inventories for all the Company s products, including product that the wholesaler returns to the Company for credit, do not affect product revenues but will be reflected as a change in deferred product revenue.

The Company s revenue recognition is subject to the inherent limitations of estimates that rely on third-party data, as certain-third party information is itself in the form of estimates. Accordingly, the Company s sales and revenue recognition under the sell-through method reflect the Company s estimates of actual product sold through the distribution channel. The estimates by third parties include inventory levels and customer sell-through information the Company obtains from wholesalers which currently account for a large percentage of the market demand for its products. The Company also uses third-party market research data to make estimates where time lags prevent the use of actual data. Certain third-party data and estimates are validated against the Company s internal product movement information. To assess the reasonableness of third-party demand (i.e. sell-through) information, the Company prepares separate demand reconciliations based on inventory in the distribution channel. Differences identified through these demand reconciliations outside an acceptable range will be recognized as an adjustment to the third-party reported demand in the period those differences are identified. This adjustment mechanism is designed to identify and correct for any material variances between reported and actual demand over time and other potential anomalies such as inventory shrinkage at wholesalers or retail pharmacies.

As a result of the Company s adoption of the sell-through method, it recorded reductions to net product sales in the amounts of $12.8 million and $30.2 million for the three and nine months ended September 30, 2004. Additionally, for the years ended December 31, 2003 and 2002, the Company recorded a corresponding reduction to net product sales in the amounts of $59.2 million and $24.2 million, respectively. Revenue which has been deferred will be recognized as the product sells through in future periods as discussed above.

Effects of the Sell-Through Method on Consolidated Financial Statements

Under the sell-through revenue recognition method, product sales and gross margins for 2004, 2003 and 2002 were affected by the timing of gross to net sales adjustments including wholesaler promotional discounts, the cost of certain services provided by wholesalers under distribution service agreements, and the impact of price increases. Additionally, cost of products sold and therefore gross margins for the Company s products were further impacted by the changes in the timing of revenue recognition and certain related changes in accounting as a result of the change to the sell-through revenue recognition method. The more significant impacts are summarized below:

Impact of changed sales volumes - a significant amount of cost of products sold is comprised of fixed costs including amortization of acquired technology and product rights that result in lower margins at lower sales levels.

Returns - as discussed above, when product is shipped into the wholesale channel, inventory held by the wholesaler (and subsequently held by retail pharmacies in the case of AVINZA) is classified as deferred cost of product sold which is included in Other current assets. At the time of shipment, the Company makes an estimate of units that may be returned and records a reserve for those units against the deferred cost of goods sold account. Upon an announced price increase, the Company revalues its estimate of deferred product revenue to be returned to recognize the potential higher credit a wholesaler may take upon product return determined as the difference between the new and the initial wholesaler acquisition cost. The impact of this reserve revaluation is likewise reflected as a charge to the Company s statement of operations in the period the Company announces such price increase.

Table of Contents

Change to AVINZA product cost in November 2002, the Company and Elan Corporation agreed to amend the terms of the AVINZA license and supply agreement. Under the terms of the amended agreement, Elan s adjusted royalty and supply price of AVINZA is approximately 10% of the product s net sales, compared to approximately 30-35% in the prior agreement. As noted above, product shipped to the wholesaler is recorded as deferred cost of goods sold and subsequently recognized as cost of sales when the product sells-through. In the restated revenue, the majority of product manufactured by Elan in 2002 at the higher contractual cost of production, sold-through and was recognized as cost of sales in 2003. Accordingly, AVINZA gross margins for 2003 under sell-through revenue recognition reflect this higher product cost compared to the previously reported 2003 margins under the sell-in revenue recognition method. If future sales volume increases and future return levels and product mix are similar to the Company s experience in 2004, the Company expects that its gross margin levels overall will increase and stabilize over time. Gross margin on all product sales for 2004, 2003, and 2002 was 67%, 52%, and 51%, respectively.

Royalties under the sell-through method, royalties paid based on unit shipments to wholesalers are deferred and recognized as royalty expense as those units are sold-through and recognized as revenue.

Sale of Royalty Rights. In March 2002, the Company entered into an agreement with Royalty Pharma AG (Royalty Pharma) to sell a portion of its rights to future royalties from the net sales of three Selective Estrogen Receptor Modulator, or SERM, products now in late stage development with two of the Company s collaborative partners, Pfizer Inc. and American Home Products Corporation, now known as Wyeth, in addition to the right, but not the obligation, to acquire additional percentages of the SERM products net sales on future dates by giving the Company notice. When the Company entered into the agreement with Royalty Pharma and upon each subsequent exercise of its options to acquire additional percentages of royalty payments to the Company, the Company recognized the consideration paid to it by Royalty Pharma as revenue. Cumulative payments totaling $63.3 million were received from Royalty Pharma from 2002 through 2004 for the sale of royalty rights from the net sales of the SERM products.

The Company determined that a portion of the revenue recognized under the Royalty Pharma agreement should have been deferred since Pfizer and Wyeth each had the right to offset a portion of future royalty payments for, and to the extent of, amounts previously paid to the Company for certain developmental milestones. As of September 30, 2004, approximately $1.2 million was recorded as deferred revenue in connection with the offset rights by the Company s collaborative partners, Pfizer and Wyeth. The amounts associated with the offset rights against future royalty payments will be recognized as revenue upon receipt of future royalties from the respective partners or upon determination that no such future royalties will be forthcoming. Additionally, the Company determined to defer a portion of such revenue as it relates to the value of the option rights sold to Royalty Pharma until Royalty Pharma exercised such options or upon the expiration of the options. As of September 30, 2004, the value of options outstanding recorded as deferred revenue was $0.1 million, which was recognized in the fourth quarter of 2004. The value of options outstanding at the end of 2002 which was recognized in 2003 was approximately $0.1 million. The value of options outstanding at the end of 2003 which was recognized in 2004 was approximately $0.2 million. As of December 31, 2004, all of the option revenue deferred during fiscal 2002 and 2003 has been recognized. Accordingly, for the years ended December 31, 2003 and 2002, the Company has restated revenue from the sale of royalty rights under the Royalty Pharma agreement, which reduced royalty revenue by approximately $0.7 million for each of the years ended December 31, 2003 and 2002.

Buy-Out of Salk Royalty Obligation. In March 2004, the Company paid The Salk Institute $1.12 million in connection with the Company s exercise of an option to buy out milestone payments, other payment-sharing obligations and royalty payments due on future sales of lasofoxifene, a product under development by Pfizer for which a NDA was expected to be filed in 2004. At the time of the Company s exercise of its buyout right, the payment was accounted for as a prepaid royalty asset to be amortized on a straight-line basis over the period for which the Company had a contractual right to the lasofoxifene royalties. This payment was included in other assets on the Company s consolidated balance sheet at September 30, 2004. Pfizer filed the NDA for lasofoxifene with the United States Food and Drug Administration in the third quarter of 2004. Because the NDA had not been filed at the time the Company exercised its buyout right, the Company determined in the course of the restatement that the payment should

have been expensed. Accordingly, the Company corrected such error and recognized the Salk payment as development expense for the three months ended March 31, 2004 and the year ended December 31, 2004.

Table of Contents

X-Ceptor Therapeutics, Inc. In June 1999, the Company invested $6.0 million in X-Ceptor Therapeutics, Inc. (X-Ceptor) through the acquisition of convertible preferred stock. Additionally, in October 1999, the Company issued warrants to X-Ceptor investors, founders and certain employees to purchase 950,000 shares of Ligand common stock with an exercise price of $10.00 per share and an expiration date of October 6, 2006. At the time of issuance, the warrants were recorded at their fair value of $4.20 per warrant or $4.0 million as deferred warrant expense within stockholders deficit and were amortized to operating expense through June 2002. The Company determined during the course of the restatement that the warrant issuance should have been capitalized as an asset rather than treated as a deferred expense within equity since the warrant issuance was deemed to be consideration for the right granted to the Company by X-Ceptor to acquire all of the outstanding stock of X-Ceptor (the Purchase Right). Accordingly, the Company recorded the Purchase Right as an other asset in the amount of $4.0 million. The effect of this change resulted in a decrease in expense for the year ended December 31, 2002 of $0.7 million. This asset was subsequently written off to Other, net expense in the quarter ended March 31, 2003, the period the Company determined that the Purchase Right would not be exercised.

Pfizer Settlement Agreement and Elan Shares. In April 1996, the Company and Pfizer entered into a settlement agreement with respect to a lawsuit filed in December 1994 by the Company against Pfizer. In connection with a collaborative research agreement the Company entered into with Pfizer in 1991, Pfizer purchased shares of the Company s common stock. Under the terms of the settlement agreement, at the option of either the Company or Pfizer, milestone and royalty payments owed to the Company can be satisfied by Pfizer by transferring to the Company shares of the Company s common stock at an exchange ratio of $12.375 per share. At the time of the settlement, the Company accounted for the prior issuance of common stock to Pfizer as equity on its balance sheet.

Additionally, in 1998, Elan International (Elan) agreed to exclusively license to the Company in the United States and Canada its proprietary product AVINZA. In connection with the November 2002 restructuring of the AVINZA license agreement with Elan, the Company agreed to repurchase approximately 2.2 million shares of the Company s common stock held by an affiliate of Elan (the Elan Shares) for $9.00 a share. At the time of the November 2002 agreement, the shares were classified as equity on the Company s balance sheet in the amount of $20.0 million. The Elan Shares were repurchased and retired in February 2003.

In conjunction with the restatement, the remaining common stock issued and outstanding to Pfizer following the settlement and the Elan Shares were reclassified as common stock subject to conditional redemption/repurchase (between liabilities and equity) in accordance with Emerging Issue Task Force Topic D-98, Classification and Measurement of Redeemable Securities (EITF D-98), which was issued in July 2001.

EITF D-98 requires the security to be classified outside of permanent equity if there is a possibility of redemption of securities that is not solely within the control of the issuer. Since Pfizer has the option to settle with Company s shares milestone and royalties payments owed to the Company and, as of December 31, 2002, the Company was required to repurchase the Elan shares, the Company determined that such factors indicated that the redemptions were not within the Company s control, and accordingly, EITF D-98 was applicable to the treatment of the common stock issued to Pfizer and the Elan Shares. This adjustment totaling $14.6 million only had an effect on the balance sheet classification, not on the consolidated statements of operations. In the third quarter of 2004, Pfizer elected to pay a $2.0 million milestone payment due the Company in stock and subsequently tendered approximately 181,000 shares to the Company. The Company retired such shares in September 2004 and common stock subject to conditional redemption was reduced by approximately $2.3 million.

Seragen Litigation. On December 11, 2001, a lawsuit was filed in the United States District Court for the District of Massachusetts against the Company by the Trustees of Boston University and other former stakeholders of Seragen. The suit was subsequently transferred to federal district court in Delaware. The complaint alleges breach of contract, breach of the implied covenants of good faith and fair dealing and unfair and deceptive trade practices based on, among other things, allegations that the Company wrongfully withheld approximately $2.1 million in consideration due the plaintiffs under the Seragen acquisition agreement. This amount had been previously accrued for in the Company s consolidated financial statements in 1998. The complaint seeks payment of the withheld consideration and treble damages. The Company filed a motion to dismiss the unfair and deceptive trade practices claim. The Court subsequently granted the Company s motion to dismiss the unfair and deceptive trade practices claim

(i.e. the treble damages claim), in April 2003. In November 2003, the Court granted Boston University s motion for summary judgment, and entered judgment for Boston University. In January 2004, the district court

Table of Contents

issued an amended judgment awarding interest of approximately $0.7 million to the plaintiffs in addition to the approximately $2.1 million withheld. The Court award of interest was previously not accrued. Though the Company had appealed the judgment in this case as well as the award of interest and the calculation of damages, in view of the judgment, the Company revised its consolidated financial statements in the fourth quarter of 2003 to record a charge of $0.7 million. In January 2006, the appeals court affirmed the district court s ruling against us. Additional interest on the above amounts of approximately $0.1 million has accrued through January 2006 and was added to the judgment. The withheld amount including interest was paid in February 2006.

Other. In conjunction with the restatement, the Company also made other adjustments and reclassifications to its accounting for various other errors, in various years, including, but not limited to: (1) a correction to the Company s estimate of the accrual for clinical trials; (2) corrections to estimates of other accrued liabilities; (3) royalty payments made to technology partners; (4) straight-line recognition of rent expense for contractual annual rent increases; and (5) corrections to estimates of future obligations and bonuses to employees.

For the quarters ended September 30, 2004, June 30, 2004, and March 31, 2004, the restatement increased the net loss by $11.7 million or $0.16 per share; $7.8 million or $0.11 per share; and $8.8 million or $0.12 per share, respectively. For the quarter ended December 31, 2003, the restatement decreased net income by $24.6 million or $0.34 per share and increased net loss for the quarters ended September 30, 2003, June 30, 2003, and March 31, 2003 by $11.6 million or $0.16 per share; $12.0 million or $0.18 per share; and $10.8 million or $0.15 per share, respectively. The restatement increased the net loss in 2003 by $59.0 million or $0.83 per share to $96.5 million or $1.36 per share. The restatement increased the net loss in 2002 by $19.7 million or $0.29 per share to $52.3 million or $0.76 per share. For periods prior to 2002, the restatement was effectuated through an aggregate adjustment as of January 1, 2002 of $15.1 million to the Company s accumulated deficit. Additionally, for periods prior to 2002, restatement of the Pfizer settlement agreement was effectuated as of January 1, 2002 through a reduction of additional paid in capital and a corresponding increase to common stock subject to conditional redemption/repurchase (between liabilities and equity) of $14.6 million. The restatement regarding the Elan shares had no effect on periods prior to 2002 since it was effectuated as of November 2002 through a reduction of additional paid in capital and a corresponding increase to common stock subject to conditional redemption/repurchase of $20.0 million.

Overview

We discover, develop and market drugs that address patients critical unmet medical needs in the areas of cancer, pain, men s and women s health or hormone-related health issues, skin diseases, osteoporosis, blood disorders and metabolic, cardiovascular and inflammatory diseases. Our drug discovery and development programs are based on our proprietary gene transcription technology, primarily related to Intracellular Receptors, also known as IRs, a type of sensor or switch inside cells that turns genes on and off, and Signal Transducers and Activators of Transcription, also known as STATs, which are another type of gene switch.

We currently market five products in the United States: AVINZA, for the relief of chronic, moderate to severe pain; ONTAK, for the treatment of patients with persistent or recurrent cutaneous T-cell lymphoma, or CTCL; Targretin capsules, for the treatment of CTCL in patients who are refractory to at least one prior systemic therapy; Targretin gel, for the topical treatment of cutaneous lesions in patients with early stage CTCL; and Panretin gel, for the treatment of Kaposi s sarcoma in AIDS patients. In Europe, we have marketing authorizations for Panretin gel and Targretin capsules and are currently marketing these products under arrangements with local distributors. In April 2003, we withdrew our ONZAR (ONTAK in the U.S.) marketing authorization application in Europe for our first generation product. It was our assessment that the cost of the additional clinical and technical information requested by the European Agency for the Evaluation of Medicinal Products, or EMEA, for the first generation product would be better spent on acceleration of the second generation ONTAK formulation development. We expect to resubmit the ONZAR application with the second generation product in 2006 or early 2007.

In February 2003, we entered into an agreement for the co-promotion of AVINZA with Organon Pharmaceuticals USA Inc. (Organon). Under the terms of the agreement, Organon committed to a specified minimum number of primary and secondary product calls delivered to certain high prescribing physicians and hospitals beginning in March 2003. Organon s compensation is structured as a percentage of net sales, based on the Company s standard accounting principles and generally accepted accounting principles (GAAP), which pays

30

Table of Contents

Organon for their efforts and also provides Organon an economic incentive for performance and results. In exchange, and prior to the termination of the co-promotion agreement with Organon discussed below, we paid Organon a percentage of AVINZA net sales based on the following schedule:

Annual Net Sales of AVINZA	% of Incremental Net Sales Paid to Organon by Ligand
$0-35 million (2003 only)	0% (2003 only)
$0-150 million	30%
$150-300 million	40%
$300-425 million	50%
> $425 million	45%

On January 17, 2006, we signed an agreement with Organon that terminates the AVINZA® co-promotion agreement between the two companies and returns AVINZA rights to Ligand. The effective date of the termination agreement is January 1, 2006, however the parties have agreed to continue to cooperate during a transition period ending September 30, 2006 (the Transition Period) to promote the product. The Transition Period co-operation includes a minimum number of product sales calls per quarter (100,000 for Organon and 30,000 for Ligand with an aggregate of 375,000 and 90,000 respectively for the Transition Period) as well as the transition of ongoing promotions, managed care contracts, clinical trials and key opinion leader relationships to Ligand. During the Transition Period, Ligand will pay Organon an amount equal to 23 % of AVINZA net sales as reported by Ligand. Ligand will also pay and be responsible for the design and execution of all clinical, advertising and promotion expenses and activities.

As previously disclosed, Organon and Ligand were in discussions regarding the calculation of prior co-promote fees under the co-promotion agreement. In connection with the termination of the co-promotion agreement, the companies resolved their disagreement concerning prior co-promote fees and Ligand paid Organon $14.75 million in January 2006. This amount had been previously accrued in the Company s consolidated financial statements as of September 30, 2005. The companies also agreed that Organon s compensation for the fourth quarter of 2005 would be calculated based on Ligand s reported AVINZA net sales determined in accordance with U.S. GAAP.

Additionally, in consideration of the early termination and return of rights under the terms of the agreement, Ligand will unconditionally pay Organon $37.75 million on or before October 15, 2006. Ligand will further pay Organon $10.0 million on or before January 15, 2007, provided that Organon has made its minimum required level of sales calls. Under certain conditions, including change of control, the cash payments will accelerate. In addition, after the termination, Ligand will make quarterly 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.

We are currently involved in the research phase of a research and development collaboration with TAP Pharmaceutical Products Inc., or TAP. Collaborations in the development phase are being pursued by Eli Lilly and Company, GlaxoSmithKline, Pfizer, TAP and Wyeth. We receive funding during the research phase of the arrangements and 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.

We have been unprofitable since our inception on an annual basis. We achieved quarterly net income of $17.3 million during the fourth quarter of fiscal 2004, which was primarily the result of recognizing approximately $31.3 million from the sale of royalty rights to Royalty Pharma. However, we expect to incur net losses in future quarters. To consistently be profitable, we must successfully develop, clinically test, market and sell our products. Even if we consistently 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 of revenues earned from product sales, expenses incurred, collaborative arrangements and other sources. Some of these fluctuations may be significant.

Table of Contents

Recent Developments

Restructuring of ONTAK Royalty

In November 2004, Ligand and Eli Lilly and Company (Lilly) agreed to amend their ONTAK royalty agreement to add options in 2005 that if exercised would restructure our royalty obligations on net sales of ONTAK. Under the revised agreement, we and Lilly each obtained two options. Our options, exercisable in January 2005 and April 2005, provided for the buy down of a portion of our ONTAK royalty obligation on net sales in the United States for total consideration of $33.0 million. Lilly also had two options exercisable in July 2005 and October 2005 to trigger the same royalty buy-downs for total consideration of up to $37.0 million dependent on whether we have exercised one or both of our options.

Our first option, providing for a one-time payment of $20.0 million to Lilly in exchange for the elimination of our ONTAK royalty obligations in 2005 and a reduced reverse-tiered royalty scale on ONTAK sales in the U.S. thereafter, was exercised in January 2005. The second option, exercised in April 2005, provided for a one-time payment of $13.0 million to Lilly in exchange for the elimination of royalties on ONTAK net sales in the U.S. in 2006 and a reduced reverse-tiered royalty thereafter. Beginning in 2007 and throughout the remaining ONTAK patent life (2014), we will pay no royalties to Lilly on U.S. sales up to $38.0 million. Thereafter, Ligand would pay royalties to Lilly at a rate of 20% on net U.S. sales between $38.0 million and $50.0 million; at a rate of 15% on net U.S. sales between $50.0 million and $72.0 million; and at a rate of 10% on net U.S. sales in excess of $72.0 million.

Targretin Capsules Development Programs

In March 2005, we announced that the final data analysis for Targretin capsules in NSCLC showed that the trials did not meet their endpoints of improved overall survival and projected two year survival. We are continuing to analyze the data and apply it to the continued development of Targretin capsules in NSCLC. Failure to demonstrate the product s safety and effectiveness would delay or prevent regulatory approval of the product and could adversely affect our business as well as our stock price. See Risk Factors Our products face significant regulatory hurdles prior to marketing which could delay or prevent sales.

Additional Manufacturing Sources

In 2004, we entered into contracts with Cardinal Health to provide a second source for AVINZA, and with Hollister-Stier to fill and finish ONTAK. In July 2005, we announced that the FDA approved the Hollister-Stier facility for fill/finish of ONTAK. In August 2005, the FDA approved the production of AVINZA at the Cardinal Health facility which provides a second source of supply, thus diversifying the AVINZA supply chain and increasing production capacity.

Amended and Restated Research, Development and License Agreement with Wyeth

On December 1, 2005, we entered into an Amended and Restated Research, Development and License Agreement with Wyeth (formerly American Home Products Corporation). Under the previous agreement, effective September 2, 1994 as amended January 16, 1996, May 24, 1996, September 2, 1997 and September 9, 1999 (collectively the Prior Agreement), Wyeth and us engaged in a joint research and development effort to discover and/or design small molecule compounds which act through the estrogen and progesterone receptors and to develop pharmaceutical products from such compounds. Wyeth sponsored certain research and development activities to be carried out by us and Wyeth may commercialize products resulting from the joint research and development subject to certain milestone and royalty payments. The Amended and Restated Agreement does not materially change the prior rights and obligations of the parties with respect to Wyeth compounds, currently in development, e.g. bazedoxifene, in late stage development for osteoporosis.

The parties agreed to amend and restate the Prior Agreement principally to better define, simplify and clarify the universe of research compounds resulting from the research and development efforts of the parties, combine and clarify categories of those compounds and related milestones and royalties and resolve a number of milestone

Table of Contents

payment issues that had arisen. Among other things, the Amended and Restated Agreement calls for Wyeth to pay Ligand $1.8 million representing the difference between amounts paid under the old compound categories versus the amounts due under the new, single category.

Termination of Organon Copromotion Agreement

On January 17, 2006, we signed an agreement with Organon that terminates the AVINZA® co-promotion agreement between the two companies and returns AVINZA rights to Ligand. For a discussion of this agreement, please see Overview above.

Restructuring of AVINZA Sales Force

In January 2006, 18 Ligand sales representatives previously promoting AVINZA to primary care physicians were redeployed to call on pain specialists and all Ligand primary care territories were eliminated. In connection with this restructuring, 11 primary-care sales representatives were terminated. The AVINZA sales force restructuring was implemented to improve sales call coverage and effectiveness among high prescribing pain specialists.

Conversion of 6% Convertible Subordinated Notes

In January 2006, certain holders of our outstanding 6% convertible subordinated notes converted notes with a face value of $24.1 million into 3,903,965 shares of common stock.

Results of Operations

Three and Nine Months Ended September 30, 2005 and September 30, 2004

Total revenues for the three months ended September 30, 2005 were $44.8 million compared to $36.8 million for the same 2004 period. Loss from operations was $3.5 million for the three months ended September 30, 2005 compared to $15.6 million for the same 2004 period. Net loss for the three months ended September 30, 2005 was $6.3 million ($0.08 per share) compared to $18.5 million ($0.25 per share) for the same 2004 period.

Total revenues for the nine months ended September 30, 2005 were $127.5 million compared to $96.5 million for the same 2004 period. Loss from operations was $25.8 million for the nine months ended September 30, 2005 compared to $53.8 million for the same 2004 period. Net loss for the nine months ended September 30, 2005 was $33.7 million ($0.46 per share) compared to $62.5 million ($0.85 per share) for the same 2004 period.

Net Product Sales

The Company s domestic net product sales for AVINZA, ONTAK, Targretin capsules and Targretin gel, are determined on a sell-through basis less allowances for rebates, chargebacks, discounts, and losses to be incurred on returns from wholesalers resulting from increases in the selling price of the Company s products. We recognize revenue for Panretin upon shipment to wholesalers as our wholesaler customers only stock minimal amounts of Panretin, if any. As such, wholesaler orders are considered to approximate end-customer demand for the product. Revenues from sales of Panretin are net of allowances for rebates, chargebacks, returns and discounts. For international shipments of our product, revenue is recognized upon shipment to our third-party international distributors. In addition, the Company incurs certain distributor service agreement fees related to the management of its product by wholesalers. These fees have been recorded within net product sales. For ONTAK, the Company also has established reserves for returns from end customers (i.e. other than wholesalers) after sell-through revenue recognition has occurred.

Table of Contents

A summary of the revenue recognition policy used for each of our products and the expiration of the underlying patents for each product is as follows:

	Method	Revenue Recognition Event	Patent Expiration
AVINZA	Sell-through	Prescriptions	November 2017
ONTAK	Sell-through	Wholesaler out-movement	December 2014
Targretin capsules	Sell-through	Wholesaler out-movement	October 2016
Targretin gel	Sell-through	Wholesaler out-movement	October 2016
Panretin	Sell-in	Shipment to wholesaler	August 2016
International	Sell-in	Shipment to international distributor	February 2011 through April 2013

For the three months ended September 30, 2005 and 2004, net product sales recognized under the sell-through method represented 97% and 96% of total net product sales and net product sales recognized under the sell-in method represented 3% and 4%, respectively. For the nine months ended September 30, 2005 and 2004, net product sales recognized under the sell-through method represented 96% of total net product sales and net product sales recognized under the sell-in method represented 4% of total net product sales in 2005 and 2004.

Our total net product sales for the three months ended September 30, 2005 were $42.6 million compared to $31.9 million for the same 2004 period. Total net product sales for the nine months ended September 30, 2005 were $119.4 million compared to $86.2 million for the same 2004 period. A comparison of sales by product is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004 (Restated)	2005	2004 (Restated)
AVINZA	$29,909	$20,004	$ 79,367	$47,458
ONTAK	7,370	7,013	24,173	24,290
Targretin capsules	4,394	3,929	13,080	11,482
Targretin gel and Panretin gel	911	988	2,744	2,942
Total product sales	$42,584	$31,934	$119,364	$86,172

AVINZA

Sales of AVINZA were $29.9 million for the three months ended September 30, 2005 compared to $20.0 million for the same 2004 period. For the nine months ended September 30, 2005, sales of AVINZA were $79.4 million compared to $47.5 million for the same 2004 period. The increase in net product sales for the three and nine months ended September 30, 2005 is due to higher prescriptions as a result of the increased level of marketing and sales activity under our co-promotion agreement with Organon, a shift in the mix of prescriptions to the higher doses of AVINZA, and the product s success in achieving state Medicaid and commercial formulary status. Formulary access removes obstacles to physicians prescribing the product and facilitates patient access to the product through lower co-pays. According to IMS data, quarterly prescription market-share for AVINZA for the three months ended September 30, 2005 was 4.5% compared to 4.2% for the same 2004 period. Since the start of co-promotion activities, AVINZA had been promoted by more than 700 sales representatives compared to approximately 50 representatives in 2003 prior to co-promotion. As a result of a recent sales force restructuring and rebalancing of the Organon AVINZA sales territories, as further discussed above under Recent Developments , and the expansion of Ligand s sales force, four separate sales forces totaling approximately 600 representatives are anticipated to be deployed throughout 2005 to provide more than 800,000 focused sales calls per year to the primary care, specialist, and long-term care and hospice markets.

For the three and nine months ended September 30, 2005 compared to the same 2004 period, AVINZA sales were negatively impacted by an increase in Medicaid rebates of approximately $1.1 million and $5.5 million, respectively, and an increase in managed care rebates of approximately $0.8 million and $2.5 million, respectively,

Table of Contents

under contracts with pharmacy benefit managers (PBMs), group purchasing organizations (GPOs) and health maintenance organizations (HMOs).

Upon an announced price increase, we revalue our estimate of deferred product revenue to be returned to recognize the potential higher credit a wholesaler may take upon product return determined as the difference between the new price and the previous price used to value the allowance. AVINZA sales for the nine months ended September 30, 2005 reflect an approximate $3.5 million reduction in sales, recorded for the three months ended March 31, 2005, for losses expected to be incurred on product returns resulting from an AVINZA price increase which became effective April 1, 2005. This compares to a $2.6 million loss on product returns for the nine months ended September 30, 2004, which was recorded during the three months ended June 30, 2004 for an AVINZA price increase which became effective July 1, 2004. Lastly, product sales for the three and nine months ended September 30, 2005 and for the three months ended September 30, 2004 are net of fees paid to our wholesaler customers under the fee for service agreements entered into during the third and fourth quarters of 2004.

Any changes to our estimates for Medicaid prescription activity or prescriptions written under our managed care contracts may have an impact on our rebate liability and a corresponding impact on AVINZA net product sales. For example, a 20% variance to our estimated Medicaid and managed care contract rebate accruals for AVINZA as of September 30, 2005 could result in adjustments to our Medicaid and managed care contract rebate accruals and net product sales of approximately $1.1 million and $0.5 million, respectively.

ONTAK

Sales of ONTAK were $7.4 million for the three months ended September 30, 2005 compared to $7.0 million for the same 2004 period. For the nine months ended September 30, 2005, sales of ONTAK were $24.2 million compared to $24.3 million for the same 2004 period. Net product sales for the three and nine months ended September 30, 2005 compared to the same periods in 2004 reflect a 9% price increase effective January 1, 2004, which under the sell-through revenue recognition method does not impact net product sales until the product sells through the distribution channel and therefore only had a limited impact on net sales for the same 2004 periods. Net product sales for the 2004 periods are also net of promotional discounts and amounts paid to wholesalers for marketing support. In connection with the implementation of fee for service agreements in the third quarter of 2004, the Company no longer provides to wholesalers promotional discounts or marketing support payments. Accordingly, sales of ONTAK for the three and nine months ended September 30, 2005 reflect no such discounts compared to approximately $1.4 million and $2.8 million, respectively, for the 2004 periods. The impact of lower discounts and marketing support payments in the 2005 periods on net product sales is partially offset by fees paid to wholesalers under the fee for service agreements for the entire nine months ended September 30, 2005 compared to for only the three months ended September 30, 2004. The increase in net product sales due to the price increase and lower promotional discounts and marketing support was largely offset, however, by a 20% and 10% decrease in wholesaler out-movement for the three and nine months ended September 30, 2005 compared to the same periods in 2004, respectively, due primarily to a decline in the office segment of the market which has been impacted by reimbursement rates. Increases in the hospital segment have not been sufficient to offset the office segment trend. ONTAK sales for the three and nine months ended September 30, 2005 were also negatively impacted by a continued increase in chargebacks and rebates of approximately $0.6 million and $1.1 million, respectively, due to changes in patient mix and evolving reimbursement rates.

We continue to study changes to the Centers for Medicare and Medicaid Services reimbursement rates. This review continues to indicate increased challenges for a sub-segment of our ONTAK Medicare patients in 2005. We expect that sales of ONTAK will continue to be negatively impacted by changes to the Centers for Medicare and Medicaid Services reimbursement rates in 2005 but expect improved reimbursement rates moving into 2006.

Table of Contents

Targretin capsules

Sales of Targretin capsules were $4.4 million for the three months ended September 30, 2005 compared to $3.9 million for the same 2004 period. For the nine months ended September 30, 2005, sales of Targretin capsules were $13.1 million compared to $11.5 million for the same 2004 period. This increase reflects a 7% price increase effective January 1, 2004 which under the sell-through revenue recognition method does not impact net product sales until the product sells-through the distribution channel and therefore had only a limited impact on net sales for the same 2004 period. As reported by IMS Health, demand for Targretin capsules, as measured by product outmovement, increased by approximately 4% and 3% for the three and nine months ended September 30, 2005, respectively, compared to the same 2004 periods. Lastly, Targretin capsules product sales for the three and nine months ended September 30, 2005 and the three months ended September 30, 2004 are net of fees paid to our wholesaler customers under the fee for service agreements entered into during the third and fourth quarters of 2004.

In June 2004, the Centers for Medicare and Medicaid Services (CMS) announced formal implementation of the Section 641 Demonstration Program under the Medicare Modernization Act of 2003 including reimbursement under Medicare for Targretin for patients with CTCL. As a result, we continue to expect improved patient access for Targretin in 2005.

Collaborative Research and Development and Other Revenues

Collaborative research and development and other revenues for the three months ended September 30, 2005 were $2.2 million compared to $4.8 million for the same 2004 period. For the nine months ended September 30, 2005, collaborative research and development and other revenues were $8.2 million compared to $10.3 million for the same 2004 period. Collaborative research and development and other revenues include reimbursement for ongoing research activities, earned development milestones, and recognition of prior years up-front fees previously deferred in accordance with SAB 104. Revenue from distribution agreements includes recognition of up-front fees collected upon contract signing and deferred over the life of the distribution arrangement and milestones achieved under such agreements.

A comparison of collaborative research and development and other revenues is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Collaborative research and development	$ 894	$1,988	$2,618	$ 6,307
Development milestones and other	1,278	2,850	5,558	3,982
	$2,172	$4,838	$8,176	$10,289

Collaborative research and development. The decrease in ongoing research activities reimbursement revenue for the three and nine months ended September 30, 2005 compared to the same 2004 period is due to the termination in November 2004 of our research arrangement with Lilly.

Development milestones and other. Development milestones revenue and other revenues for the three months ended September 30, 2005 reflects $1.2 million earned from Lilly. For the nine months ended September 30, 2005, development milestones revenue also includes $3.0 million earned from GlaxoSmithKline and $1.1 million from TAP. For the three months ended September 30, 2004, development milestone revenue includes a $2.0 million milestone earned from Pfizer and a $0.8 million milestone earned from TAP. For the nine months ended September 30, 2004, development milestone revenue also includes a $0.8 million milestone from GlaxoSmithKline.

Gross Margin

Gross margin on product sales was 77.0% for the three months ended September 30, 2005 compared to 69.3% for the same 2004 period. For the nine months ended September 30, 2005, gross margin on product sales was 73.6% compared to 68.6% for the same 2004 period.

Table of Contents

The increase in the margin for the three and nine months ended September 30, 2005 compared to the same 2004 period is primarily due to the increase in sales of AVINZA. AVINZA represented 70.2% and 66.5% of net product sales for the three and nine months ended 2005 compared to 62.6% and 55.1% for the same 2004 periods, respectively. For both AVINZA and ONTAK we have capitalized license, royalty and technology rights recorded in connection with the acquisition of the rights to those products and accordingly, margins improve as sales of these products increase and there is greater coverage of the fixed amortization of the intangible assets. AVINZA cost of product sold includes the amortization of license and royalty rights capitalized in connection with the restructuring of our AVINZA license and supply agreement in November 2002. The total amount of capitalized license and royalty rights, $114.4 million, is being amortized to cost of product sold on a straight-line basis over 15 years. The total amount of ONTAK acquired technology, $45.3 million, is also amortized to cost of product sold on a straight-line basis over 15 years. ONTAK margins were also positively impacted during the three and nine months ended September 30, 2005 by lower royalties as a result of the partial impact of the restructuring of the Company s royalty obligation to Lilly as further discussed under Recent Development Restructuring of ONTAK Royalty. This restructuring resulted in no royalty liability owed to Lilly for the three and nine months ended September 30, 2005. This impact was partially offset by amortization of the $33.0 million paid to Lilly as of September 30, 2005 to restructure the ONTAK royalty and the recognition of deferred royalty expense previously paid to Lilly which under the sell-through revenue recognition method is recognized as the related product sales are recognized. The amount paid to restructure the ONTAK royalty is being amortized through 2014, the remaining life of the underlying patent, using the greater of the straight-line method or expense determined based on the tiered royalty schedule set forth under Restructuring of ONTAK Royalty above. In accordance with SFAS 142, *Goodwill and Other Intangibles* (SFAS 142), for both AVINZA and ONTAK, capitalized license, royalty and technology rights are amortized on a straight-line basis since the pattern in which the economic benefits of the assets are consumed (or otherwise used up) cannot be reliably determined. At September 30, 2005, acquired technology and products rights, net totaled $150.3 million.

Gross margins for the nine months ended September 30, 2005 were also favorably impacted by price increases on ONTAK, Targretin capsules and Targretin gel which became effective January 1, 2004 and for AVINZA which became effective July 1, 2004. Under the sell-through revenue recognition method, changes to prices do not impact net product sales and therefore gross margins until the product sells-through the distribution channel. Accordingly, the price increases did not have a significant effect on the margins for the nine months ended September 30, 2004.

Gross margin for the three and nine months ended September 30, 2005 compared to the same 2004 period was negatively impacted, however, by a higher proportionate level of AVINZA rebates and ONTAK chargebacks and rebates and the costs associated with our wholesaler distribution service agreements as further discussed under *Product Sales*. Additionally, gross margin for the nine months ended September 30, 2005 compared to the same 2004 period was negatively impacted by a $0.5 million write-off of ONTAK finished goods inventory in the quarter ended March 31, 2005, due to the Company s updated assessment in December 2005 of the timing of certain clinical trials.

Overall, given the fixed level of amortization of the capitalized AVINZA license and royalty rights, we expect the AVINZA gross margin percentage to continue to increase as sales of AVINZA increase. Additionally, we expect the gross margin on ONTAK to further improve in 2005 due to the lowering of the royalty obligation to Lilly in connection with the restructuring of the ONTAK royalty agreement as further discussed under *Recent Developments.*

Research and Development Expenses

Research and development expenses were $12.9 million for the three months ended September 30, 2005 compared to $16.7 million for the same 2004 period. For the nine months ended September 30, 2005, research and development expenses were $42.2 million compared to $50.8 million for the same 2004 period. The major components of research and development expenses are as follows (in thousands):

Table of Contents

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004 (Restated)	2005	2004 (Restated)
Research				
Research performed under collaboration agreements	$ 875	$ 1,946	$ 2,870	$ 5,918
Internal research programs	5,074	4,135	15,405	11,836
Total research	$ 5,949	$ 6,081	$18,275	$17,754
Development				
New product development	4,156	6,698	15,479	22,153
Existing product support (1)	2,806	3,968	8,416	10,923
Total development	$ 6,962	$10,666	$23,895	$33,076
Total research and development	$12,911	$16,747	$42,170	$50,830

(1) Includes costs incurred to comply with post-marketing regulatory commitments.

Spending for research expenses decreased to $5.9 million for the three months ended September 30, 2005 compared to $6.1 million for the same 2004 period. For the nine months ended September 30, 2005, research expenses amounted to $18.3 million compared to $17.8 million for the same 2004 period. The overall increase for the nine months ended September 30, 2005 is due to an increased level of internal program research in the area of thrombopoietin (TPO) agonists. This increase is partially offset by a decrease in research performed under collaboration agreements due primarily to a lower contractual level of research funding under our agreement with TAP and lower research funding under the Lilly collaboration which concluded in November 2004.

Spending for development expenses decreased to $7.0 million for the three months ended September 30, 2005 compared to $10.7 million for the same 2004 period and to $23.9 million for the nine months ended September 30, 2005 compared to $33.1 million for the same 2004 period. These decreases reflect a lower level of expense for both new product development and existing product support. The decrease in expenses for new product development is due primarily to a reduced level of spending on Phase III clinical trials for Targretin capsules in NSCLC. In March 2005, we announced that the final data analysis for Targretin capsules in NSCLC showed that the trials did not meet their endpoints of improved overall survival and projected two-year survival. We are continuing to analyze the data and apply it to the continued development of Targretin in NSCLC. The decrease in existing product support in 2005 as compared to 2004 is primarily due to lower expenses for Targretin capsules and ONTAK post-marketing regulatory studies.

As a result of the findings for Targretin capsules in NSCLC, we expect overall development expenses to further decrease in 2005 compared to 2004.

Table of Contents

A summary of our significant internal research and development programs is as follows:

Program	Disease/Indication	Development Phase
AVINZA	Chronic, moderate-to-severe pain	Marketed in U.S. Phase IV
ONTAK	CTCL	Marketed in U.S., Phase IV
	Chronic lymphocytic leukemia	Phase II
	Peripheral T-cell lymphoma	Phase II
	B-cell Non-Hodgkin s lymphoma	Phase II
	NSCLC third line	Phase II
Targretin capsules	CTCL	Marketed in U.S. and Europe
	NSCLC first-line	Phase III
	NSCLC monotherapy	Planned Phase II/III
	NSCLC second/third line	Planned Phase II/III
	Advanced breast cancer	Phase II
	Renal cell cancer	Phase II
Targretin gel	CTCL	Marketed in U.S.
	Hand dermatitis (eczema)	Planned Phase II/III
	Psoriasis	Phase II
LGD4665 (Thrombopoietin oral mimic)	Chemotherapy-induced thrombocytopenia (TCP), other TCPs	IND Track
LGD5552 (Glucocorticoid agonists)	Inflammation, cancer	IND Track
Selective androgen receptor modulators, e.g., LGD3303 (agonist/antagonist)	Male hypogonadism, female & male osteoporosis, male & female sexual dysfunction, frailty. Prostate cancer, hirsutism, acne, androgenetic alopecia.	Pre-clinical

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 ability to predict the outcome of complex research, our ability to predict the results of clinical studies, regulatory requirements placed upon us by regulatory authorities such as the FDA and EMEA, our ability 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 Risk Factors below for additional discussion of the uncertainties surrounding our research and development initiatives.

Selling, General and Administrative Expense

Selling, general and administrative expense was $17.8 million for the three months ended September 30, 2005 compared to $17.3 million for the same 2004 period. For the nine months ended September 30, 2005, selling, general and administrative expense was $57.2 million compared to $50.1 million for the same 2004 period. The increase for the three and nine months ended September 30, 2005 is primarily due to costs associated with additional Ligand sales representatives hired to promote AVINZA and higher advertising and promotion expenses for AVINZA, ONTAK and Targretin capsules. The 2005 period also reflects higher accounting and legal expenses incurred in connection with the

Audit Committee s review of the Company s consolidated financial statements, the restatement of the Company s consolidated financial statements, and ongoing shareholder litigation. Selling, general and administrative expense is expected to further increase in 2005 due to higher accounting and legal expenses incurred in connection with the restatement of our consolidated financial statements, SEC investigation and shareholder litigation.

Table of Contents

Co-promotion Expense

Co-promotion expense under our co-promotion arrangement with Organon amounted to $7.8 million for the three months ended September 30, 2005 compared to $8.5 million for the same 2004 period. For the nine months ended September 30, 2005, co-promotion expense was $22.5 million compared to $22.2 million for the same 2004 period. As discussed under Overview , prior to the termination of the co-promotion agreement with Organon USA, we paid Organon, under the terms of our co-promotion agreement, 30% of net AVINZA sales, determined in accordance with GAAP and our standard accounting principles up to $150.0 million and higher percentage payments for net sales in excess of $150.0 million. Co-promotion expense recognized for the 2005 and 2004 quarterly periods was determined based upon the Company s shipments of AVINZA to wholesalers under the sell-in revenue recognition method. However, AVINZA shipments made to wholesalers did not meet the revenue recognition criteria under GAAP and such transactions were restated using the sell-through method. For the three and nine months ended September 30, 2004, net AVINZA product sales under the sell-in method were higher than net product sales under the sell-through method. Accordingly, co-promotion expense for these periods is higher than 30% of the reported net AVINZA product sales under the sell-through method. As previously disclosed, the companies were in discussions regarding the calculation of prior co-promote fees under the co-promotion agreement. In connection with the termination of the co-promotion agreement with Organon, Organon and Ligand resolved their disagreement concerning prior co-promote fees and Ligand paid Organon $14.75 million in January 2006. Such fee was previously accrued at September 30, 2005.

Restated Results for Fiscal Years 2004, 2003 and 2002

Total revenues for 2004 increased to $163.5 million compared to $81.1 million in 2003 and $71.8 million in 2002. Loss before the cumulative effect of a change in accounting principle was $45.1 million ($ 0.61 per share) in 2004, compared to $94.5 million ($1.33 per share) in 2003 and $52.3 million ($0.76 per share) in 2002. Net loss for 2004 was $45.1 million ($0.61 per share), compared to $96.5 million ($1.36 per share) in 2003 and $52.3 million ($0.76 per share) in 2002. As more fully described in Note 3 of the notes to consolidated financial statements, results for 2003 reflect the implementation of FASB Interpretation No. 46*, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51*, as revised December 2003, which required us to consolidate the entity from which we leased one of our corporate office buildings under a synthetic lease arrangement. The effect on 2003 results, recorded as a cumulative effect of a change in accounting principle, increased net loss by $2.0 million or $0.03 per share.

Product Sales

Our product sales for any individual period can be influenced by a number of factors including changes in demand for a particular product, competitive products, the level and nature of promotional activity, the timing of announced price increases, and the level of prescriptions subject to rebates and chargebacks. According to IMS data, AVINZA ended 2004 with a market share of prescriptions in the sustained-release opioid market of 3.9% compared to 1.4% at the end of 2003. Quarterly prescription market share for the three months ended December 31, 2004 was 4.3% compared to 2.7% for the three months ended December 31, 2003. We expect that AVINZA prescription market share will continue to increase as a result of a more balanced and focused sales and marketing activity compared to 2004. We also continue to expect that demand for and sales of ONTAK will be positively impacted as further data is obtained from ongoing expanded-use clinical trials and the initiation of new expanded-use trials but negatively impacted by continuing reimbursement trends resulting from changes to the Centers for Medicare and Medicaid Services reimbursement rates. The level and timing of any such increases, however, are influenced by a number of factors outside our control, including the accrual of patients and overall progress of clinical trials that are managed by third parties.

Excluding AVINZA, our products are small-volume specialty pharmaceutical products that address the needs of cancer patients in relatively small niche markets with substantial geographical fluctuations in demand. To ensure patient access to our drugs, we maintain broad distribution capabilities with inventories held at approximately 150 locations throughout the United States. The purchasing and stocking patterns of our wholesaler customers for all our products are influenced by a number of factors that vary from product to product. These factors include, but are not limited to, overall level of demand, periodic promotions, required minimum shipping quantities and wholesaler competitive initiatives. If any or all of our major wholesalers decide to reduce the inventory they carry in a given

40

Table of Contents

period (subject to the terms of our fee-for-service agreements discussed below), our shipments and cash flow for that period could be substantially lower than historical levels.

In the third and fourth quarters of 2004, we entered into one-year fee-for-service agreements (or distribution service agreements) for each of our products with the majority of our wholesaler customers. The principal fee-for-service agreements were subsequently renewed during the third quarter of 2005. In exchange for a set fee, the wholesalers have agreed to provide us with certain information regarding product stocking and out-movement; agreed to maintain inventory quantities within specified minimum and maximum levels; inventory handling, stocking and management services; and certain other services surrounding the administration of returns and chargebacks. In connection with implementation of the fee-for-service agreements, we no longer offer these wholesalers promotional discounts or incentives and as a result, we expect a net improvement in product gross margins as volumes grow. Additionally, we believe these arrangements will provide lower variability in wholesaler inventory levels and improved management of inventories within and between individual wholesaler distribution centers that we believe will result in a lower level of product returns compared to prior periods.

Certain of our products are included on the formularies (or lists of approved and reimbursable drugs) of many states health care plans, as well as the formulary for certain Federal government agencies. In order to be placed on these formularies, we generally sign contracts which provide discounts to the purchaser off the then-current list price and limit how much of an annual price increase we can implement on sales to these groups. As a result, the discounts off list price for these groups can be significant for products where we have implemented list price increases. We monitor the portion of our sales subject to these discounts, and accrue for the cost of these discounts at the time of the recognition of product sales. We believe that by being included on these formularies, we will gain better physician acceptance, which will then result in greater overall usage of our products. If the relative percentage of our sales subject to these discounts increases materially in any period, our sales and gross margin could be substantially lower than historical levels.

Our total net product sales for 2004 were $120.3 million, compared to $55.3 million in 2003 and $30.3 million in 2002. A comparison of sales by product is as follows (in thousands):

	Year Ended December 31,		
	2004	2003 (Restated)	2002 (Restated)
AVINZA	$ 69,470	$ 16,482	$ 1,114
ONTAK	32,200	24,108	17,706
Targretin capsules	15,105	11,556	8,563
Other	3,560	3,178	2,943
Total product sales	$ 120,335	$ 55,324	$ 30,326

AVINZA

Sales of AVINZA were $69.5 million in 2004 compared to $16.5 million in 2003. This increase is due to higher prescriptions as a result of the increased level of marketing and sales activity under our co-promotion agreement with Organon, which started in March 2003, and the product s success in achieving state Medicaid and commercial formulary status. Formulary access removes obstacles to physicians prescribing the product and facilitates patient access to the product through lower co-pays. Demand for AVINZA as measured by prescription levels (or patient consumption for channels with no prescription requirements) increased by 235.6% for 2004 compared to 2003, as reported by IMS Health. Sales in 2004 also benefited from a 9.9% price increase effective January 1, 2004 and a 9.0% price increase effective July 1, 2004. Since the start of co-promotion activities, AVINZA had been promoted by more than 700 sales representatives compared to approximately 50 representatives in 2003 prior to co-promotion. However, as a result of a recent sales force restructuring and rebalancing of the Organon AVINZA sales territories, as further discussed above under Recent Developments , and the expansion of Ligand s sales force, four separate sales forces totaling approximately 600 representatives are anticipated to be deployed in 2005 to provide more than 800,000

focused sales calls per year to the primary care, specialist, and long-term care and hospice markets.

AVINZA sales were negatively impacted during 2004 by an increase in Medicaid rebates of approximately $11.3 million, which significantly increased in the fourth quarter of 2003, driven by increased prescriptions in states

Table of Contents

where AVINZA (1) obtained preferred formulary status relative to competing products and (2) came onto the state formulary but not in a preferred position. AVINZA sales during 2004 compared to 2003 were also impacted by an increase in managed care rebates of approximately $4.6 million under contracts entered into in late 2003 and early 2004 with pharmacy benefit managers (PBMs), group purchasing organizations (GPOs) and health maintenance organizations (HMOs). Any changes to our estimates for Medicaid prescription activity or prescriptions written under our managed care contracts may have an impact on our rebate liability and a corresponding impact on AVINZA net product sales. For example, a 20% variance to our estimated Medicaid and managed care contract rebate accruals for AVINZA as of December 31, 2004 could result in adjustments to our Medicaid and managed care contract rebate accruals and net product sales of approximately $0.9 million and $0.3 million, respectively.

Sales of AVINZA were $16.5 million in 2003 compared to $1.1 million in 2002. This increase is due to increasing prescriptions as a result of the increased level of marketing and sales activity under our co-promotion arrangement with Organon, and to 2003 being the first full year of AVINZA sales. Demand for AVINZA as measured by prescription levels (or patient consumption for channels with no prescription requirements) was 17 times greater for 2003 than for 2002, as reported by IMS Health. Sales of AVINZA in 2003 compared to 2002 were negatively impacted, however, by an increase in Medicaid rebates of approximately $1.7 million and an increase in rebates under managed care contracts of approximately $0.8 million.

ONTAK

Sales of ONTAK were $32.2 million in 2004 compared to $24.1 million in 2003. Sales in 2004 were positively impacted by a 9% price increase effective January 1, 2004 and increasing use (impacted in part by expanded clinical data) in CTCL, CLL, and NHL. Demand for ONTAK as measured by shipments to end users as reported by our wholesalers increased by 28% for 2004 compared to 2003. Sales of ONTAK in 2004 were negatively impacted, however, by a continued increase in chargebacks and rebates of approximately $1.9 million due to changes in patient mix and evolving reimbursement rates. We expect that sales of ONTAK will be negatively impacted by changes to the Centers for Medicare and Medicaid Services reimbursement rates in 2005 but expect improved reimbursement rates moving into 2006. A 20% variance to our Medicaid rebate and estimated chargeback accruals for ONTAK as of December 31, 2004 could result in an adjustment to such accruals and net product sales of approximately $0.1 million.

Sales of ONTAK were $24.1 million in 2003 compared to $17.7 million in 2002. This increase reflects price increases and increasing use (impacted in part by expanded clinical data) in CTCL, CLL, and NHL. Overall demand for ONTAK measured by unit shipments to end users increased 20% for 2003 compared to the prior year. Sales of ONTAK were negatively impacted, however, by increased chargebacks and rebates of approximately $0.8 million reflecting changes in our patient mix and reimbursement rates.

Targretin Capsules

Sales of Targretin capsules were $15.1 million in 2004 compared to $11.6 million in 2003. This increase reflects a 7% price increase effective January 1, 2004 and the full period impact of a 15% price increase effective April 1, 2003. Additionally, demand for Targretin capsules as measured by product outmovement increased by 5.4% for 2004 compared to 2003, as reported by IMS Health.

In June 2004, the Centers for Medicare and Medicaid Services (CMS) announced formal implementation of the Section 641 Demonstration Program under the Medicare Modernization Act of 2003 including reimbursement under Medicare for Targretin for patients with CTCL. As a result, we continue to expect improved patient access for Targretin in 2005.

Sales of Targretin capsules were $11.6 million in 2003 compared to $8.6 million in 2002. This increase reflects a 15% price increase effective April 1, 2003. Additionally, demand for Targretin capsules as measured by product outmovement increased by 1.0% for 2003 compared to 2002, as reported by IMS Health.

Table of Contents

Sale of Royalty Rights

Revenue from the sale of royalty rights represents the sale to third parties of rights and options to acquire future royalties we may earn from the sale of products in development with our collaborative partners. In those instances where we have no continuing involvement in the research or development of these products, sales of royalty rights are recognized as revenue in the period the transaction is consummated or the options are exercised or expire. See Footnote 3 Significant Accounting Policies of Notes to Consolidated Financial Statements for further discussion of our revenue recognition policy with respect to sales of royalty rights.

Sale of royalty rights recognized in 2004, 2003 and 2002 amounted to $31.3 million, $11.8 million, and $17.6 million, respectively, net of the deferral of offset rights of $1.4 million, $0.6 million and $0.6 million, respectively, and the recognition in 2004 and 2003 of $0.2 million and $0.1 million, respectively, of option value deferred in previous periods.

In March 2002, we entered into an agreement with Royalty Pharma AG (Royalty Pharma), to sell a portion of our rights to future royalties from the net sales of three selective estrogen receptor modulator (SERM) products now in late stage development with two of our collaborative partners, Pfizer and Wyeth. The agreement provided for the initial sale of rights to 0.25% of such product net sales for $6.0 million and options to acquire up to an additional 1.00% of net sales for $50.0 million. Of the initial $6.0 million sale of rights, $0.2 million was attributed to the options and recorded as deferred revenue.

In July and December of 2002, the agreement was amended to replace the existing options with new options providing for the rights to acquire an additional 1.3125% of net sales for $63.8 million. Royalty Pharma exercised each of the three available 2002 options, as amended, acquiring rights to 0.4375% of net sales for $12.3 million. The fair value estimated for the amended options, $0.2 million, was recorded as deferred revenue.

In October 2003, the existing royalty agreement was amended and Royalty Pharma exercised an option for $12.5 million in exchange for 0.7% of potential future sales of the three SERM products for 10 years. Under the revised agreement, Royalty Pharma had three additional options to purchase up to 1.3% of such product net sales for $39.0 million.

In November 2004, Royalty Pharma agreed to purchase an additional 1.625% royalty on future sales of the SERM products for $32.5 million and cancel its remaining two options.

Under the underlying royalty agreements, both Pfizer and Wyeth have the right to offset a portion of any future royalty payments owed to the Company. Accordingly, the Company deferred a portion of the revenue associated with each tranche of royalty right sold, including rights acquired upon the exercise of options, equal to the pro-rata share of the potential royalty offset. Such amounts associated with the offset rights against future royalty payments will be recognized as revenue upon receipt of future royalties from the respective partners.

Collaborative Research and Development and Other Revenue

Collaborative research and development and other revenues for 2004 were $11.8 million, compared to $14.0 million for 2003 and $23.8 million for 2002. Collaborative research and development and other revenues include reimbursement for ongoing research activities, earned development milestones, and recognition of prior years up-front fees previously deferred in accordance with SAB 104. Revenue from distribution agreements includes recognition of up-front fees collected upon contract signing and deferred over the life of the distribution arrangement and milestones achieved under such agreements.

Table of Contents

A comparison of collaborative research and development and other revenues is as follows (in thousands):

	Year Ended December 31,		
	2004	2003	2002
Collaborative research and development	$ 7,843	$ 10,887	$ 18,268
Development milestones	3,681	2,807	5,060
Other	311	314	515
	$ 11,835	$ 14,008	$ 23,843

Collaborative Research and Development. The decrease in ongoing research activities reimbursement revenue in 2004 compared to 2003 is due to lower funding from our research arrangement with Lilly, which contributed $4.0 million to revenue in 2004 compared to $5.7 million in 2003. The research term of the Lilly collaboration was extended for an additional year effective November 2003 at a lower level of funding, through November 2004. Additionally, the decrease is due to the contractually agreed lower level of research activity and funding under our collaboration arrangement with TAP, which contributed $3.4 million to revenue in 2004 compared to $4.2 million in 2003. In December 2004, the TAP collaboration was extended for a second time, until June 2006.

The decrease in ongoing research activities reimbursement revenue in 2003 compared to 2002 is due to lower funding from our research arrangement with Lilly, which contributed $5.7 million to revenue in 2003 compared to $8.2 million in 2002. Additionally, the decrease is due to the contractually agreed lower level of research activity and funding under our research arrangement with TAP, which contributed $4.2 million to revenue in 2003 compared to $5.0 million in 2002.

Revenue from up-front fees, which is included in collaborative research and development, is recognized over the period during which we provide research services. Revenue from TAP up-front fees decreased to $0.4 million in 2004 from $1.0 million in 2003 and from $1.3 million in 2002. Revenue from Lilly up-front fees was $3.4 million in 2002 and none thereafter, due to the completion of the initial research term of the Lilly collaboration.

Development Milestones. Development milestone revenue in 2004 includes net development milestones of $2.0 million from Pfizer as a result of Pfizer s filing with the FDA of a new drug application for lasofoxifene, $0.8 million earned from TAP in connection with TAP s selection of an additional selective androgen receptor modulator (SARM) as a second clinical candidate for development for the treatment of major androgen-related diseases, and $0.8 million earned from GlaxoSmithKline.

Development milestone revenue in 2003 represents $0.9 million earned from Wyeth, a $1.1 million milestone from Lilly, and a $0.8 million milestone from GlaxoSmithKline. Development milestone revenue in 2002 represents a $2.4 million milestone from Lilly, $0.6 million earned from Wyeth, and a $2.0 million milestone from GlaxoSmithKline.

Gross Margin

Gross margin on product sales was 66.9% in 2004 compared to 52.0% in 2003 and 51.4% in 2002. The increase in the margin in 2004 compared to 2003 is primarily due to the relative increase of sales of AVINZA. AVINZA, which represented 58% of net product sales in 2004 compared to 30% in the prior year, has significantly higher margins than ONTAK for which we owed third party royalties of approximately 27% of ONTAK product sales. For both AVINZA and ONTAK we have capitalized license, royalty and technology rights recorded in connection with the acquisition of the rights to those products. AVINZA cost of product sold includes the amortization of license and royalty rights capitalized in connection with the restructuring of our AVINZA license and supply agreement in November 2002. The total amount of capitalized license and royalty rights, $114.4 million, is being amortized to cost of product sold on a straight-line basis over 15 years. The total amount of ONTAK acquired technology, $45.3 million, is also amortized to cost of product sold on a straight-line basis over 15 years. In accordance with SFAS 142, Goodwill and Other Intangibles (SFAS 142), these assets are amortized on a straight line basis since the pattern in which the economic benefits of the assets are consumed (or otherwise used up) cannot be reliably determined. At December 31, 2004, acquired technology and product rights net totaled $127.4 million.

44

Table of Contents

Gross margin in 2004 was also favorably impacted by price increases on our products which became effective January 1, 2004 and July 1, 2004 and a lower level of promotional discounts paid to the Company s wholesaler customers. As discussed, under Product Sales , in the third and fourth quarters of 2004, we entered into distribution service agreements with the majority of our wholesaler customers. In connection with the implementation of these agreements, we no longer offer wholesalers promotional discounts or incentives.

Lastly, the cost of AVINZA product sold in 2004 reflects the full-year impact of a reduction to the pricing of AVINZA purchases from Elan which occurred in prior periods. In November 2002, the Company and Elan agreed to amend the terms of the AVINZA license and supply agreement. Under the terms of the amended agreement, Elan s adjusted royalty and supply price of AVINZA was reduced to approximately 10% of the product s net sales, compared to approximately 30-35% in the prior agreement. Under the sell-through revenue recognition model, product shipped to the wholesaler is recorded as deferred cost of goods sold and subsequently recognized as cost of sales when it sells-through. Accordingly, the majority of product manufactured by Elan in 2002 at the higher contractual cost of production sold-through and was recognized as cost of sales in 2003. As a result, AVINZA gross margins for 2003 under sell-through revenue recognition reflect this higher product cost compared to cost of product sold in 2004.

Gross margin in 2004 compared to 2003 was negatively impacted, however, by a higher proportionate level of AVINZA rebates and ONTAK chargebacks and rebates and the costs associated with our wholesaler distribution service agreements as further discussed under *Product Sales.* Additionally, gross margin in 2004 reflects a charge to royalty expense in the amount of $3.0 million, recorded in the fourth quarter of 2004, for deferred royalties at the end of the contracted royalty period for which we did not have offset rights. Under the sell-through revenue recognition method, royalties paid based on unit shipments to wholesalers are deferred and recognized as royalty expense as those units are sold through and recognized as revenue. Royalties paid to technology partners are deferred as we have the right to offset royalties paid for product that are later returned against subsequent royalty obligations. Royalties for which we do not have the right to offset, however, (for example, at the end of the contracted royalty period) are expensed in the period the royalty obligation becomes due.

Gross margin on product sales was 52.0% in 2003 compared to 51.4% in 2002. The increase in the margin reflects a lower proportionate level of ONTAK sales in 2003. ONTAK has lower overall margins than our other oncology products due to a higher royalty rate owed to third party technology partners. Gross margins also improved in 2003 as a result of a higher absolute level of ONTAK sales which resulted in a higher base to absorb the fixed amortization of the ONTAK acquired technology. This increase was largely offset by a higher proportionate level of AVINZA sales in 2003 compared to 2002 when the product was launched. The cost of the majority of AVINZA products recognized in 2003 was manufactured in 2002 under the terms of the existing license and supply agreement with Elan, which provided for a cost of production of approximately 30-35% of the product s net sales. This cost was significantly higher than the manufacturing cost of our other products.

Overall, given the fixed level of amortization of the capitalized AVINZA license and royalty rights, we expect the AVINZA gross margin percentages in 2005 to continue to increase as sales of AVINZA increase.

Table of Contents

Research and Development Expenses

Research and development expenses were $65.2 million in 2004 compared to $66.7 million in 2003 and $59.1 million in 2002. The major components of research and development expenses are as follows (in thousands):

	Year Ended December 31,		
	2004	2003 (Restated)	2002 (Restated)
Research			
Research performed under collaboration agreements	$ 7,853	$ 10,535	$ 14,906
Internal research programs	15,517	12,013	9,990
Total research	23,370	22,548	24,896
Development			
New product development	28,329	30,771	20,518
Existing product support (1)	13,505	13,359	13,646
Total development	41,834	44,130	34,164
Total research and development	$ 65,204	$ 66,678	$ 59,060

(1) Includes costs incurred to comply with post-marketing regulatory commitments.

Overall, spending for research expenses remained relatively constant in 2004 compared to 2003, with increases in expenses for internal research programs offset by decreases in expenses for research performed under collaboration agreements. The decrease in expenses for research performed under collaboration agreements was due primarily to a lower contractual level of research funding under our agreement with TAP and a lower level of research funding agreed to with Lilly in connection with the November 2003 extension of our collaboration agreement through November 2004. The increase in internal research program expenses in 2004 compared to the 2003 period reflects an increased level of effort in the areas of thrombopoietin (TPO) agonists and peroxisome proliferation activated receptors (PPARs). The level of effort on selective androgen receptor modulators (SARMs) remained constant in 2004 as compared to 2003.

Spending for development expenses decreased to $41.8 million in 2004 compared to $44.1 million in 2003 reflecting a lower level of expense for new product development. The decrease in expenses for new product development is due primarily to a reduced level of spending on Phase III clinical trials for Targretin capsules in NSCLC, which became fully enrolled in 2003. In March 2005, we announced that the final data analysis for Targretin capsules in NSCLC showed that the trials did not meet their primary endpoints of improved overall survival and projected two-year survival. We are continuing to analyze the data and apply it to the continued development of Targretin in NSCLC. As a result of these findings, we expect the overall spending on the NSCLC trials to further decrease in 2005. The decrease in 2004 as compared to 2003 is partially offset by a $1.1 million payment to The Salk Institute in March 2004 to buy out milestone payments, other payment sharing obligations and royalty payments due on future sales of lasofoxifine, a product under development by Pfizer. Pfizer filed an NDA for lasofoxifene with the FDA in August 2004.

The overall increase in research and development expenses in 2003 compared to 2002 is primarily due to development funding of Phase III clinical trials for Targretin capsules in NSCLC. This increase was partially offset by a lower level of research funding agreed to with Lilly in connection with the two one-year extensions of our collaboration agreements through November 2004. This lower level of funding resulted in lower research expenses performed under collaboration agreements by approximately $4.4 million in 2003 compared to 2002.

We expect overall development expenses to be the same or lower in 2005 due to lower expenses for the completed NSCLC Phase III trials as discussed above, partially offset by higher expense for AVINZA clinical trials and development of our thrombopoietin oral mimic (TPO) compound.

Table of Contents

A summary of our significant internal research and development programs is as follows:

Program	Disease/Indication	Development Phase
AVINZA	Chronic, moderate-to-severe pain	Marketed in U.S. Phase IV
ONTAK	CTCL	Marketed in U.S., Phase IV
	Chronic lymphocytic leukemia	Phase II
	Peripheral T-cell lymphoma	Phase II
	B-cell Non-Hodgkin s lymphoma	Phase II
	NSCLC third line	Phase II
Targretin capsules	CTCL	Marketed in U.S. and Europe
	NSCLC first-line	Phase III
	NSCLC monotherapy	Planned Phase II/III
	NSCLC second/third line	Planned Phase II/III
	Advanced breast cancer	Phase II
	Renal cell cancer	Phase II
Targretin gel	CTCL	Marketed in U.S.
	Hand dermatitis (eczema)	Planned Phase II/ III
	Psoriasis	Phase II
LGD4665 (Thrombopoietin oral mimic)	Chemotherapy-induced thrombocytopenias (TCP), other TCPs	IND Track
LGD5552 (Glucocorticoid agonists)	Inflammation, cancer	IND Track
Selective androgen receptor modulator, e.g., LGD3303 (agonist/antagonist)	Male hypogonadism, female & male osteoporosis, male & female sexual dysfunction, frailty. Prostate cancer, hirsutism, acne, androgenetic alopecia.	Pre-clinical

A summary of our significant internal research and development programs is as follows:

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 ability to predict the outcome of complex research, our ability to predict the results of clinical studies, regulatory requirements placed upon us by regulatory authorities such as the FDA and EMEA, our ability 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 the Risks and Uncertainties section for additional discussion of the uncertainties surrounding our research and development initiatives.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $65.8 million for 2004 compared to $52.5 million for 2003 and $41.8 million for 2002. The increase in 2004 is primarily due to costs associated with 36 additional Ligand sales representatives hired to promote AVINZA as further discussed under Recent Developments Sales Force Activity/Realignment above, and higher advertising and promotion expenses for AVINZA in connection with our co-promotion activities with Organon which started in March 2003. The 36 additional sales representatives were hired

in the second and third quarters of 2004 resulting in higher expenses in the third and fourth quarters of 2004 compared to the first two quarters of 2004 and the full year of 2003. Marketing expenses also increased in 2004 as a result of our increased emphasis on physician-attended product information and advisory meetings for AVINZA. Additionally, selling, general and administrative expenses reflect increased costs incurred in 2004 in connection with the development of an alternate source of supply (Cardinal Health PGS LLC or Cardinal) for AVINZA. See further discussion of our agreement with Cardinal under *Liquidity and Capital Resources Contractual Obligations.*

Table of Contents

The increase in 2003 compared to 2002 is primarily due to costs associated with additional Ligand sales representatives hired to promote AVINZA and higher advertising and promotion expenses for AVINZA which was launched in June 2002. Additionally, marketing expenses increased in 2003 in connection with our increased emphasis on physician-attended product information and advisory meetings for our oncology products. Selling, general and administrative expense for 2003 also includes a $0.7 million interest accrual recorded in the fourth quarter of 2003 for a legal judgment against the Company, related to ongoing litigation with Boston University resulting from amounts withheld from Boston University in connection with the Company s 1998 acquisition of Seragen. We continue to believe that the plaintiff s claims are without merit and have appealed the judgment in this case as well as the award of interest and the calculation of damages. The appeal has been fully briefed and was argued in June 2005 and the parties are awaiting the court s decision.

Selling, general and administrative expenses are expected to increase in 2005 due to the full year impact of hiring of an additional 36 pain specialist sales representatives as discussed above. Additionally, 2005 expenses will increase due to significantly higher accounting and legal expenses incurred in connection with the restatement of our consolidated financial statements, SEC investigation and shareholder litigation as more fully discussed above under *The Restatement and Other Related Matters.*

Co-promotion Expense

Co-promotion expense payable to Organon amounted to $30.1 million in 2004 compared to $9.4 million for 2003. As discussed under Overview , prior to the termination of the co-promotion agreement with Organon USA, we paid Organon, under the terms of our co-promotion agreement, 30% of net AVINZA sales, determined in accordance with GAAP and our standard accounting principles up to $150.0 million and higher percentage payments for net sales in excess of $150.0 million. For 2003, we were required to pay Organon 30% of net AVINZA sales in excess of $35.0 million. Co-promotion expense recognized for 2004 and 2003 was determined based upon the Company s shipments of AVINZA to wholesalers under the sell-in revenue recognition method. Sell-in AVINZA revenue recognized for 2004 and 2003 was $100.3 million and $66.2 million, respectively. For 2003, the co-promotion expense of $9.4 million was recorded in the fourth quarter, the period in which sell-in revenues exceeded the $35.0 million threshold. However, AVINZA shipments made to wholesalers did not meet the revenue recognition criteria under GAAP and such transactions were restated using the sell-through method. See - Results of Operation Three and Nine Months Ended September 30, 2005 and September 30, 2004 Co-promotion Expense.

Other Expenses, Net

Other expenses, net were $7.5 million for 2004 compared to $20.4 million for 2003 and $8.4 million for 2002. Interest expense increased to $12.3 million for 2004 compared to $11.1 million for 2003 and $6.3 million for 2002. Interest expense in 2004 and 2003 primarily represents interest on the $155.3 million of 6% convertible subordinated notes that we issued in November 2002. The increase in interest expense in 2004 compared to the prior year is due primarily to interest on a note payable secured by one of our corporate office buildings and was partially offset by factoring expense attributable to our accounts receivable factoring arrangement (as more fully discussed in Note 6 to the annual consolidated financial statements included elsewhere in this prospectus).

Effective December 31, 2003, the entity from which we leased the building (Nexus Equity VI LLC or Nexus) was consolidated in connection with the implementation of FIN 46(R) *Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51.* Prior to that, the lease arrangement with Nexus was treated as an operating lease. We subsequently acquired the portion of Nexus we did not previously own in April 2004.

The 2002 interest expense represents interest on the $20.0 million in issue price of zero coupon convertible senior notes that were converted into common stock in March 2002 and interest on our outstanding $50.0 million face value of convertible subordinated debentures that were redeemed in June 2002. The increase in interest expense in 2003 compared to 2002 is partially offset by the reduction in debt conversion expense of which $2.0 million was incurred in March 2002 in connection with the early conversion of $20.0 million in issue price of zero coupon convertible senior notes into common stock.

Table of Contents

In 2004, Other, net reflects income of $3.7 million compared to net expenses of $10.0 million in 2003. In September 2004, we agreed to vote our shares of X-Ceptor in favor of the acquisition of X-Ceptor by Exelixis Inc. (Exelixis). Exelixis acquisition of X-Ceptor was subsequently completed on October 18, 2004 and in connection therewith, Ligand received shares of Exelixis common stock. The shares were restricted securities for which a resale registration statement has been filed. Such shares are subject to trading restrictions for up to two years. Additionally, approximately 21% of the shares were placed in escrow for up to one year to satisfy indemnification and other obligations. We recorded a net gain on the transaction in the fourth quarter of 2004 of approximately $3.7 million, based on the fair market value of the consideration received.

Other, net expenses of $10.0 million in 2003 include the March 2003 write-off of a $5.0 million one-time payment made in July 2002 to X-Ceptor Therapeutics, Inc., or X-Ceptor, to extend Ligand s right to acquire the outstanding stock of X-Ceptor not already held by Ligand. In March 2003, we informed X-Ceptor that we would not exercise the purchase right and wrote-off the purchase right valued at $4.0 million that was recorded in 1999.

Cumulative Effect of Accounting Change

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51*, which was subsequently revised in December 2003 (FIN 46(R)). FIN 46(R) requires the consolidation of certain variable interest entities (VIEs) by the primary beneficiary of the entity if the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or if the equity investors lack the characteristics of a controlling financial interest.

We implemented FIN 46(R) effective December 31, 2003, and consolidated the entity from which we lease one of our two corporate office buildings as of that date, as we determined that the entity is a VIE, as defined by FIN 46(R), and that we would absorb a majority of its expected losses if any, as defined by FIN 46(R). Accordingly, we consolidated the assets of the entity, which consist of land, the building, and related tenant improvements, with a total carrying value of $13.6 million, net of accumulated depreciation. Additionally, we consolidated the entity s debt of $12.5 million and non-controlling interest of $0.6 million. In connection with the implementation of FIN 46(R), we also recorded a $2.0 million charge ($0.03 per share) as a cumulative effect of the accounting change on December 31, 2003.

Income Taxes

Income tax expense was $0.2 million for 2004 compared to approximately $0.1 million for each of 2003 and 2002. At December 31, 2004, we have both federal and state net operating loss carryforwards of approximately $530.2 million and $94.1 million, respectively, which will begin expiring in 2005. The difference between the federal and California tax loss carryforwards is primarily due to the capitalization of research and development expenses for California income tax purposes and the 50% to 60% limitation on losses incurred prior to 2004 in California. We have $25.0 million of federal research and development credits carryforwards which will expire beginning in 2005, and $13.7 million of California research and development credits that have no expiration date.

Pursuant to Internal Revenue Code Sections 382 and 383, use of a portion of net operating loss and credit carryforwards will be limited because of cumulative changes in ownership of more than 50% that occurred within three periods during 1989, 1992 and 1996. In addition, use of Glycomed s and Seragen s preacquisition tax net operating and credit carryforwards will also be limited because the acquisitions by the Company represent changes in ownership of more than 50%. Such tax net operating loss and credit carryforwards have been reduced, including the related deferred tax assets. In addition, it is possible that we have had subsequent changes in ownership since 1996 that could further limit our net operating loss and credit carryforwards generated during that period. We have not determined whether any such cumulative ownership change has occurred and if so, the extent of any resulting carryforward limitations. The Company s research & development credits pertain to federal and California jurisdictions. These jurisdictions require that the Company create minimum documentation and support, such as done via a Research & Development Credit Study. In the absence of sufficient documentation and support these government jurisdictions may disallow some or all of the credits. Although the Company has not performed a formal study, the Company believes that it maintains sufficient documentation to support the benefitting of the credits in the

Table of Contents

consolidated financial statements. Prior to utilizing a significant portion of the credits to reduce taxes payable, the Company will review its documentation and support to determine if a formal study is necessary.

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, capital and operating lease transactions, accounts receivable factoring and equipment financing arrangements and investment income.

Working capital was a deficit of $106.9 million at September 30, 2005 compared to a deficit of $48.5 million at December 31, 2004. Cash, cash equivalents, short-term investments, and restricted investments totaled $75.6 million at September 30, 2005 compared to $114.9 million at December 31, 2004. We primarily invest our cash in United States government and investment grade corporate debt securities. Restricted investments consist of certificates of deposit held with a financial institution as collateral under equipment financing and third-party service provider arrangements.

Operating Activities

Operating activities used cash of $3.7 million for the nine months ended September 30, 2005 compared to $23.4 million for the same 2004 period. Operating activities for 2005 reflect a lower net loss adjusted by $2.2 million of higher amortization of acquired technology and license rights resulting from the capitalization of $33.0 million paid to Lilly in connection with the restructuring of the Company s ONTAK royalty agreement. Additionally, the net loss for the 2004 period includes a $2.0 million non-cash development milestone earned from Pfizer in the third quarter of 2004. The lower use of cash for the 2005 period also reflects changes in operating assets and liabilities primarily due to an increase in deferred revenue, net of $5.5 million, an increase in accounts payable and accrued liabilities of $2.3 million, a decrease in accounts receivable, net of $6.5 million, and a decrease in other current assets of $5.0 million partially offset by an increase in inventories, net of $3.1 million. For the same 2004 period, use of operating cash was impacted by changes in operating assets and liabilities primarily due to an increase in deferred revenue, net of $35.6 million, an increase in accounts payable and accrued liabilities of $11.2 million partially offset by an increase in accounts receivable, net of $11.6 million, an increase in inventories, net of $3.1 million, and an increase in other current assets of $2.6 million.

Operating activities provided cash of $5.8 million in 2004 and $0.3 million in 2003 and used cash of $26.9 million in 2002. Operating cash flow in 2004 benefited from increased product sales and $32.5 million of cash received in connection with the sale to Royalty Pharma AG of rights to future royalties from certain collaborative partners net sales of three SERM products compared to cash received in 2003 of $12.5 million for royalty rights sales. Operating cash was negatively impacted, however, by higher operating expenses including development expenses to fund clinical trials of our existing products in new indications including Phase III registration trials for Targretin capsules in NSCLC, and higher selling and marketing expenses for AVINZA.

Non-cash operating items in 2004 decreased $17.2 million compared to 2003. The decrease includes a development milestone of approximately $2.0 million received from Pfizer, in connection with Pfizer s filing with the FDA of a new drug application for lasofoxifene, paid in stock in September 2004. Non-cash activity in 2004 also includes a net gain on sale of equity investments totaling $3.7 million. Non-cash operating items in 2003 include the $9.0 million write-off of the $5.0 million X-Ceptor payment to extend our X-Ceptor purchase right and capitalization of the purchase right of $4.0 million in March 2003, in connection with our decision to not acquire X-Ceptor, and the non-cash cumulative effect of the change in accounting principle (approximately $2.0 million) recognized in connection with the implementation of FIN 46(R).

Changes in operating assets and liabilities provided cash of $41.2 million in 2004 primarily due to increases in deferred revenue of $47.9 million and accounts payable and accrued liabilities of $9.8 million, partially offset by increases in accounts receivable and inventories of $11.9 million and $3.3 million, respectively. This compares to cash provided by changes in operating assets and liabilities in 2003 of $69.9 million due to increases in deferred revenue of $57.0 million and accounts payable and accrued liabilities of $24.2 million, partially offset by increases in accounts receivable and inventories of $6.5 million and $3.5 million, respectively. The increase in deferred revenue in each period reflects shipments of product into the wholesale and retail distribution channels offset in part

Table of Contents

by end-customer product demand recognized as revenue under the sell-through revenue recognition method. The increase in accounts receivable in each period reflects increasing wholesaler purchases in connection with the growth of product demand, primarily AVINZA for which co-promotion activities with Organon started in 2003. Likewise, the increase in accounts payable and accrued liabilities for each year primarily reflects the growth in Medicaid rebates and government chargebacks in connection with the growth in demand of AVINZA and ONTAK. Operating cash flows in 2003 also benefited from the impact of the accounts receivable factoring arrangement which was entered into in the second quarter of 2003.

Operating cash flow in 2003 compared to 2002 benefited from increased product shipments, as reflected in the increase in deferred revenue. The increase in 2003 was also due to increases in our sales related liability accounts.

We expect operating cash flows to benefit in 2005 from increased product demand due primarily to growth in AVINZA. Operating cash is expected to be negatively impacted, however, by lower product shipments to wholesalers in accordance with reduced inventory levels we negotiated with our major wholesaler customers in the distribution service agreements. The impact of the lower shipments will be partially offset by lower fees paid under the distribution service agreements. Operating cash flows are expected to be further negatively impacted by higher selling and marketing expenses on AVINZA and increased accounting and legal expenses incurred in connection with the restatement of our consolidated financial statements.

Investing Activities

Investing activities used cash of $38.8 million for the nine months ended September 30, 2005 compared to cash provided of $2.5 million for the same 2004 period. The use of cash for the nine months ended September 30, 2005 reflects $33.0 million of payments for the buy-down of ONTAK royalty payments in connection with the amended royalty agreement entered into in November 2004 between the Company and Lilly, $3.5 million of net purchases of short-term investments, $1.8 million of purchases of property and equipment, and a $0.5 million capitalized payment to The Salk Institute for the exercise of an option to buy out royalty payments due on future sales of lasofoxifene for a second indication. Cash provided by investing activities for the nine months ended September 30, 2004 primarily reflects a decrease in restricted investments and net proceeds from the sale of short-term investments of $4.6 million and $1.1 million respectively, partially offset by purchases of property and equipment of $2.8 million.

Investing activities provided cash of $19.6 million in 2004 and used cash of $14.2 million in 2003 and $124.1 million in 2002. Cash provided by investing activities for 2004 reflects net proceeds of $14.1 million from the sale of short-term investments and $9.2 million from the maturing of restricted investments which was subsequently used to pay interest on our 6% Convertible Subordinated Notes. The use of cash in 2004 reflects $3.6 million for capital purchases. The use of cash in 2003 reflects the net purchase of short-term investments of $18.0 million, a $4.1 million payment to Elan in connection with the November 2002 restructuring of the AVINZA license and supply agreement and capital purchases of $2.8 million. Cash provided by investing activities for 2003 includes $10.4 million from the maturing of restricted investments which was subsequently used to pay interest on our 6% Convertible Subordinated Notes.

The use of cash in 2002 includes $100.0 million paid to Elan to restructure the AVINZA license and supply agreement and $1.3 million in related transaction fees. The use of cash in 2002 also includes the restriction of $18.0 million of the proceeds from the Company s issuance in November 2002 of 6% Convertible Subordinated Notes. The $18.0 million was required to be invested in a U.S. government securities and placed with a trustee to pay the first four scheduled interest payments on the notes. Other investing activity in 2002 includes a $5.0 million payment to X-Ceptor Therapeutics, Inc. (X-Ceptor) and capital expenditures of $3.2 million, partially offset by net proceeds of $4.1 million from the sale of short-term investments. The payment to X-Ceptor was pursuant to a 1999 investment agreement where we maintained the right to acquire all of the outstanding stock of X-Ceptor not held by Ligand at June 30, 2002, or to extend the purchase right for 12 months by providing additional funding of $5.0 million. In April 2002, we elected to extend the purchase right and payment was subsequently made in July 2002. In March 2003, Ligand informed X-Ceptor that it would not exercise the purchase right.

Table of Contents

Financing Activities

Financing activities used cash of $0.2 million for the nine months ended September 30, 2005 compared to cash provided of $8.0 million for the same 2004 period. Cash used in financing activities for the nine months ended September 30, 2005 reflects repayment of long-term debt and net payments under equipment financing arrangements of $0.2 million and $0.8 million, respectively, partially offset by net proceeds from the exercise of employee stock options and purchases under the Company s employee stock purchase plan of $0.9 million. Cash provided by financing activities for the nine months ended September 30, 2004 includes proceeds from the exercise of employee stock options and purchases under the Company s employee stock purchase plan and net proceeds from equipment financing arrangements of $6.3 million and $1.9 million, respectively.

Financing activities provided cash of $7.9 million in 2004 compared to $32.1 million in 2003 and $171.1 million in 2002. Cash provided by financing activities in 2004 includes net proceeds of $6.6 million from the exercise of employee stock options and stock purchases under our employee stock purchase plan and $1.8 million of net proceeds received under equipment financing arrangements. Cash provided by financing activities in 2003 includes net proceeds of $45.0 million from the issuance of common stock through a private placement of 3,483,593 shares of our common stock, $4.5 million from the exercise of employee stock options and employee stock purchases, and $1.1 million from equipment financing arrangements. The net proceeds of $45.0 million from the private placement were used to support our working capital priorities, including qualifying second source manufacturer(s) for AVINZA, work on a second generation formulation of ONTAK, continuing expansion of commercial support activities for AVINZA and ONTAK, and for general corporate purposes. These proceeds were offset by the $15.9 million repurchase and retirement of approximately 2.2 million shares of our outstanding common stock held by an affiliate of Elan in connection with a November 2002 share repurchase agreement completed in February 2003, and payments of $2.5 million on equipment financing arrangements.

Cash provided by financing activities in 2002 includes net proceeds of $150.1 million from the issuance of 6% Convertible Subordinated Notes in November 2002, net proceeds of $66.1 million through a private placement of 4,252,500 shares of our common stock, and $3.8 million from the exercise of employee stock options and employee stock purchases. This was partially offset by the $50.0 million early redemption of convertible subordinated debentures in June 2002. The Convertible Subordinated Notes issued in November 2002 pay interest at a semi-annual rate of 6% and mature on November 16, 2007. Of the net proceeds, $18.0 million was used to pay the first four scheduled interest payments.

Certain of our property and equipment is pledged as collateral under various equipment financing arrangements. As of September 30, 2005, $5.8 million was outstanding under such arrangements with $2.5 million classified as current. Our equipment financing arrangements have terms of three to five years with interest ranging from 4.73% to 10.66%.

We believe our available cash, cash equivalents, short-term investments and existing sources of funding will be sufficient to satisfy our anticipated operating and capital requirements through at least the next 12 months. Our future operating and capital requirements will depend on many factors, including: the effectiveness of our commercial activities; 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 ability to establish additional collaborations or changes in existing collaborations; the efforts of our collaborators; and the cost of production. We will also consider additional equipment financing arrangements similar to arrangements currently in place.

Table of Contents

Leases and Off-Balance Sheet Arrangements

We lease certain of our office and research facilities under operating lease arrangements with varying terms through July 2015. 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%.

As of September 30, 2005, we are not involved in any off-balance sheet arrangements.

As of December 31, 2003, we leased one of our corporate office buildings from Nexus Equity VI LLC (Nexus), a limited liability company in which Ligand held a 1% ownership interest. No Ligand officer or employee had any financial interest with regard to this lease arrangement or with Nexus. The lease agreement provided for increases in annual rent of 4% and terminated in 2014. In addition, we had the option to either purchase the portion of Nexus that we did not own, purchase the property from the lessor at a purchase price equal to the outstanding debt on the property plus a calculated return on the investment made by Nexus other shareholder, sell the property to a third party, or renew the lease arrangement.

This specific type of operating lease is commonly referred to as a synthetic lease. Prior to the issuance of FIN 46(R), synthetic leases represented a form of off-balance sheet financing under which they were treated as an operating lease for financial reporting purposes and as a financing lease for tax purposes. Under FIN 46(R), a synthetic lease is evaluated to determine i) if it qualifies as a VIE and if so, ii) the primary beneficiary required to consolidate the VIE.

Under FIN 46(R), we determined that Nexus qualified as a VIE, and that we were the primary beneficiary of the VIE, as we would absorb the majority of the entity s expected losses, if any, as defined by the Interpretation. In accordance with FIN 46(R), we consolidated Nexus as of December 31, 2003. See Note 3, Significant Accounting Policies Cumulative Effect of Accounting Change section for information on the impact of the Company s adoption of FIN 46(R).

In April 2004, we exercised our right to acquire the portion of Nexus that we did not own. The acquisition resulted in our assumption of the existing loan against the property and payment to Nexus other shareholder of approximately $0.6 million.

Table of Contents

Contractual Obligations

As of December 31, 2004, 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 (1)	$ 7,365	$ 2,980	$ 3,684	$ 701	$
Operating lease obligations	22,464	2,939	4,177	3,721	11,627
Loan payable to bank (2)	15,190	1,191	2,381	11,618	
6% Convertible Subordinated Notes (3)	183,195	9,315	173,880		
Other liabilities (4)	3,549	3,000	549		
Distribution service agreements	6,864	6,864			
Consulting agreements	418	418			
Manufacturing agreements (5)	11,231	11,131	100		
Total contractual obligations	$ 250,276	$ 37,838	$ 184,771	$ 16,040	$ 11,627

(1) Includes $0.8 million of interest payments.

(2) Includes interest of $0.9 million, $1.7 million, and $0.5 million for 2005, the period from 2006 to 2007 and 2008, respectively.

(3) Includes interest of $9.3 million and $18.6 million for 2005 and the period from 2006 to 2007, respectively.

(4) Other liabilities include merger contingencies and a liability under a royalty financing arrangement. Deferred revenues are excluded because they have no effect on future liquidity.

(5) Includes $9.2 million related to the amended Elan agreement described below and $2.0 million of other manufacturing contractual commitments.

As of December 31, 2004, we had net open purchase orders (defined as total open purchase orders at period end less any accruals or invoices charged to or amounts paid against such purchase orders) totaling approximately $18.5 million. In the next twelve months, we also plan to spend approximately $3.0 million on capital expenditures.

In November 2002, Ligand and Elan agreed to amend the terms of the AVINZA license and supply agreement. Under the terms of the amendment, we paid Elan $100.0 million in return for a reduction in Elan s product supply price on sales of AVINZA by Ligand, rights to sublicense and obtain a co-promotion partner in its territories, and rights to qualify, and purchase AVINZA from a second manufacturing source. Elan s adjusted royalty and supply price of AVINZA is approximately 10% of the product s net sales. We also committed to purchase an annual minimum number of batches of AVINZA from Elan through 2005 estimated at approximately $9.2 million per year.

In March 2004, we entered into a five-year manufacturing and packaging agreement with Cardinal Health PTS, LLC (Cardinal) under which Cardinal will manufacture AVINZA at its Winchester, Kentucky facility. Under the terms of the agreement, we committed to certain minimum annual purchases ranging from approximately $1.6 million to $2.3 million. In August 2005, the FDA approved the production of AVINZA at the Cardinal facility.

Table of Contents

Critical Accounting Policies

Certain of our policies require the application of management judgment in making estimates and assumptions that affect the amounts reported in the consolidated financial statements and disclosures made in the accompanying notes. Those estimates and assumptions are based on historical experience and various other factors deemed to be applicable and reasonable under the circumstances. The use of judgment in determining such estimates and assumptions is by nature, subject to a degree of uncertainty. Accordingly, actual results could differ materially from the estimates made. Our critical accounting policies are as follows:

Revenue Recognition

The Company generates revenue from product sales, collaborative research and development arrangements, and other activities such as distribution agreements, royalties, and sales of technology rights. The Company s collaborative arrangements and distribution agreements may include multiple elements within a single contract. Each element of the contract is separately negotiated. Payments received may include non-refundable fees at the inception of the contract for technology rights under collaborative arrangements or product rights under distribution agreements, fully burdened funding for services performed during the research phase of collaborative arrangements, milestone payments for specific achievements designated in the collaborative or distribution agreements, royalties on sales of products resulting from collaborative arrangements, and payments for the supply of products under distribution agreements.

The Company recognizes product revenue in accordance with SAB 104 and SFAS 48. SAB 104 states that revenue should not be recognized until it is realized or realizable and earned. Revenue is realized or realizable and earned when all of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the seller s price to the buyer is fixed and determinable; and (4) collectibility is reasonably assured. SFAS 48 states that revenue from sales transactions where the buyer has the right to return the product shall be recognized at the time of sale only if (1) the seller s price to the buyer is substantially fixed or determinable at the date of sale, (2) the buyer has paid the seller, or the buyer is obligated to pay the seller and the obligation is not contingent on resale of the product, (3) the buyer s obligation to the seller would not be changed in the event of theft or physical destruction or damage of the product, (4) the buyer acquiring the product for resale has economic substance apart from that provided by the seller, (5) the seller does not have significant obligations for future performance to directly bring about resale of the product by the buyer, and (6) the amount of future returns can be reasonably estimated.

Product sales

The Company has determined that domestic shipments made to wholesalers for AVINZA, ONTAK, Targretin capsules and Targretin gel do not meet the revenue recognition criteria of SFAS 48 and SAB 104 at the time of shipment, and therefore such shipments are accounted for using the sell-through method. Under the sell-through method, the Company does not recognize revenue upon shipment of product to the wholesaler. For these product sales, the Company invoices the wholesaler, records deferred revenue at gross invoice sales price less estimated cash discounts and for ONTAK, end-customer returns, and classifies the inventory held by the wholesaler as deferred cost of goods sold within Other current assets. At that point, the Company makes an estimate of units that may be returned and records a reserve for those units against the deferred cost of goods sold account. The Company recognizes revenue when such inventory is sold through (as defined hereafter), on a first-in first-out (FIFO) basis. Sell through for ONTAK, Targretin capsules and Targretin gel are considered to be at the point of out movement from the wholesaler to the wholesaler s customer. Sell through for AVINZA is considered to be at the prescription level or at the point of patient consumption for channels with no prescription requirements.

A summary of the revenue recognition policy used for each of our products and the expiration of the underlying patents for each product is as follows:

Table of Contents

	Method	Revenue Recognition Event	Patent Expiration
AVINZA	Sell-through	Prescriptions	November 2017
ONTAK	Sell-through	Wholesaler out-movement	December 2014
Targretin capsules	Sell-through	Wholesaler out-movement	October 2016
Targretin gel	Sell-through	Wholesaler out-movement	October 2016
Panretin	Sell-in	Shipment to wholesaler	August 2016
International	Sell-in	Shipment to international distributor	February 2011 through April 2013

For the years ended December 31, 2004, 2003 and 2002, net product sales recognized under the sell-through method represented 96%, 94%, and 95%, respectively, of total net product sales.

Additionally under the sell-through method, royalties paid based on unit shipments to wholesalers are deferred and recognized as royalty expense as those units are sold through and recognized as revenue. Royalties paid to technology partners are deferred as the Company has the right to offset royalties paid for product that are later returned against subsequent royalty obligations. Royalties for which the Company does not have the ability to offset (for example, at the end of the contractual royalty period) are expensed in the period the royalty obligation becomes due.

The Company estimates sell-through based upon (1) analysis of third-party information, including information obtained from certain wholesalers with respect to their inventory levels and sell-through to customers, and third-party market research data, and (2) the Company s internal product movement information. To assess the reasonableness of third-party demand (i.e. sell-through) information, the Company prepares separate demand reconciliations based on inventory in the distribution channel. Differences identified through these reconciliations outside an acceptable range will be recognized as an adjustment to the third-party reported demand in the period those differences are identified. This adjustment mechanism is designed to identify and correct for any material variances between reported and actual demand over time and other potential anomalies such as inventory shrinkage at wholesalers. The Company s estimates are subject to the inherent limitations of estimates that rely on third-party data, as certain third-party information is itself in the form of estimates. The Company s sales and revenue recognition under the sell-through method reflect the Company s estimates of actual product sold through the channel.

We use information from external sources to estimate our gross product sales under the sell-through revenue recognition method and significant gross to net sales adjustments. Our estimates include product information with respect to prescriptions, wholesaler out-movement and inventory levels, and retail pharmacy stocking levels, and our own internal information. We receive information from IMS Health, a supplier of market research to the pharmaceutical industry, which we use to estimate sell-through demand for our products and retail pharmacy inventory levels. We also receive wholesaler out-movement and inventory information from our wholesaler customers that is used to support and validate our demand-based, sell-through revenue recognition estimates. Additionally, we use wholesaler provided out-movement information to estimate ONTAK sell-through revenue as this data is not available from IMS. The inventory information received from wholesalers is a product of their record-keeping process and their internal contacts surrounding such processes.

We recognize revenue for Panretin upon shipment to wholesalers as our wholesaler customers only stock minimal amounts of Panretin, if any. As such, wholesaler orders are considered to approximate end-customer demand for the product. Revenues from sales Panretin are net of allowances for rebates, chargebacks and discounts. For international shipments of our product, revenue is recognized upon shipment to our third-party international distributors.

Sale of Royalty Rights

Revenue from the sale of royalty rights represents the non-refundable sale to third parties of rights for and exercise of options to acquire future royalties the Company may earn from the sale of products in development with its collaborative partners. If the Company has no continuing involvement in the research, development or marketing of these products, sales of royalty rights are recognized as revenue in the period the transaction is consummated or

Table of Contents

the options are exercised or expired. If the Company has significant continuing involvement in the research, development or marketing of the product, proceeds received for the sale of royalty rights are accounted for as a financing arrangement in accordance with EITF 88-18: *Sales of Future Royalties*.

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. 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 Ligand has continuing involvement through research and development collaborations or other contractual obligations is recognized ratably over the development period or the period for which Ligand 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.

Net Product Sales

The Company s net product sales represent total product sales less allowances for rebates, chargebacks, discounts, and promotions and losses to be incurred on returns from wholesalers resulting from increases in the selling price of the Company s products. In addition, the Company incurs certain distributor service agreement fees related to the management of its product by wholesalers. These fees have been recorded within net revenues. For ONTAK, the Company also has established reserves for returns from end customers after sell-through revenue recognition has occurred. Due to estimates and assumptions inherent in determining the amount of returns, chargebacks, and rebates, the actual amount of product returns and claims for chargeback and rebates may be materially different from our estimates.

Table of Contents

The following summarizes the activity in the accrued liability accounts related to allowances for loss on returns, rebates, chargebacks, other discounts, ONTAK end-customer and Panretin returns (in thousands):

	Nine Months Ended		Year Ended December 31,		
	September 30, 2005	September 30, 2004 (Restated)	2004	2003 (Restated)	2002 (Restated)
Balance beginning of period	$ 16,151	$ 9,196	$ 9,196	$ 3,952	$ 3,190
Provision for ONTAK end-customer and Panretin returns	2,360	1,948	3,015	1,547	2,886
Returns	(2,853)	(1,397)	(2,492)	(1,308)	(2,986)
Net change ONTAK end-customer and Panretin returns	(493)	551	523	239	(100)
Provision for losses on returns due to changes in prices	4,380	3,034	5,018	4,229	2,265
Charges	(3,281)	(2,536)	(3,025)	(856)	(1,802)
Net change losses on returns	1,099	498	1,993	3,373	463
Provision for Medicaid rebates	15,215	9,792	14,430	2,724	511
Payments	(14,335)	(5,714)	(11,074)	(1,239)	(445)
Net change Medicaid rebates	880	4,078	3,356	1,485	66
Provision for chargebacks	4,263	2,784	3,962	2,184	936
Payments	(4,573)	(2,494)	(3,684)	(2,123)	(958)
Net change chargebacks	(310)	290	278	61	(22)
Provision for managed care rebates and other contract discounts	7,362	3,736	5,773	852	34
Payments	(6,273)	(2,161)	(4,455)	(457)	(3)

Net change managed care rebates and other contract discounts	1,089	1,575	1,318	395	31
Provision for other discounts		6,321	6,495	9,035	2,091
Payments	(4)	(5,643)	(7,008)	(9,344)	(1,767)
Net change other discounts	(4)	678	(513)	(309)	324
Balance end of period	$ 18,412	$ 16,866	$ 16,151	$ 9,196	$ 3,952

Table of Contents

Allowance for Return Losses

Product sales are also net of adjustments for losses resulting from price increases the Company may experience on product returns from its wholesaler customers. Our policy for returns allows customers, primarily wholesale distributors, to return our oncology products three months prior to and six months after expiration. For ONTAK, customers are generally allowed to return product in exchange for replacement ONTAK vials. Our policy for returns of AVINZA allows customers to return the product six months prior to and six months after expiration. Upon an announced price increase, typically in the quarter prior to when a price increase becomes effective, the Company revalues its estimate of deferred product revenue to be returned to recognize the potential higher credit a wholesaler may take upon product return determined as the difference between the new price and the previous price used to value the allowance. Due to estimates and assumptions inherent in determining the amount of return losses, the actual amount of product returns may be materially different from our estimates. In addition, because of the inherent difficulties of predicting possible changes to the estimates and assumptions used to determine losses to be incurred on returns from price changes due to, among other factors, changes in future prescription levels and wholesaler inventory practices, we are unable to quantify an estimate of the reasonably likely effect of any such changes on our results of operations or financial position. For reference purposes, a 10% 20% variance to our estimated allowance for return losses as of September 30, 2005 would result in an approximate $0.7 million to $1.5 million adjustment to net product sales.

ONTAK End-Customer Returns

Under the sell-through method of revenue recognition, the estimate of product returns from the wholesalers does not result in a gross to net sales adjustment since the shipment of product to the wholesalers does not result in revenue recognition. For ONTAK, revenue is recognized when product is shipped from wholesalers to end-customers, primarily hospitals and clinics that have the capability to administer the product to patients. These customers have the right to return expired product to the wholesaler who in turn can return the product to the Company. In accordance with SFAS 48, we record a return provision upon sell-through of ONTAK by establishing a reserve in an amount equal to our estimate of sales recorded but for which the related products are expected to be returned by the end customer. We determine our estimate of the sales return accrual based on historical experience. Due to the estimates and assumptions inherent in determining the amount of ONTAK end-customer returns, the actual amount of product returns may be materially different from our estimates. Based on the Company s experience with returns of ONTAK from end-customers, however, we do not believe that a material change to our estimated allowance for ONTAK end-customer returns is reasonably likely.

Medicaid rebates

Our products are subject to state government-managed Medicaid programs whereby discounts and rebates are provided to participating state governments. We account for Medicaid rebates by establishing an accrual in an amount equal to our estimate of Medicaid rebate claims attributable to sales recognized in that period. We determine our estimate of the Medicaid rebates accrual primarily based on historical experience regarding Medicaid rebates, as well as current and historical prescription activity provided by external sources, current contract prices and any expected contract changes. We additionally consider any legal interpretations of the applicable laws related to Medicaid and qualifying federal and state government programs and any new information regarding changes in the Medicaid programs regulations and guidelines that would impact the amount of the rebates. We adjust the accrual periodically throughout each period to reflect actual experience, expected changes in future prescription volumes and any changes in business circumstances or trends. Due to estimates and assumptions inherent in determining the amount of rebates, the actual amount of claims for rebates may be materially different from our estimates. In addition, because of the inherent difficulties of predicting the impact on our estimates and assumptions of rapidly evolving state Medicaid programs and regulations, we are unable to quantify an estimate of the reasonably likely effect of any such changes on our results of operations or financial position. For reference purposes, a 10% 20% variance to our estimated allowance for state Medicaid rebates as of September 30, 2005 would result in an approximate $0.6 million to $1.2 million adjustment to net product sales.

Table of Contents

Government chargebacks

Our products are subject to certain programs with federal government entities and other parties whereby pricing on products is extended below wholesaler list price to participating entities. These entities purchase products through wholesalers at the lower vendor price, and the wholesalers charge the difference between their acquisition cost and the lower vendor price back to us. We account for chargebacks by establishing an accrual in an amount equal to our estimate of chargeback claims. We determine our estimate of the chargebacks primarily based on historical experience regarding chargebacks and current contract prices under the vendor programs. We consider vendor payments and our claim processing time lag and adjust the accrual periodically throughout each period to reflect actual experience and any changes in business circumstances or trends. Due to estimates and assumptions inherent in determining the amount of government chargebacks, the actual amount of claims for chargebacks may be materially different from our estimates. Based on the Company s experience with government chargebacks, however, we do not believe that a material change to our estimated allowance for chargebacks is reasonably likely.

Managed health care rebates and other contract discounts

We offer rebates and discounts to managed health care organizations and to other contract counterparties such as hospitals and group purchasing organizations in the U.S. We account for managed health care rebates and other contract discounts by establishing an accrual in an amount equal to our estimate of managed health care rebates and other contract discounts. We determine our estimate of the managed health care rebates and other contract discounts accrual primarily based on historical experience regarding these rebates and discounts and current contract prices. We also consider the current and historical prescription activity provided by external sources, current contract prices and any expected contract changes and adjust the accrual periodically throughout each period to reflect actual experience and any changes in business circumstances or trends. Due to estimates and assumptions inherent in determining the amount of rebates and contract discounts, the actual amount of claims for rebates and discounts may be materially different from our estimates. In addition, because of the inherent difficulties of predicting the impact on our estimates and assumptions of rapidly evolving managed care programs, we are unable to quantify an estimate of the reasonably likely effect of any such changes on our results of operations or financial position. For reference purposes, a 10% 20% variance to our estimated allowance for managed health care and other contract discounts as of would result in an approximate $0.2 million to $0.5 million adjustment to net product sales.

Inventories

Our inventories are stated at the lower of cost or market value. Cost is determined using the first-in, first-out method. We record reserves for estimated obsolescence to account for unsaleable products including products that are nearing or have reached expiration, and slow-moving inventory. If actual future demand or market conditions are less favorable than our estimates, then additional material inventory write-downs might be required.

Acquired Technology and Product Rights

Acquired technology and product rights represent payments related to our acquisition of ONTAK and license and royalty rights for AVINZA. In accordance with SFAS 142, these payments are amortized on a straight line basis since the pattern in which the economic benefit of these assets are consumed (or otherwise used up) cannot be reliably determined. Accordingly, acquired technology and product rights are amortized on a straight-line basis over 15 years, which approximated the remaining patent life at the time the assets were acquired and represents the period estimated to be benefited. Specifically, we are amortizing the ONTAK asset through June 2014, which is approximate to the expiration date of its U.S. patent of December 2014. The AVINZA asset is being amortized through November 2017, the expiration of its U.S. patent.

Impairment of Long-Lived Assets

We review long-lived assets, including acquired technology and product rights and property and equipment, during the fourth quarter of each year, or whenever events or circumstances indicate that the carrying amount of the assets may not be fully recoverable. We measure the recoverability of assets to be held and used by comparing the

Table of Contents

carrying amount of an asset to the future undiscounted net cash flows expected to be generated by the asset. If an asset is considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds its fair value. Fair value of our long-lived assets are determined using the expected cash flows discounted at a rate commensurate with the risk involved. Assumptions and estimates used in the evaluation of impairment may affect the carrying value of long-lived assets, which could result in impairment charges in future periods.

We believe that the future cash flows to be received from our long-lived assets will exceed the assets carrying value, and accordingly have not recorded any impairment losses through December 31, 2004. Our impairment assessment could be impacted by various factors including a more than insignificant disruption of supply, new competing products or technologies that could result in a significant decrease in the demand for or the pricing of our products, regulatory actions that require us to restrict or cease promotion of the products, a product recall to address regulatory issues, and/or patent claims by third parties.

Income Taxes

Income taxes are accounted for under the liability method. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of differences between the tax basis of assets or liabilities and their carrying amounts in the consolidated financial statements. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will either expire before we are able to realize their benefit or if future deductibility is uncertain. Developing the provision for income taxes requires significant judgment and expertise in federal and state income tax laws, regulations and strategies, including the determination of deferred tax assets and liabilities and, if necessary, any valuation allowances that may be required for deferred tax assets. Our judgments and tax strategies are subject to audit by various taxing authorities. While we believe we have provided adequately for our income tax liabilities in our consolidated financial statements, adverse determinations by these taxing authorities could have a material adverse effect on our consolidated financial condition and results of operations.

Stock-Based Compensation

We grant stock options to our employees at an exercise price equal to the fair value of the shares at the date of grant and account for these stock option grants in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and related interpretations. Under APB 25, when stock options are issued with an exercise price equal to the market price of the underlying stock on the date of grant, no compensation expense is recognized in the statement of operations. Refer to Note 3 of the notes to consolidated financial statements for pro-forma disclosures of the impact on our consolidated financial statements of accounting for stock options under the fair-value requirements of SFAS No. 123, *Accounting for Stock-based Compensation*.

New Accounting Pronouncements

In November 2005, the Financial Accounting Standards Board (FASB) issued Staff Position Nos. FAS 115-1 and FAS 124-1 (FSP 115-1 and FSP 124-1), The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, in response to Emerging Issues Task Force 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments (EITF 03-1). FSP 115-1 and FSP 124-1 provide guidance regarding the determination as to when an investment is considered impaired, whether that impairment is other-than-temporary, and the measurement of an impairment loss. FSP 115-1 and FSP 124-1 also include accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than temporary-impairments. These requirements are effective for annual reporting periods beginning after December 15, 2005. Adoption of the impairment guidance contained in FSP 115-1 and FSP 124-1 is not expected to have a material impact on the Company s financial position or results of operations.

In December 2004, the FASB issued SFAS No. 123R (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R replaced SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), and superseded Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). In March 2005, the U.S. Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107 (SAB 107), which

Table of Contents

expresses views of the SEC staff regarding the interaction between SFAS 123R and certain SEC rules and regulations, and provides the staff s views regarding the valuation of share-based payment arrangements for public companies. SFAS 123R will require compensation cost related to share-based payment transactions to be recognized in the financial statements. SFAS 123R required public companies to apply SFAS 123R in the first interim or annual reporting period beginning after June 15, 2005. In April 2005, the SEC approved a new rule that delays the effective date, requiring public companies to apply SFAS 123R in their next fiscal year, instead of the next interim reporting period, beginning after June 15, 2005. As permitted by SFAS 123, the Company elected to follow the guidance of APB 25, which allowed companies to use the intrinsic value method of accounting to value their share-based payment transactions with employees. SFAS 123R requires measurement of the cost of share-based payment transactions to employees at the fair value of the award on the grant date and recognition of expense over the requisite service or vesting period. SFAS 123R requires implementation using a modified version of prospective application, under which compensation expense of the unvested portion of previously granted awards and all new awards will be recognized on or after the date of adoption. SFAS 123R also allows companies to adopt SFAS 123R by restating previously issued financial statements, basing the amounts on the expense previously calculated and reported in their pro forma footnote disclosures required under SFAS 123. The Company will adopt SFAS 123R in the first interim period of fiscal 2006 and is currently evaluating the impact that the adoption of SFAS 123R will have on its consolidated results of operations and financial position.

In November 2004, the FASB issued SFAS No. 151, *Inventory Pricing* (SFAS 151). SFAS 151 amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). This statement requires that those items be recognized as current-period charges. In addition, SFAS 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The impact of the adoption of SFAS No. 151 is not expected to have a material impact to our consolidated statements of operations or consolidated balance sheets.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*, to address the measurement of exchanges of nonmonetary assets. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, and replaces it with an exception for nonmonetary exchanges that do not have commercial substance. This statement specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The impact of the adoption of SFAS No. 153 did not have a material impact to our consolidated statements of operations or consolidated balance sheets for the quarter ended September 30, 2005.

In May 2005, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 154, *Accounting Changes and Error Corrections* (SFAS 154). SFAS 154 requires retrospective application to prior-period financial statements of changes in accounting principles, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also redefines restatement as the revising of previously issued financial statements to reflect the correction of an error. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

Table of Contents

Quantitative And Qualitative Disclosures About Market Risk

At December 31, 2004, our investment portfolio included fixed-income securities of $18.3 million. At December 31, 2004, we held no other market risk sensitive instruments. Our fixed-income securities are subject to interest rate risk and will decline in value if interest rates increase. This risk is mitigated, however, due to the relatively short effective maturities of the debt instruments in our investment portfolio. Accordingly, 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 would, 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.

Table of Contents

BUSINESS

Overview

Our goal is to build a profitable pharmaceutical company that discovers, develops and markets new drugs that address critical unmet medical needs in the areas of cancer, men s and women s health, skin diseases, osteoporosis, and metabolic, cardiovascular and inflammatory diseases. We strive to develop drugs that are more effective and/or safer than existing therapies, that are more convenient (taken orally or topically administered) and that are cost effective. We plan to build a profitable pharmaceutical company by generating income from the specialty pharmaceutical products we develop and market, and from research, milestone and royalty revenues resulting from our collaborations with large pharmaceutical partners, which develop and market products in large markets that are beyond our strategic focus or resources.

We currently market four oncology products in the United States: Panretin gel, ONTAK and Targretin capsules, each of which was approved by the FDA in 1999; and Targretin gel, which was approved by the FDA in 2000. Our fifth and newest product, AVINZA, is a treatment for chronic, moderate-to-severe pain that was approved by the FDA in March 2002. In Europe, the EC granted an MA for Panretin gel in October 2000 and an MA for Targretin capsules in March 2001. We also continue efforts to acquire or in-license other products, like ONTAK and AVINZA, which have near-term prospects of FDA approval and which can be marketed by our specialty sales forces. We are developing additional products through our internal development programs and currently have various products in clinical development, including marketed products that we are testing for larger market indications such as NSCLC, CLL, NHL and hand dermatitis.

We have formed research and development collaborations with numerous global pharmaceutical companies, including Abbott Laboratories, Allergan, Inc., Bristol-Myers Squibb, Eli Lilly & Company, GlaxoSmithKline, Organon (Akzo Nobel), Parke-Davis, Pfizer Inc., TAP Pharmaceutical Products, Inc. (TAP), and Wyeth. As of August 31, 2005, our corporate partners had 13 Ligand products in human development and numerous compounds on an IND track or in preclinical and research stages. These corporate partner products are being studied for the treatment of large market indications such as osteoporosis, diabetes, contraception and cardiovascular disease. One of these partner products, lasofoxifene, is being developed by Pfizer for osteoporosis and other indications. Pfizer filed a NDA with the FDA in August 2004 for the use of lasofoxifene in the prevention of osteoporosis and then filed a supplemental NDA in December 2004 for the use of lasofoxifene in the treatment of vaginal atrophy. Two of these partner products are in pivotal Phase III clinical trials: bazedoxifene, which is being developed by Wyeth as monotherapy for osteoporosis and in combination with Wyeth s PREMARIN for osteoporosis prevention, and vasomotor symptoms of menopause. A fourth partner product, LY519818, is being developed by Eli Lilly & Company for the treatment of type 2 diabetes. Lilly has announced plans to advance this product into Phase III registration studies after completion of two-year carcinogenicity studies and appropriate consultation with the FDA. Another Lilly product, LY674 has recently advanced into Phase II development for atherosclerosis and LY929 is in Phase I development for type 2 diabetes. Two additional partner products being developed by GlaxoSmithKline are in Phase II: GSK516 for cardiovascular disease and dislipidemia and SB497115 for thrombocytopenia. Other partner products in Phase II include pipendoxifene (formerly ERA-923) being developed by Wyeth for breast cancer and NSP-989 for contraception and NSP-989 combo for contraception in Phase I. In February 2005, GlaxoSmithKline commenced Phase I studies of SB-449448, a second product for thrombocytopenia and TAP commenced Phase I studies for LGD 2941 for the treatment of osteoporosis and frailty. Additionally, in September 2005, Pfizer announced the receipt of a non-approvable letter from the FDA for the prevention of osteoporosis. However, lasofoxifene continues in Phase III clinical trials by Pfizer for the treatment of osteoporosis.

Internal and collaborative research and development programs are built around our proprietary science technology, which is based on our leadership position in gene transcription technology. Panretin gel, Targretin capsules, and Targretin gel as well as our corporate partner products currently on human development track are modulators of gene transcription, working through key cellular or intracellular receptor targets discovered using our IR technology.

Table of Contents

Effective January 1, 2006, we terminated our agreement with Organon USA Inc. This agreement terminates the AVINZA® co-promotion agreement between the two companies and returns AVINZA rights to Ligand. However. the parties have agreed to continue to cooperate during a transition period ending September 30, 2006 to work to promote the product. That transition period co-operation includes among other things, a minimum number of product sales calls per quarter - 100,000 for Organon and 30,000 for Ligand with an aggregate of 375,000 and 90,000 respectively for the transition period . See Overview-Ligand Marketed Products AVINZA Co-Promotion Agreement with Organon.

Business Strategy

Our goal is to become a profitable pharmaceutical research, development and marketing company that generates significant cash flow. Building primarily on our proprietary IR technology, our strategy is to generate cash flow primarily from the sale of specialty pharmaceutical products we develop, acquire or in-license, and from research, milestone and royalty revenues from the development and sale of products our collaborative partners develop and market.

Building a Specialty Pharmaceutical Franchise.

Our strategy with respect to specialty pharmaceutical products is to develop a product pipeline based on our IR technologies and acquired and in-licensed products, and to market these products initially with a specialized sales force in the U.S. and through marketing partners in selected international markets. Our execution of this strategy to date has been implemented in the U.S., Europe and Latin America. We expect to address additional global markets when and where practicable. Ligand s current international distribution partners are Zeneus (principally in Western and Eastern Europe), Ferrer (in Spain, Portugal, Greece, Central and South America) and Sigma Tau (in Italy). In October 2005, the Italian distribution rights were transferred from Alfa Wasserman to Sigma Tau.

Focusing initially on niche pharmaceutical and dermatology indications with the possibility of expedited regulatory approval has allowed us to bring products to market quickly. This strategy also has allowed us to spread the cost of our sales and marketing infrastructure across multiple products. Our goal is to expand the markets for our products through approvals in additional indications and in international markets. To further leverage our sales forces, we intend to acquire selectively or license-in complementary technology and/or products currently being marketed or in advanced stages of development.

Building a Collaborative-Based Business in Large Product Markets.

Our strategy in our collaborative research and development business is to share the risks and benefits of discovering and developing drugs to treat diseases that are beyond our strategic focus or resources. These diseases typically affect large populations often treated by primary care physicians. Drugs to treat these diseases may be more costly to develop and/or market effectively with a small specialty sales force. On the other hand, drugs approved for these indications may have large market potential often in excess of $1 billion annually in global sales.

We have entered into a number of collaborative arrangements with global pharmaceutical companies focusing on a broad range of disease targets. The table below lists those of our corporate partners which have one or more compounds identified in our collaborative research efforts moving through clinical development.

Table of Contents

Corporate Collaborator	Initiation of Collaboration	Focus
Pfizer Inc.	May 1991	Osteoporosis, breast cancer prevention, vaginal atrophy
GlaxoSmithKline (Glaxo Wellcome plc)	September 1992	Cardiovascular diseases
Wyeth	September 1994	Women s health, oncology
GlaxoSmithKline (SmithKline Beecham)	February 1995	Blood disorders
Eli Lilly & Company	November 1997	Type II diabetes, metabolic and cardiovascular diseases
TAP Pharmaceutical Products, Inc.	June 2001	Men s and women s health, osteoporosis

In addition to the collaborations listed above, we have also entered into collaborations with Allergan, Inc. (in June 1992 focused on skin disorders), Abbott Laboratories (in July 1994 focused on inflammatory diseases) and Organon (in February 2000 in women s health). Allergan, Abbott and Organon retain the right to move compounds identified during our collaborative research activities forward into clinical development, although we believe none of them is currently doing so. Two other collaborative partners, Parke-Davis and Bristol-Myers Squibb, no longer have rights to move compounds forward into clinical development.

Our collaborative programs focus on discovering drugs for cardiovascular, inflammatory, metabolic and other diseases, as well as broad applications for women s and men s health. We believe that our collaborators have the resources, including clinical and regulatory experience, manufacturing capabilities and marketing infrastructure, needed to develop and commercialize drugs for these large markets. The arrangements generally provide for collaborative discovery programs funded largely by the corporate partners aimed at discovering new therapies for diseases treated by primary care physicians. In general, drugs resulting from these collaborations will be developed, manufactured and marketed by the corporate partners. Our collaborative agreements provide for us to receive: research revenue during the drug discovery stage; milestone revenue for compounds successfully moving through clinical development and regulatory submission and approval; and royalty revenue from the sale of approved drugs developed through collaborative efforts. In some instances, we have sold a portion of our rights to future royalties to Royalty Pharma AG. See Royalty Pharma Agreement.

Ligand Marketed Products

U.S. Specialty Pharmaceutical Franchise. We currently market five pharmaceutical products in the U.S.

Marketed Product	Approved Indication	European Status	Additional Indications Studied or in Development
AVINZA	Chronic, moderate-to-severe pain	N/A	None
ONTAK	CTCL	MAA withdrawn (ONZAR)	CLL, B-cell NHL, other T-cell lymphomas, NSCLC
Targretin capsules	CTCL	MA issued	NSCLC, renal cell cancer, breast, prostate/colon cancer and other solid capsules
Targretin gel	CTCL	MAA withdrawn	Hand dermatitis, psoriasis
Panretin gel	KS	MA issued	None

AVINZA. AVINZA was approved by the FDA in March 2002 for the once-daily treatment of moderate-to-severe pain in patients who require continuous, around-the-clock opioid therapy for an extended period of time. We launched the product in the second quarter of 2002. AVINZA consists of two components: an immediate-release component that rapidly achieves morphine concentrations in plasma, and an extended-release component that maintains plasma concentrations throughout a 24-hour dosing interval. This unique drug delivery technology makes AVINZA the first

true once-daily sustained release opioid. AVINZA was developed by Elan, which licensed the U.S. and Canadian rights to us in 1998. The U.S. sustained-release opioid market grew to approximately $4.1 billion in 2004, the largest initial market we have entered. Because tens of thousands of U.S. physicians prescribe sustained-release opioids, our goal was to co-promote the product with another company to maximize its potential. Early in 2003, we finalized a co-promotion agreement with Organon which was terminated effective January 1, 2006. However, the parties have agreed to continue to co-operate during a transition period ending September 30, 2006 to promote the product. The details of the termination agreement are discussed below under the caption AVINZA Co-Promotion Agreement with Organon.

Table of Contents

CTCL Market. CTCL is a type of NHL that appears initially in the skin, but over time may involve other organs. CTCL is a cancer of T-lymphocytes, white blood cells that play a central role in the body s immune system. The disease can be extremely disfiguring and debilitating. Median survival for late-stage patients is less than three years. The prognosis for CTCL is based in part on the stage of the disease when diagnosed. CTCL is most commonly a slowly progressing cancer, and many patients live with the complications of CTCL for 10 or more years after diagnosis. However, some patients have a much more aggressive form of this disease. CTCL affects an estimated 16,000 people in the U.S. and 12,000 to 14,000 in Europe. With ONTAK, Targretin capsules, and Targretin gel currently approved in the U.S. for the treatment of CTCL, our strategy is to have multiple products available for treating this disease.

ONTAK. ONTAK was approved by the FDA and launched in the U.S. in February 1999 as our first product for the treatment of patients with CTCL. ONTAK was the first treatment to be approved for CTCL in nearly 10 years. ONTAK is currently in Phase II clinical trials for the treatment of patients with CLL, B-cell NHL, other T-cell lymphomas, NSCLC, and graft-versus-host disease, or GVHD. Results from several of these studies were reported in 2002, 2003 and 2004. Ligand s top priorities for additional ONTAK development are B-cell NHL and T-cell NHL. We began a Phase II CLL study in 2003 which is still continuing as are Phase II studies in NHL. Clinical trials using ONTAK for the treatment of patients with psoriasis and rheumatoid arthritis also have been conducted, and further trials are being considered. These indications provide significantly larger market opportunities than CTCL. A European Marketing Authorization Application, or MAA, for CTCL was filed in December 2001, which we withdrew in April 2003. It was our assessment that the cost of the additional clinical and technical information requested by the European Agency for the EMEA would be better spent on the acceleration of the second generation ONTAK formulation development. We expect to resubmit the ONZAR (the tradename for ONTAK in the EU) application with the second generation product in 2006 or early 2007.

Targretin capsules. We launched U.S. sales and marketing of Targretin capsules in January 2000 following receipt of FDA approval in December 1999. Targretin capsules offer the convenience of a daily oral dose administered by the patient at home. In March 2001, the EC granted marketing authorization for Targretin capsules in Europe for the treatment of patients with CTCL, and our network of distributors began marketing the drug in the fourth quarter of 2001 in Europe. We are developing Targretin capsules in a variety of larger market opportunities, including NSCLC and other solid tumors. NSCLC is Ligand s largest and most important development program. In March 2005, we announced that the final data analysis for Targretin capsules in NSCLC showed that the trials did not meet their primary endpoints of improved overall survival and projected two-year survival. We are continuing to analyze the data and apply it to the continued development of Targretin in NSCLC. The details of the final data analysis for Targretin capsules in NSCLC are discussed below.

Targretin gel. We launched U.S. sales and marketing of Targretin gel in September 2000 following receipt of FDA approval in June 2000. Targretin gel offers patients with refractory, early stage CTCL a novel, non-invasive, self-administered treatment topically applied only to the affected areas of the skin. Targretin gel is currently in clinical development for hand dermatitis. In 2002 and early 2003, we reported positive Phase I/II data that showed nearly 40% of patients with chronic, severe hand dermatitis improved by 90% or more after being treated with Targretin gel monotherapy and nearly 80% responded with greater than 50% improvement. Based on these promising results, we intend to design and implement Phase II/III registration trials in hand dermatitis. We filed an MAA in Europe for CTCL in March of 2001, but withdrew it in 2002. Due to the small size of the European early stage CTCL market and the limited revenue potential of Targretin gel, we believed that the additional comparative clinical studies requested by the EMEA were not economically justified.

Panretin gel. Panretin gel was approved by the FDA and launched in February 1999 as the first FDA-approved patient-applied topical treatment for AIDS-related Kaposi s sarcoma, or KS. Panretin gel represents a non-invasive option to the traditional management of this disease. Most approved therapies require the time and expense of periodic visits to a healthcare facility, where treatment is administered by a doctor or nurse. AIDS-related KS adversely affects the quality of life of thousands of people in the U.S. and Europe. Panretin gel was approved in Europe for the treatment of patients with KS in October 2000, and was launched through our distributor network in the fourth quarter of 2001 in Europe.

67

Table of Contents

AVINZA Co-Promotion Agreement with Organon. In February 2003, we entered into an agreement for the co-promotion of AVINZA with Organon Pharmaceuticals USA Inc. (Organon). Under the terms of the agreement, Organon committed to specified minimum numbers of primary and secondary product calls delivered to high prescribing physicians and hospitals beginning in March 2003 as well as additional sales calls as approved by the companies joint steering committee in annual marketing plans.

On January 17, 2006, we signed an agreement with Organon that terminates the AVINZA® co-promotion agreement between the two companies and returns AVINZA rights to Ligand. The effective date of the termination agreement is January 1, 2006, however the parties have agreed to continue to cooperate during a transition period ending September 30, 2006 (the Transition Period) to promote the product. The Transition Period co-operation includes a minimum number of product sales calls per quarter (100,000 for Organon and 30,000 for Ligand with an aggregate of 375,000 and 90,000 respectively for the Transition Period) as well as the transition of ongoing promotions, managed care contracts, clinical trials and key opinion leader relationships to Ligand. During the Transition Period, Ligand will pay Organon an amount equal to 23 % of AVINZA net sales as reported by Ligand. Ligand will also pay and be responsible for the design and execution of all clinical, advertising and promotion expenses and activities.

As previously disclosed, Organon and Ligand were in discussions regarding the calculation of prior co-promote fees under the co-promotion agreement. In connection with the termination of the co-promotion agreement, the companies resolved their disagreement concerning prior co-promote fees and Ligand paid Organon $14.75 million in January 2006. This amount had been previously accrued in the Company s consolidated financial statements as of September 30, 2005. The companies also agreed that Organon s compensation for the fourth quarter of 2005 would be calculated based on Ligand s reported AVINZA net sales determined in accordance with U.S. GAAP.

Additionally, in consideration of the early termination and return of rights under the terms of the agreement, Ligand will unconditionally pay Organon $37.75 million on or before October 15, 2006. Ligand will further pay Organon $10.0 million on or before January 15, 2007, provided that Organon has made its minimum required level of sales calls. Under certain conditions, including change of control, the cash payments will accelerate. In addition, after the termination, Ligand will make quarterly 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.

Ligand Product Development Programs

We are developing several proprietary products for which we have worldwide rights for a variety of cancers and skin diseases, as summarized in the table below. This table is not intended to be a comprehensive list of our internal research and development programs. Many of the indications being pursued may present larger market opportunities for our currently marketed products. Our clinical development programs are primarily based on products discovered through our IR technology, with the exception of ONTAK, which was developed using Seragen s fusion protein technology, and AVINZA, which was developed by Elan. Five of the products in our proprietary product development programs are retinoids, discovered and developed using our proprietary IR technology. Our research is based on our IR technology. See Technology for a discussion of our IR technology and retinoids.

General Product Development Process.

There are three phases in product development the research phase, the preclinical phase and the clinical trials phase. See Government Regulation for a more complete description of the regulatory process involved in developing drugs. At Ligand, activities during the research phase include research related to specific IR targets and the identification of lead compounds. Lead compounds are chemicals that have been identified to meet pre-selected criteria in cell culture models for activity and potency against IR targets. More extensive evaluation is then undertaken to determine if the compound should enter preclinical development. Once a lead compound is selected, chemical modification of the compound is undertaken to create an optimal drug candidate.

The preclinical phase includes pharmacology and toxicology testing in preclinical models (*in vitro* and *in vivo*), formulation work and manufacturing scale-up to gather necessary data to comply with applicable regulations prior to

Table of Contents

commencing human clinical trials. Development candidates are lead compounds that have successfully undergone *in vitro* and *in vivo* evaluation to demonstrate that they have an acceptable profile that justifies taking them through preclinical development with the intention of filing an IND and initiating human clinical testing.

Clinical trials are typically conducted in three sequential phases that may overlap. In Phase I, the initial introduction of the pharmaceutical into humans, the emphasis is on testing for adverse effects, dosage tolerance, absorption, metabolism, distribution, excretion and clinical pharmacology. Phase II involves studies in a representative patient population to determine the efficacy of the pharmaceutical for specific targeted indications, to determine dosage tolerance and optimal dosage, and to identify related adverse side effects and safety risks. Once a compound is found to be effective and to have an acceptable safety profile in Phase II studies, Phase III trials are undertaken to evaluate clinical efficacy further and to test further for safety. Sometimes Phase I and II trials or Phase II and III trials are combined. In the U.S., the FDA reviews both clinical plans and results of trials, and may discontinue trials at any time if there are significant safety concerns. Once a product has been approved, Phase IV post-market clinical studies may be performed to support the marketing of the product.

Program	**Disease/Indication**	**Development Phase**
AVINZA	Chronic, moderate-to-severe pain	Marketed in U.S. Phase IV
ONTAK	CTCL	Marketed in U.S., Phase IV
	CLL	Phase II
	Peripheral T-cell lymphoma	Phase II
	B-cell NHL	Phase II
	NSCLC third line	Phase II
Targretin capsules	CTCL	Marketed in U.S. and Europe
	NSCLC first-line	Phase III
	NSCLC monotherapy	Planned Phase II/III
	NSCLC second/third line	Planned Phase II/III
	Advanced breast cancer	Phase II
	Renal cell cancer	Phase II
Targretin gel	CTCL	Marketed in U.S.
	Hand dermatitis (eczema)	Planned Phase II/III
	Psoriasis	Phase II
LGD4665 (Thrombopoietin oral mimic)	Chemotherapy-induced thrombocytopenias (TCP), other TCPs	IND Track
LGD5552 (Glucocorticoid agonists)	Inflammation, cancer	IND Track
Selective androgen receptor modulators, e.g., LGD3303 (agonist/antagonist)	Male hypogonadism, female & male osteoporosis, male & female sexual dysfunction, frailty. Prostate cancer, hirsutism, acne, androgenetic alopecia.	Pre-clinical

Table of Contents

AVINZA Development Programs

AVINZA (oral morphine sulfate extended-release capsules) is the first true once-a-day treatment for chronic moderate-to-severe pain in patients who require continuous, around-the-clock opioid therapy for an extended period of time. Approved by the FDA in March 2002, AVINZA consists of two components: an immediate-release component that rapidly achieves morphine concentrations in plasma, and an extended-release component that maintains plasma concentrations throughout a 24-hour dosing interval.

In a poster presented at the American Pain Society (APS) annual meeting in March of 2005, AVINZA showed better control of chronic pain and improved sleep in a large study comparing once-daily AVINZA (once-a-day morphine sulfate extended-release capsules) to twice-daily OxyContin® (oxycodone hydrochloride controlled-release). In initial results of the first phase of the study, with 212 evaluable patients (105 in the AVINZA arm and 107 in the oxycodone CR arm) followed through two months, the study showed that at lower, mean morphine-equivalent doses, patients receiving AVINZA once daily demonstrated statistically significant better around the clock pain control (evaluated using the Brief Pain Inventory assessment instrument), statistically significant better quality of sleep (evaluated using the Pittsburgh Sleep Quality Index assessment instrument), and a statistically significant reduction in the total number of rescue medications. The final study results for all patients enrolled are expected later in 2005. The results from an additional four-month treatment phase to collect long-term comparator data are expected to be reported at the American Pain Society meeting in 2006.

A second poster at the March 2005 APS meeting presented the initial results of a study evaluating AVINZA s effects on various sleep measures for patients with chronic, moderate-to-severe osteoarthritis pain of the hip or knee who self-report trouble sleeping. This was a 29-patient, placebo/baseline-controlled, single blind study using both polysomnography and subjective sleep measurements to assess and better quantify sleep parameters. Preliminary results demonstrated AVINZA s ability to provide improved quality and quantity of sleep as well as improved pain control. Final results are expected later in 2005.

A third study of AVINZA, involving 507 patients, extends the findings of previously published controlled studies. The primary objective of this study was to measure the efficacy of once-daily AVINZA when used according to the package insert in patients with chronic non-cancer pain. Patients were recruited by office-based physicians. They were interviewed 4 times over a period of 3 months using questionnaires assessing pain, sleep, functional status, and rescue medication use. Measures were collected at baseline and at Month 1, 2, and 3. Interviews were conducted by phone or via the internet. The interim analysis, presented in a poster session at the College on Problems of Drug Dependence in June of 2005, showed that for patients who continue to take AVINZA for 3 months, 88% report their pain to be better compared to baseline and 88% rate AVINZA as effective or extremely effective. Full results are expected in late 2005.

ONTAK Development Programs

ONTAK is a fusion protein that represents the first of a new class of targeted cytotoxic biologic agents. Rights to ONTAK were acquired from Eli Lilly in 1997 and in the acquisition of Seragen in 1998. ONTAK is marketed in the U.S. for patients with CTCL, which affects approximately 16,000 people in the U.S. In addition to ongoing CTCL trials, we are conducting clinical trials with ONTAK in patients with CLL, peripheral T-cell lymphoma, B-cell NHL, NSCLC, and GVHD, indications that represent significantly larger market opportunities than CTCL.

In early 1999, ONTAK entered Phase II trials for the treatment of patients with NHL. NHL affects approximately 300,000 people in the U.S. and Ligand estimates that more than 50,000 of these patients would be candidates for ONTAK therapy. One multicenter study conducted by the Eastern Cooperative Oncology Group (ECOG) assessed ONTAK in patients with certain types of low-grade B-cell NHL who have previously been treated with at least one systemic anti-cancer treatment. The study results were presented at ASCO 2005 and showed the efficacy of ONTAK in patients with small cell lymphocytic lymphoma. A second multicenter trial evaluated ONTAK in 54 patients with relapsed/refractory low or intermediate grade lymphoma. The results of this study are being analyzed and are expected to be presented in 2006.

Table of Contents

Separately, a Phase II study of ONTAK in 45 patients with relapsed/refractory B-cell NHL was conducted by researchers from the M.D. Anderson Cancer Center and published in 2004 in the Journal of Clinical Oncology. The study enrolled late-stage, heavily pretreated patients (median of 4 prior treatments) and showed that 25% of the patients achieved a complete or partial response and an additional 20% achieved stabilization of disease. Furthermore, this study showed that ONTAK could be administered in patients with low blood counts, a patient population that cannot tolerate treatment with chemotherapy or radio-immunotherapy. On the basis of these favorable findings, two Phase II studies of ONTAK in relapsed/refractory B-cell lymphoma were launched in 2004. One multicenter trial conducted by Ligand is evaluating ONTAK in patients with poor blood cell counts at entry and another study conducted by investigators at MD Anderson Cancer Center is evaluating ONTAK plus Rituxan® (a monoclonal antibody marketed for the treatment of relapsed low grade lymphoma) in patients who have failed prior treatment with Rituxan. The interim results of the latter study have been submitted for presentation at a scientific meeting later in 2005.

Investigators at MD Anderson Cancer Center also conducted a Phase II study on ONTAK in relapsed/refractory T-cell NHL. Interim results of this study were presented at ASH in 2004, which showed that in 17 evaluable patients, there was a 53% response rate with an additional 29% of patients experiencing stable disease. The final results of this study, which enrolled a total of 26 patients, have been submitted for presentation at a scientific meeting later in 2005. The company is also conducting a multicenter Phase II study of ONTAK plus a chemotherapy regimen designated as CHOP as first line treatment of patients with T-cell NHL. Although the CHOP chemotherapy regimen is considered as the standard of care for patients with T-cell NHL, about 50% of patients fail to achieve a complete response and, of those who respond, over 50% relapse within 2 years. The trial is designed to demonstrate whether the addition of ONTAK to CHOP will increase the response rate and the duration of response. Interim results of the trial are expected in 2006.

ONTAK is also being evaluated to treat CLL, which affects more than 60,000 people in the U.S. Researchers from Wake Forest University conducted a multicenter Phase II study of ONTAK in patients with CD25-positive CLL who have failed prior treatment with fludarabine. The results of this pilot study were published in the journal Clinical Cancer Research in 2003 and showed that ONTAK reduced CLL in blood cells, lymph nodes and bone marrow. In the study, nine of 10 patients who received at least three courses of ONTAK experienced reductions in peripheral CLL cells, with three of these patients showing reductions of at least 99%. In addition, six of 10 patients showed reductions in the diameter of their cancerous lymph nodes, with one patient showing an 80% reduction. One of 12 evaluable patients showed a partial remission, with 80% node shrinkage and 100% clearance of CLL cells from bone marrow. Based on these encouraging results, three multicenter Phase II studies were launched in 2003 to further evaluate the role of ONTAK in patients with relapsed/refractory CLL. Preliminary results from one study of 18 patients conducted by investigators from Wake Forest University were reported at ASH in 2004 , and showed there was a 40% response rate among the 10 evaluable patients with fludarabine-refractory B-cell chronic lymphocytic leukemia. The investigators concluded that ONTAK has activity in CLL with toxicities that can be managed with adequate premedication and close monitoring. The final results of this study and another study conducted by the Hoosier Oncology Group are expected to be published later in 2005. The Company conducted a third trial which is nearing completion.

Clinical trials with ONTAK have demonstrated benefits in patients with steroid-resistant acute graft-versus-host disease (GVHD) after allogeneic bone marrow transplantation. One Phase I-II study conducted by investigators from the Dana Farber Cancer Center in Boston enrolled 30 patients and the results were published in the journal Blood in 2004. The study established a dose of ONTAK that is safe in this patient population and showed that ONTAK resulted in a 71% response rate. Another multicenter Phase I-II study conducted by investigators from the Texas Transplant Institute enrolled 21 patients and the results were published in the journal Biology of Blood and Marrow Transplantation in 2005. The study confirmed that ONTAK can be safely administered in this patient population and that ONTAK achieved a 47% response rate at Day 36 of treatment with an additional 31% of patients achieving a response by Day 100. On the basis of these promising results, a randomized 4-arm study is being conducted by the Bone Marrow Transplant Network with NCI funding to evaluate the efficacy and safety of ONTAK and three other investigational agents in the primary treatment of acute GVHD.

A multicenter Phase II study exploring the use of ONTAK as a monotherapy for patients with relapsed/refractory advanced NSCLC was conducted by investigators from the University of Cincinnati and completed in late 2004. The preliminary study results reported at the American Society of Clinical Oncology (ASCO) meeting in May of 2005

showed that ONTAK resulted in an unconfirmed partial response or disease stabilization in 40% of patients and noted an association between disease stabilization and an increase in a subset of T-lymphocytes in the circulation, suggesting that ONTAK s effect could be ascribed to an activation of the immune system. These findings were consistent with the results of a study conducted by investigators from Duke University and presented at an oral session at ASCO in 2004 which showed that ONTAK significantly activated the immune system in patients with solid tumors receiving ONTAK in combination with an investigational anti-tumor vaccine.

Targretin Capsules Development Programs

Targretin capsules are marketed in the U.S. for patients with refractory CTCL. Ligand also is investigating the use of Targretin capsules in several cancer and skin disease markets that represent significantly larger market opportunities than CTCL.

In August 2000, we reported that Phase I/II clinical results demonstrated that Targretin capsules, in conjunction with chemotherapy, may be an effective treatment for patients with NSCLC and renal cell cancer. These results were published in the May 2001 issue of the Journal of Clinical Oncology. These results add to a growing body of evidence that suggests Targretin therapy may delay disease progression and extend survival of patients with some forms of solid tumors. This body of evidence led us to begin two large-scale Phase III clinical studies in 2001 to demonstrate conclusively Targretin capsules benefit in the treatment of patients with NSCLC. The studies were designed to support a supplemental indication for Targretin capsules for first-line treatment of patients with advanced NSCLC. One of these multicenter studies evaluated Targretin in combination with the chemotherapy drugs cisplatin and vinorelbine, and was conducted primarily in Europe and Latin America. The other multicenter study examined Targretin in combination with carboplatin and paclitaxel, and was conducted mainly in the U.S. Both studies were randomized with approximately 600 patients each, and had survival as the primary endpoint. Patient enrollments were completed in August and September 2003, respectively. The original statistical plan called for efficacy data analysis at the later of 456 deaths or twelve months following the last patient entered into each study. That plan, combined with the actual pace of accrual rates as observed in the last six months of the second study, would have resulted in a limited number of patients whose actual survival could be observed for two years or longer. The final statistical plan was modified as agreed with the FDA to specify the analysis trigger to be at the 456th death event or 18 months of follow-up from the date the last patient was entered into each study, whichever occurs later. Based on enrollment dates, that 18-month time point was reached in mid-March, 2005. This modification resulted in the majority of patients having between 1.5 and 2.5 years of follow-up observation based upon actual accrual rates. We also expected the assessment of projected two-year survival, the study secondary endpoint, to be enhanced by the revised statistical plan.

We publicly released top-line data within approximately two weeks after the commencement of final data analysis showing that the trials did not meet their endpoints of improved overall survival and projected two-year survival. For both studies, the primary endpoint was overall survival and the secondary endpoint was Kaplan-Meier projected two-year survival. No statistically significant differences in primary or secondary endpoints in the intent to treat population were seen in either trial. In both trials, additional subset analysis completed after the initial intent to treat results were analyzed revealed a significant correlation between high-grade (grade 3 and 4) hypertriglyceridemia and increased survival, potentially identifying a large subgroup patient population that may receive significant survival benefit of added Targretin treatment in first line therapy. Data from both trials was presented during the plenary session at the 2005 annual ASCO meeting. Review of data from current and prior Phase II studies shows a similar correlation between hypertriglyceridemia and increased survival. The data will further shape our future plans for Targretin. If further studies are justified, they will be conducted on our own or with a partner or cooperative group.

In 2003 we also began a Phase II study of Targretin as monotherapy for late-stage lung cancer patients who have failed at least two prior treatments with chemotherapy and/or biologic therapy. A poster presentation at the 2005 annual meeting of ASCO reported on the interim analysis of data covering all 146 patients enrolled. Patients in the study were heavily pre-treated, having received a median of three prior treatments, and 54% of these patients had already failed treatment with Iressa. Overall median survival was five months and overall one-year survival was 15 percent. The data was also analyzed to evaluate the survival of patients based on the triglyceride response to Targretin treatment, in view of the SPIRIT results reported earlier at this meeting that showed an improved survival in patients who showed high grade triglyceridemia after Targretin administration. With this subanalysis, two

72

Table of Contents

populations of patients were identified. Those with increased triglyceridemia (grade 1 4) had a median survival of 7 months ($p<0.0001$) and a projected 1 year survival of 23%, compared with those with no hypertriglyceridemia who had a median survival of 2 months and a projected 1 year survival of 5%. The data from this study provides new information for Targretin monotherapy for patients with third-line treatment or beyond and also adds additional support to the subgroup analysis that came out of our SPIRIT trials about a triglyceride biomarker that may identify patients with the potential to benefit from Targretin therapy. This information will factor into our evolving plans for further studies.

The American Cancer Society estimates that approximately 170,000 Americans are diagnosed with lung cancer each year; of those approximately 80% were diagnosed with NSCLC.

Our primary focus for Targretin capsules during 2005 continues to be NSCLC. We will, however, continue to explore in Phase II/III trials the potential of Targretin capsules in combination regimens for the treatment of patients in solid tumor indications.

Targretin Gel Development Program

Targretin gel is marketed in the U.S. for patients with refractory CTCL. In 2002 and early 2003, we reported exciting Phase I/II data that showed 39% of patients with chronic, severe hand dermatitis improved by 90% or more after being treated with Targretin gel monotherapy. In addition, 79% of patients improved by at least 50%. Fifty-five patients with a history of chronic severe hand dermatitis for at least six months were enrolled in the 22-week, randomized, open-label study, which was designed to evaluate safety, tolerability and activity. Patients were treated with Targretin alone, Targretin in combination with a medium potency topical steroid, and Targretin in combination with a low potency topical steroid. Based on these promising results, we intend to design and implement Phase II/III registration trials in hand dermatitis in 2006/2007. There are many subtypes of hand dermatitis, and many causes. Most hand dermatitis is caused by contact with irritating environmental substances, such as chemicals, soaps and cleaning fluids, and some cases are caused by allergic reactions to a wide variety of environmental substances. We estimate that more than 4 million people in the United States have hand dermatitis and seek treatment.

We filed an MAA for Targretin gel in Europe for CTCL in March of 2001, but withdrew it in 2002. Due to the small size of the European early stage CTCL market and the limited revenue potential of Targretin gel, we believed that the additional comparative clinical studies requested by the EMEA were not economically justified.

Thrombopoietin (TPO) Research Programs

In our TPO program, we seek to develop our own drug candidates that mimic the activity of thrombopoietin (TPO) for use in the treatment or prophylaxis of thrombocytopenia with indications in a variety of conditions including cancer and disorders of blood cell formation. In 2005, we selected a TPO mimetic, LGD4665, as a clinical candidate. Our goal is to complete the preclinical studies necessary for filing an IND for this in 2006. Our partner GlaxoSmithKline (GSK) has two TPO mimics that were part of our collaboration with GSK in clinical trials: SB-497115 in Phase II and SB-559448 in Phase I. For a discussion of these clinical trials, see Collaborative Research and Development Program TPO/Inflammatory Disease/Oncology Collaborative Program GSK Collaboration.

Selective Glucocorticoid Receptor Modulators Research and Development Program

As part of the research and development collaboration we entered into with Abbott in 1994, Ligand received exclusive worldwide rights for all anti-cancer products discovered in the collaboration. When the research phase of the collaboration ended in July 1999, Abbott retained rights to certain Selective Glucocorticoid Receptor Modulators, or SGRMs. We retained rights to all other compounds discovered through the collaboration, as well as recapturing technology rights. As a result, we then initiated an internal effort to develop SGRMs for inflammation, oncology and other therapeutic applications. As a result of that effort, in 2001, we moved several SGRMs into late preclinical development. During 2003, LGD5552 was designated a clinical candidate. Phase I studies are being planned for LGD5552. Additional preclinical studies are being conducted to determine the appropriate formulation and timing of IND filing. These non-steroidal SGRM molecules have anti-inflammatory activity that may be useful against diseases such as asthma and rheumatoid arthritis, as well as anti-proliferative effects that could be beneficial

Table of Contents

in treating certain leukemias and myelomas. Our goal is to develop novel products that maintain the efficacy of corticosteroids but lack the side effects of current therapies, which can include osteoporosis, hyperglycemia and hypertension.

Another group of SGRMs from this program, selected from a different chemical class, are being targeted for the treatment of multiple myeloma and other blood cancers. The profile of these molecules is to have activity equal to dexamethasone but a significant reduction in side effects, particularly in bone and other parameters affecting quality of life.

SARM 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, or AR, in different tissues, providing a wide range of opportunities for the treatment of many diseases and disorders in both men and women. Tissue-selective AR agonists or antagonists may provide utility in male hormone therapy, or HT, and the treatment of patients with male hypogonadism, female & male osteoporosis, male & female sexual dysfunction, frailty, prostate cancer, hirsutism, acne, androgenetic alopecia, and other diseases. The use of androgen antagonists has shown efficacy in the treatment of prostate cancer, with three androgen antagonists currently approved by the FDA for use in the treatment of the disease. However, we believe that there is a substantial medical need for improved androgen modulators for use in the treatment of prostate cancer due to the significant side effects seen with currently available drugs.

SARM programs have been one of our largest programs over the past several years. We have assembled an extensive SARM compound library and one of the largest and most experienced AR drug discovery teams in the pharmaceutical industry. We intend to pursue the specialty applications emerging from SARMs internally, but may seek collaborations with major pharmaceutical companies to exploit broader clinical applications.

Consistent with this strategy, we formed in June 2001 a joint research and development alliance with TAP Pharmaceutical Products to focus on the discovery and development of SARMs. In December 2004, we announced the second extension of this collaboration for an additional year through June, 2006. Please see the Collaborative Research and Development Programs/Sex Hormone Modulators Collaborative Programs/TAP Collaboration section below for more details on this alliance.

As part of the TAP alliance, we exercised an option to select for development one compound and a back-up, LG 123303 and LG 123129, out of a pool of compounds available for development in the TAP field. The SARM agonist which we now refer to as LGD3303 was designated a clinical candidate in late 2004. Preclinical studies indicate that the compound may have utility for osteoporosis, male and female sexual dysfunction, frailty and male 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.

Collaborative Research and Development Programs

We are pursuing several major collaborative drug discovery programs to further develop the research and development of compounds based on our IR technologies. These collaborations focus on several large market indications as estimated (as of 2004, except contraception, which is as of 2002) in the table below.

Table of Contents

Indication	Estimated U.S. Prevalence
Menopausal symptoms	50 million
Osteoporosis/osteopenia (men and women)	55 million
Dyslipidemias	109 million
Contraception	38 million
Type II diabetes	18 million
Breast cancer	.8 million

As of August 31, 2005, 13 of our collaborative product candidates were in human development - lasofoxifene, bazedoxifene, bazedoxifene CE (PREMARIN combo), pipendoxifene, NSP989, NSP989 combo, LGD2941, GW516, LY818, LY929, LY674, SB497115, and SB559448. Please see Note 15 of the consolidated financial statements for a description of the financial terms of our key ongoing collaboration agreements. The table below summarizes our collaborative research and development programs, but is not intended to be a comprehensive summary of these programs.

Table of Contents

Program	Disease/Indication	Development Phase	Marketing Rights
SEX HORMONE MODULATORS			
SERMs			
Lasofoxifene (1)	Osteoporosis prevention, vaginal atrophy	NDA and SNDA filed	Pfizer
Lasofoxifene	Breast cancer prevention, Osteoporosis treatment	Phase III	Pfizer
Bazedoxifene	Osteoporosis	Phase III	Wyeth
Bazedoxifene CE	Osteoporosis prevention Vasomoter symptoms	Phase III	Wyeth
Pipendoxifene (formerly ERA-923) (2)	Breast cancer	Phase II	Wyeth
PR modulators			
NSP-989 (PR agonist) (3)	Contraception	Phase II	Wyeth
NSP-989 combo (PR agonist) (3)	Contraception	Phase I	Wyeth
SARMs			
LGD 2941 (androgen agonist)	Osteoporosis, frailty, HT and sexual dysfunction	Phase I	TAP
METABOLIC/CARDIOVASCULAR DISEASES			
PPAR modulators			
GW516	Cardiovascular disease, dyslipidemia	Phase II	GlaxoSmithKline
LY818 (naveglitazar) (4)	Type II diabetes	Phase II	Lilly
LY929 (5)	Type II diabetes, metabolic diseases, dyslipidemia	Phase I	Lilly
LY674	Atherosclerosis/ dyslipidemia	Phase II	Lilly
LYWWW (6)	Atherosclerosis	IND track	Lilly
Selective PPAR modulators	Type II diabetes, metabolic diseases, dyslipidemia	IND track	Lilly
LYYYY (6)	Atherosclerosis	Pre-clinical	Lilly
INFLAMMATORY DISEASES, ONCOLOGY			
SB-497115 (TPO agonist)	Thrombocytopenia	Phase II	GlaxoSmithKline
SB-559448 (TPO agonist)	Thrombocytopenia	Phase I	GlaxoSmithKline

(1) In September 2005, Pfizer announced receipt of a non-approvable letter from the FDA for the prevention of osteoporosis.

(2) Pipendoxifene development has been terminated for oncology; it is currently on hold as a potential back-up to bazedoxifene.

(3) On internal hold; strategic alternatives for Phase III development being explored.

(4)

Lilly decision to advance to Phase III announced March 2004; timing of initiation delayed by new FDA guidelines.

(5) Product placed on internal hold.

(6) Compound number not disclosed.

Sex Hormone Modulators Collaborative Programs

The primary objective of our sex hormone modulators collaborative programs is to develop drugs for hormonally responsive cancers of men and women, hormone therapies, the treatment and prevention of diseases affecting women s health, and hormonal disorders prevalent in men. Our programs, both collaborative and internal, target development of tissue-selective modulators of the Progesterone Receptor, or PR, the Estrogen Receptor, or ER, and the AR. Through our collaborations with Pfizer and Wyeth, three SERM compounds are in development for

Table of Contents

osteoporosis, breast cancer, vaginal atrophy and vasomotor symptoms of menopause. In addition, we entered into a joint research and development program in 2001 with TAP Pharmaceutical Products to focus on the discovery and development of SARMs.

Pfizer Collaboration. In May 1991, we entered into a research and development collaboration with Pfizer to develop better therapies for osteoporosis. In November 1993, we jointly announced the successful completion of the research phase of our alliance with the identification of a development candidate and backups for the prevention and treatment of osteoporosis. In preclinical studies, the candidates from the program mimic the beneficial effects of estrogen on bone and have an impact on blood serum lipids often associated with cardiac benefits without increasing uterine or breast tissue proliferation.

We have milestone and royalty rights to lasofoxifene, which is being developed by Pfizer for osteoporosis prevention and other diseases. Portions of these royalty rights have been sold to Royalty Pharma AG. See Royalty Pharma Agreement.

Lasofoxifene is a second-generation estrogen partial agonist discovered through our collaboration with Pfizer. Pfizer has retained marketing rights to the drug. Lasofoxifene has been shown in Phase II clinical studies to reduce bone loss and decrease low-density lipoprotein (LDL or bad cholesterol) levels. In September 2000, Pfizer announced that it initiated Phase III studies of lasofoxifene for the treatment and prevention of osteoporosis in post-menopausal women. In December 2001, Pfizer announced that two Phase III studies were fully enrolled with more than 1,800 patients, and that an additional Phase III risk reduction trial was underway to evaluate lasofoxifene s effects on bone mineral density, lipid-lowering and breast cancer prevention. In January of 2003, Pfizer disclosed that this large, 7,500-patient risk-reduction study was fully enrolled.

In August 2004, Pfizer submitted an NDA to the FDA for lasofoxifene for the prevention of osteoporosis in postmenopausal women. We earned a development milestone of approximately $2.0 million from Pfizer in connection with the filing. Under the terms of the agreement between Ligand and Pfizer, payment of milestones can occur in either cash or shares of Ligand common stock held by Pfizer. Pfizer elected to pay the milestone in stock and subsequently tendered 181,818 shares to the Company. We retired the tendered shares in September 2004. In September 2005, Pfizer announced the receipt of a non-approvable letter from the FDA for the prevention of osteoporosis. However, lasofoxifene continues in Phase III clinical trials by Pfizer for the treatment of osteoporosis.

In December 2004, Pfizer filed a supplemental NDA for the use of lasofoxifene for the treatment of vaginal atrophy for which no additional milestone was due and which remains pending at the FDA.

Wyeth Collaboration. In September 1994, we entered into a research and development collaboration with Wyeth-Ayerst Laboratories, the pharmaceutical division of American Home Products (AHP), to discover and develop drugs that interact with ERs or PRs for use in HT, anti-cancer therapy, gynecological diseases, and central nervous system disorders associated with menopause and fertility control. AHP has since changed its name to Wyeth. We granted Wyeth exclusive worldwide rights to all products discovered in the collaboration that are agonists or antagonists to the PR and ER for application in the fields of women s health and cancer therapy.

As part of this collaboration, we tested Wyeth s extensive chemical library for activity against a selected set of targets. In 1996, Wyeth exercised its option to include compounds we discovered that modulate PRs, and to expand the collaboration to encompass the treatment or prevention of osteoporosis through the ER. Wyeth also added four advanced chemical compound series from its internal ER-osteoporosis program to the collaboration. The research phase of the collaboration ended in August 1998.

Wyeth has ongoing clinical studies with two SERMs from the collaboration. Wyeth is developing bazedoxifene (TSE-424) and bazedoxifene CE for the treatment of post-menopausal osteoporosis. We have milestone and royalty rights for bazedoxifene (TSE-424) and bazedoxifene CE. Portions of these royalty rights have been sold to Royalty Pharma AG. See Royalty Pharma Agreement.

Phase III trials for bazedoxifene (TSE-424) and bazedoxifene CE were initiated in June 2001. In late 2002, Wyeth disclosed that it had completed enrollment in a Phase III osteoporosis prevention trial, and that it expected

Table of Contents

enrollment in a bazedoxifene fracture prevention trial to finish in 2003, and that bazedoxifene is on track for regulatory submission in 2005. In January of 2005, Wyeth indicated that it is now targeting the bazedoxifene regulatory submission for the first half of 2006. Wyeth has reiterated its commitment to developing bazedoxifene CE as a progesterone-free treatment for menopausal symptoms in the wake of the well-publicized Women s Health Initiative (WHI) study of hormone therapies. Ligand believes it is important to recognize that bazedoxifene is a synthetic drug that was specifically designed to increase bone density and reduce cholesterol levels while at the same time protecting breast and uterine tissue. In other words, bazedoxifene may represent a potential solution to some of the side effects associated with progestin in the WHI study.

Wyeth also has conducted Phase II studies of pipendoxifene (formerly ERA 923) for the treatment of breast cancer. In 2003, Wyeth began Phase II studies of NSP-989, a progesterone agonist that may be useful in contraception. These studies were completed in 2004. Wyeth also continues to do preclinical work in the area of PR antagonists.

Organon (Akzo Nobel) Collaboration. In February 2000, we entered into a research and development collaboration with Organon to focus on small molecule compounds with potential effects for the treatment and prevention of gynecological diseases mediated through the PR. The objective of the collaboration is the discovery of new non-steroidal compounds that are tissue-selective in nature and that may have fewer side effects. Such compounds may provide utility in hormone therapy, oral contraception, reproductive diseases, and other hormone-related disorders. The initial research phase concluded in February 2002.

TAP Collaboration. In June 2001, we entered into a joint research and development alliance with TAP Pharmaceutical Products to focus on the discovery and development of SARMs. SARMs may contribute to the prevention and treatment of diseases including hypogonadism (low testosterone), sexual dysfunction, male and female osteoporosis, frailty, and male HT. The three-year collaboration carries an option to extend by up to two additional one-year terms. In December 2004, we announced the second extension of this collaboration for an additional year through June 2006.

Under the terms of the agreement, TAP received exclusive worldwide rights to manufacture and sell any products resulting from the collaboration in its field, which would include treatment and prevention of hypogonadism, male sexual dysfunction, female osteoporosis, male HT and other indications not retained by Ligand. We may also receive milestones and up to double-digit royalties as compounds are developed and commercialized. LGD 2941, an androgen agonist targeting osteoporosis and frailty, commenced Phase I development in April 2005. Ligand retains certain rights in the androgen receptor field, including the prevention or treatment of prostate cancer, benign prostatic hyperplasia, acne and hirsutism.

In addition, we had an option at the expiration of the original three-year term to develop one compound not being developed by TAP in its field, with TAP retaining an option to negotiate to co-develop and co-promote such compounds with Ligand. We recently exercised our option to select one compound and a back-up for development, LG 123303 and LG 123129, out of a pool of compounds available for development in the TAP field. TAP retains certain royalty rights and an option to negotiate to co-develop and co-promote such compounds with us up to the end of Phase II development.

Metabolic and Cardiovascular Disease Collaborative Programs

We are exploring the role of certain IRs, including the PPARs, in cardiovascular and metabolic diseases. PPARs, a subfamily of orphan IRs, have been implicated in processes that regulate plasma levels of very low density lipoproteins and triglycerides. See Technology/Intracellular Receptor Technology for a discussion of PPARs and orphan IRs. Data implicate PPARs in the mechanism of action of lipid-lowering drugs such as Lopid®. There are three subtypes of the PPAR subfamily with defined novel aspects of their action alpha, beta and gamma. The subtype PPAR alpha appears to regulate the metabolism of certain lipids and is useful in treating hyperlipidemia. PPAR gamma plays a role in fat cell differentiation and cellular responses to insulin. Modulators of PPAR gamma activity (e.g., the glitazone class of insulin sensitizers) have utility in managing type II diabetes. PPARs are believed to function in cells in partnership with Retinoid X Receptors, or RXRs. In addition to compounds that act directly on PPARs and that may have utility in various cardiovascular and metabolic diseases, certain retinoids (e.g., Targretin capsules) are able to activate this RXR/PPAR complex and may also have utility in these disorders. We have two

Table of Contents

collaborative partners, GlaxoSmithKline and Lilly, in the areas of cardiovascular and metabolic diseases, with four compounds in clinical development.

GlaxoSmithKline Collaboration. In September 1992, we entered into a research and development collaboration with Glaxo Wellcome plc (now GlaxoSmithKline) to discover and develop drugs for the prevention or treatment of atherosclerosis and other disorders affecting the cardiovascular system. The collaboration focuses on discovering drugs that produce beneficial alterations in lipid and lipoprotein metabolism in three project areas: (1) regulation of cholesterol biosynthesis and expression of a receptor that removes cholesterol from the blood stream, (2) the IRs influencing circulating HDL levels, and (3) PPARs, the subfamily of IRs activated by lipid lowering drugs such as Lopid and Atromid-S. The research phase was successfully completed in 1997 with the identification of a novel lead structure that activates selected PPAR subfamily members and the identification of a different lead compound that shows activity in preclinical models for lowering LDL cholesterol by up-regulating LDL receptor gene expression in liver cells. We retain the right to develop and commercialize products arising from the collaboration in markets not exploited by GlaxoSmithKline, or where GlaxoSmithKline is not developing a product for the same indication.

In 1999, two compounds were advanced to exploratory development: (1) GW544, a PPAR agonist for cardiovascular disease and dyslipidemia; and (2) GW516, a second candidate that is in clinical development for cardiovascular disease and dyslipidemia. GW516 remains in Phase II studies. The American Heart Association estimates that 62 million Americans have some form of cardiovascular disease, and that cardiovascular disease accounts for more than 40% of deaths in the U.S. annually.

Eli Lilly Collaboration. In November 1997, we entered into a research and development collaboration with Eli Lilly & Co. (Lilly) for the discovery and development of products based upon our IR technology with broad applications in the fields of metabolic diseases, including diabetes, obesity, dyslipidemia, insulin resistance and cardiovascular diseases associated with insulin resistance and obesity. Under the collaboration, Lilly received: (1) worldwide, exclusive rights to our compounds and technology associated with the RXR receptor in the field; (2) rights to use our technology to develop an RXR compound in combination with a SERM in cancer; (3) worldwide, exclusive rights in certain areas to our PPAR technology, along with rights to use PPAR research technology with the RXR technology; and (4) exclusive rights to our HNF-4 receptor and obesity gene promoter technology. Lilly has the right to terminate the development of compounds under the agreements. We would receive rights to certain of such compounds in return for a royalty to Lilly, the rate of which is dependent on the stage at which the development is terminated. In April 2002, Lilly and Ligand announced the companies would extend the collaboration until November of 2003. In May 2003, the companies announced the second and final extension of the collaboration through November 2004.

Under the Lilly collaboration, we retained or received: (1) exclusive rights to independently research, develop and commercialize Targretin and other RXR compounds in the fields of cancer and dermatology; (2) an option to obtain selected rights to one of Lilly s specialty pharmaceutical products; and (3) rights to receive milestones, royalties and options to obtain certain co-development and co-promotion rights for the Lilly-selected RXR compound in combination with a SERM.

Our rights under the initial agreements have changed. In connection with the acquisition of Seragen in 1998, we obtained from Lilly its rights to ONTAK in satisfaction of our option to obtain selected rights to one of Lilly s specialty pharmaceutical products. In November 2004, Ligand and Lilly agreed to amend the ONTAK royalty agreement to add options in 2005 that if exercised would restructure our royalty obligations on net sales of ONTAK. Under the revised agreement, Ligand and Lilly each had two options. We received options exercisable in January 2005 and April 2005 to buy down a portion of the Company s ONTAK royalty obligation on net sales in the United States for total consideration of $33.0 million. Lilly received two options exercisable in July 2005 and October 2005 to trigger the same royalty buy-downs for total consideration of up to $37.0 million dependent on whether we have exercised one or both of our options.

In January 2005 we exercised the first option which provided for a one-time payment of $20.0 million to Lilly in exchange for the elimination of our ONTAK royalty payment obligations in 2005 and a reduced reverse-tiered royalty scale on ONTAK sales in the U.S. thereafter. The second option, exercised in April 2005, provided for a one-time payment of $13.0 million to Lilly in exchange for the elimination of royalties on ONTAK net sales in the U.S. in 2006

and a reduced reverse-tiered royalty thereafter. Since both options were exercised, beginning in 2007

Table of Contents

and throughout the remaining ONTAK patent life (2014), we will pay no royalties to Lilly on U.S. sales up to $38.0 million. Thereafter, we will pay royalties to Lilly at a rate of 20% on net U.S. sales between $38.0 million and $50.0 million; at a rate of 15% on net U.S. sales between $50.0 million and $72.0 million; and at a rate of 10% on net U.S. sales in excess of $72.0 million.

In 1999, we agreed to focus our collaborative efforts on the RXR modulator second-generation program, which has compounds with improved therapeutic indices relative to the three first-generation compounds, and on co-agonists of the PPAR receptor program. In early 1999, Lilly opted not to proceed with the development of certain first-generation compounds, including Targretin, in the RXR program for diabetes. As a result of this decision, all rights to the oral form of Targretin reverted to us, and LGD1268 and LGD1324 returned to the pool of eligible RXR modulators for possible use in oncology in combination with a SERM under the collaboration agreement between Ligand and Lilly.

In September 2001, we announced that we had earned an undisclosed milestone from Lilly as a result of Lilly s filing with the FDA an IND for LY818 (naveglitazar), a PPAR modulator for type II diabetes and metabolic diseases. Naveglitazar entered Phase II studies early in 2003, resulting in a $1.5 million milestone payment. In March 2004, Lilly announced their decision to move naveglitazar into Phase III registration studies. Shortly afterwards, the FDA provided new guidance regarding preclinical and clinical safety assessments for current and future PPAR molecules in clinical development. Accumulated rodent data reviewed by the agency for a number of PPAR agonists (gamma, alpha or dual agonists), but not including naveglitazar, showed carcinogenicity findings that did not demonstrate adequate margins of safety to support continued clinical development with some members of this class of compounds. Based on this information, the new guidance provided by the FDA for all compounds in this class indicates that clinical studies longer than six months in duration cannot be initiated until two-year rodent carcinogenicity studies are completed and submitted for agency review. Any proposed studies of greater than six months duration have been placed on clinical hold until carcinogenicity data are reviewed and adequate margins of safety are demonstrated.

Two-year carcinogenicity studies on naveglitazar are ongoing and data for evaluation should be available in 2005. While the full impact of these guidelines on naveglitazar clinical development plans and timelines is being reviewed, it is clear that, based on the timing of the completion of the carcinogenicity studies and subsequent FDA review of the data allowing the initiation of long-term safety studies, there will be an estimated delay of 18-24 months in the initiation of clinical studies of greater than six months duration. Lilly will review and revise their naveglitazar Phase III development plan accordingly.

In June 2002, we announced that we had earned a $1.1 million milestone payment as a result of Lilly s filing with the FDA an IND for LY929, a PPAR modulator for the treatment of Type II diabetes, metabolic diseases and dyslipidemias. In November 2002, we announced that we had earned a $2.1 million milestone payment as a result of Lilly s filing with the FDA an IND for LY674, a PPAR modulator for the treatment of atherosclerosis. In July 2005, we announced that we had earned a $1.6 million milestone payment as a result of LY674 entering Phase II studies. We will receive additional milestones if these products continue through the development process, and royalties on product sales if the products receive marketing approval. Lilly also has two other PPAR compounds on IND track, the compound numbers for which have not been disclosed.

Inflammatory Disease Collaborative Program

Abbott Collaboration. In July 1994, we entered into a research and development collaboration with Abbott Laboratories (Abbott) to discover and develop small molecule compounds for the prevention or treatment of inflammatory diseases. The collaborative program includes several molecular approaches to discovering modulators of glucocorticoid receptor activity that have significantly improved therapeutic profiles relative to currently known anti-inflammatory steroids such as prednisone and dexamethasone. The collaboration was focused on the development of novel non-steroidal glucocorticoids that maintain the efficacy of corticosteroids, but lack some or all of corticosteroids dose-limiting side effects. The research phase concluded in July 1999.

When the research phase of the collaboration ended in July 1999, Abbott retained rights to certain selective glucorcorticoid receptor modulators, or SGRMs, whose development has now been slowed or halted. We retained rights to all other compounds discovered through the collaboration, as well as recaptured technology rights. Abbott

Table of Contents

will make milestone and royalty payments on products targeted at inflammation resulting from the collaboration. Each party will be responsible for the development, registration, and commercialization of the products in its respective field.

TPO / Inflamatory Disease / Oncology Collaborative Program

GlaxoSmithKline Collaboration. In February 1995, we entered into a research and development collaboration with SmithKline Beecham (now GlaxoSmithKline) to use our proprietary expertise to discover and characterize small molecule, orally bioavailable drugs to control hematopoiesis (the formation and development of blood cells) for the treatment of a variety of blood cell deficiencies. In 1998, we announced the discovery of the first non-peptide small molecule that mimics in mice the activity of Granulocyte-Colony Stimulating Factor (G-CSF), a natural protein that stimulates production of infection-fighting neutrophils (a type of white blood cell). While this lead compound has only been shown to be active in mice, its discovery is a major scientific milestone and suggests that orally active, small-molecule mimics can be developed not only for G-CSF, but for other cytokines as well.

A number of lead molecules have been found that mimic the activity of natural growth factors for white cells and platelets. In the fourth quarter of 2002, we earned a $2.0 million milestone payment from GlaxoSmithKline, which has begun human trials of SB-497115, an oral, small molecule drug that mimics the activity of thrombopoietin (TPO), a protein factor that promotes growth and production of blood platelets. In February 2005, we announced that we had earned a $1 million milestone payment from GlaxoSmithKline with that company s commencement of Phase II trials of SB-497115. In June 2005, we earned a $2 million milestone payment as SB-559448, a second TPO agonist began Phase I development. There are no approved oral TPO agents for the treatment or prevention of thrombocytopenias (decreased platelet count). Investigational use of injectable forms of recombinant human TPO has been effective in raising platelet levels in cancer patients undergoing chemotherapy, and has led to accelerated hematopoietic recovery when given to stem cell donors. Some of these investigational treatments have not moved forward to registration due to the development of neutralizing antibodies. Thus, a small molecule TPO mimic with no apparent immunogenic potential and oral activity that may facilitate dosing may provide an attractive therapeutic profile for a major unmet medical need.

The research phase of the collaboration concluded in February 2001. Under the collaboration, we have the right to select up to three compounds related to hematopoietic targets for development as anti-cancer products other than those compounds selected for development by GlaxoSmithKline. GlaxoSmithKline has the option to co-promote these products with us in North America and to develop and market them outside North America.

Dermatology Collaborative Program

Allergan. In September 1997, in conjunction with the buyback of Allergan Ligand Retinoid Therapeutics, Inc. (ALRT), we agreed with Allergan to restructure the terms and conditions relating to research, development, and commercialization and sublicense rights for the ALRT compounds. Under the restructured arrangement, we received exclusive, worldwide development, commercialization, and sublicense rights to Panretin capsules and Panretin gel, LGD1550, LGD1268 and LGD1324. Allergan received exclusive, worldwide development, commercialization and sublicense rights to LGD4310, a Retinoic Acid Receptor, or RAR, antagonist. Allergan also received LGD4326 and LGD4204, two advanced preclinical RXR selective compounds. In addition, we participated in a lottery with Allergan for each of the approximately 2,000 retinoid compounds existing in the ALRT compound library as of the closing date, with each party acquiring exclusive, worldwide development, commercialization, and sublicense rights to the compounds that they selected. We and Allergan will each pay the other a royalty based on net sales of products developed from the compounds selected by each in the lottery and the other ALRT compounds to which each acquires exclusive rights. We will also pay to Allergan royalties based on our net sales of Targretin for uses other than oncology and dermatology indications. In the event that we license commercialization rights to Targretin to a third party, we will pay to Allergan a percentage of royalties payable to us with respect to sales of Targretin other than in oncology and dermatology indications. During 2001, Allergan elected not to proceed with development of AGN4310 for mucocutaneous toxicity.

Table of Contents

Royalty Pharma Agreement

In March 2002, we announced an agreement with Royalty Pharma AG, which purchased rights to a share of future royalty payments from our collaborative partners sales of three SERMs in Phase III development. The SERM products included in the transaction are lasofoxifene, which is being developed for osteoporosis and other indications at Pfizer, bazedoxifene and bazedoxifene CE (PREMARIN combo) which are in development at Wyeth for osteoporosis and for vasomotor symptoms of menopause. (See the detailed discussions of these products under the Pfizer and Wyeth collaborations above.)

Since March 2002, and following certain amendments to the original agreement, Royalty Pharma has acquired cumulative rights to 3.0125% of the potential future net sales of the three SERM products for an aggregate of $63.3 million. In addition, in December 2002 Royalty Pharma agreed to acquire a 1.0% royalty interest in the Company s net sales of Targretin capsules from January 2003 through 2016 for $1.0 million.

Under the terms of the agreements, payments from the royalty rights purchase are non-refundable, regardless of whether the products are ever successfully registered or marketed. Milestone payments owed by our partners as the products complete development and registration are not included in the Royalty Pharma agreement and will be paid to us as earned.

Technology

In our successful efforts to discover new and important medicines, we and our academic collaborators and consultants have concentrated on two areas of research: advancing the understanding of the activities of hormones and hormone-related drugs, and making scientific discoveries related to IR technology. We believe that our expertise in this technology will enable us to develop novel, small-molecule drugs acting through IRs with more target-specific properties than currently available drugs. Our efforts may result in improved therapeutic and side effect profiles and new indications for IRs. IRs are families of transcription factors that change cell function by selectively turning on or off particular genes in response to circulating signals that impinge on cells. In addition to our proprietary IR technology, we have acquired fusion protein technology, which was used by Seragen in the development of ONTAK.

Intracellular Receptor Technology

Hormones occur naturally within the body and control processes such as reproduction, cell growth and differentiation. Hormones generally fall into two classes, non-peptide hormones and peptide hormones. Non-peptide hormones include retinoids, sex steroids (estrogens, progestins and androgens), adrenal steroids (glucocorticoids and mineralocorticoids), vitamin D and thyroid hormone. These non-peptide hormones act by binding to their corresponding IRs to regulate the expression of genes in order to maintain and restore balanced cellular function within the body. Hormonal imbalances can lead to a variety of diseases. The hormones themselves and drugs that mimic or block hormone action may be useful in the treatment of these diseases. Furthermore, hormone mimics (agonists) or blockers (antagonists) can be used to treat diseases in which the underlying cause is not hormonal imbalance. The effectiveness of IRs as drug targets is clearly demonstrated by currently available drugs acting through IRs for several diseases. However, the use of most of these drugs has been limited by their often significant side effects. Examples of currently marketed hormone-related drugs acting on IRs are glucocorticoids (steroids used to treat inflammation), natural and synthetic estrogens and progesterones (used for hormone therapy and contraception), tamoxifen (an estrogen antagonist used in the treatment of breast cancer), and various retinoids such as Accutane® and Retin-A® (used to treat acne) and Dovonex® (used to treat psoriasis).

We have built a strong proprietary position and accumulated substantial expertise in IRs applicable to drug discovery and development. Building on our scientific findings about the molecular basis of hormone action, we have created proprietary new tools to explore and manipulate non-peptide hormone action for potential therapeutic benefit. We employ a proprietary cell-culture based assay system for small molecules that can modulate IRs, referred to as the co-transfection assay. The co-transfection assay system simulates the actual cellular processes controlled by IRs and is able to detect whether a compound interacts with a particular human IR and whether this interaction mimics or blocks the effects of the natural regulatory molecules on target gene expression.

Table of Contents

The understanding of non-peptide hormones and their actions has increased substantially in the last 15 years. Driving this rapid expansion of knowledge has been the discovery of the family of IRs through which all known small-molecule, non-peptide hormones act. We and our academic collaborators and consultants have made major discoveries pertaining to IRs and to small molecule hormones and compounds that interact with these IRs. These discoveries include: (1) the identification of the IR superfamily, (2) the recognition of IR subtypes, (3) the heterodimer biology of RXR-selective compounds and (4) the discovery of orphan IRs. We believe that each of these broad areas of knowledge provides important opportunities for drug discovery.

IR Superfamily. The receptors for non-peptide hormones are closely related members of a superfamily of proteins known as IRs. Human IRs for all the known non-peptide hormones now have been cloned, in many cases by our scientists or our collaborators. The structure and underlying mechanism of action of IRs have many common features, such that drug discovery insights about one IR often can be directly applied to other members of the IR superfamily, bringing synergy to our IR-focused drug discovery efforts. First-generation drugs were developed and commercialized for their therapeutic benefits prior to the discovery of IRs. As a result, they often cross-react with the IRs for hormones other than the intended target, which can result in significant side effects. The understanding that IRs are structurally similar has enabled us to determine the basis for the side effects of some first-generation drugs and to discover improved drug candidates.

IR Subtypes. For some of the non-peptide hormones, several closely related but non-identical IRs, known as IR subtypes, have been discovered. These include six subtypes of the IRs for retinoids, two subtypes of the IRs for thyroid hormone, two subtypes for the ER, and three subtypes for the PPARs. Patent applications covering many of these IR subtypes have been exclusively licensed by us. We believe that drugs capable of selective modulation of IR subtypes will allow more specific pharmacological intervention that is better matched to therapeutic need. Targretin, an RXR-selective molecule, was discovered as a result of our understanding of retinoid receptor subtypes.

Retinoid Responsive IRs. Retinoic acid, a derivative of Vitamin A, is one of the body s natural regulatory hormones that has a broad range of biological actions, influencing cell growth, differentiation, programmed cell death and embryonic development. Many chemical analogues of retinoic acid, called retinoids, also have biological activity. Specific retinoids have been approved by the FDA for the treatment of psoriasis and certain severe forms of acne. Evidence also suggests that retinoids can be used to arrest and, to an extent, reverse the effects of skin damage arising from prolonged exposure to the sun. Other evidence suggests that retinoids are useful in the treatment of a variety of cancers, including kidney cancer and certain forms of leukemia. For example, all-trans-retinoic-acid has been approved by the FDA to treat acute promyelocytic leukemia. Retinoids also have shown an ability to reverse precancerous (premalignant) changes in tissues, reducing the risk of development of cancer, and may have potential as preventive agents for a variety of epithelial malignancies, including skin, head and neck, bladder and prostate cancer. Currently marketed retinoids, which were developed and commercialized prior to the discovery of retinoid-responsive IRs, cause significant side effects. These include severe birth defects if fetal exposure occurs, severe irritation of the skin and mucosal surfaces, elevation of plasma lipids, headache and skeletal abnormalities.

The six Retinoid Responsive Intracellular Receptors, or RRs, that have been identified to date can be grouped in two subfamilies RARs and RXRs. Patent applications covering members of both families of RRs have been licensed exclusively to us primarily from The Salk Institute. The RR subtypes appear to have different functions, based on their distribution in various tissues within the body and data arising from *in vitro* and *in vivo* studies, including studies of transgenic mice. Several of the retinoids currently in commercial use are either non-selective in their pattern of RR subtype activation or are not ideal drugs for other reasons. We are developing chemically synthesized retinoids that, by selectively activating RR subtypes, may preserve desired therapeutic effects while reducing side effects.

We have three retinoid products approved by the FDA (Panretin gel, Targretin capsules and Targretin gel) and two retinoid products in clinical trials (Targretin capsules and Targretin gel). Panretin gel incorporates 9-*cis* retinoic acid, a retinoid isolated and characterized by us in 1991 in collaboration with scientists at The Salk Institute and Baylor College of Medicine. 9-*cis* retinoic acid is the first non-peptide hormone discovered in more than 25 years and appears to be a natural ligand for the RAR and RXR subfamilies of retinoid receptors. Bexarotene, the active substance in Targretin, is a synthetic retinoid developed by us that shows selective retinoid receptor subtype activity that is different from that of 9-*cis* retinoic acid, the active substance in Panretin. Targretin selectively activates a

83

Table of Contents

subclass of retinoid receptors called RXRs. RXRs play an important role in the control of a variety of cellular functions.

RXRs. RXRs can form a dimer with numerous IRs, such as the PPAR, LXR, RAR, thyroid hormone and vitamin D receptors. While RXRs are widely expressed, their IR partners are more selectively expressed in different tissues, such as liver, fat or muscle. As a result, compounds that bind RXRs offer the unique potential to treat a variety of diseases, including cancer and metabolic diseases. In preclinical models of type II diabetes, RXR agonists appear to stimulate the physiological pathways responsive to RXR/PPAR receptor partners expressed in key target tissues that are involved in glucose metabolism. As a result, a discrete set of genes is activated in these tissues, resulting in a decrease in serum glucose levels and insulin.

Orphan Receptors. More than 40 additional members of the IR superfamily that do not interact with the known non-peptide hormones have been discovered. These members of the IR superfamily have been designated orphan receptors. We believe that among the orphan IRs there may be receptors for uncharacterized small molecule hormones, and that the physiological roles of the various orphan IRs are likely to be diverse. We have devised strategies to isolate small molecules that interact with orphan IRs. In 1999, we invested in and exclusively licensed specified orphan IR technology to a new private corporation, X-Ceptor Therapeutics, Inc. (X-Ceptor). Under the 1999 license agreement, we will receive a royalty of 1.5% on net sales of any products which are discovered using the licensed technologies.

Fusion Protein Technology

Our fusion protein technology was developed by Seragen, which we acquired in 1998. Seragen s fusion proteins consist of a fragment of diphtheria toxin genetically fused to a ligand that binds to specific receptors on the surface of target cells. Once bound to the cell, the fusion proteins are designed to enter the cell and destroy the ability of the cell to manufacture proteins, resulting in cell death. Using this platform, Seragen genetically engineered six fusion proteins, each of which consists of a fragment of diphtheria toxin fused to a different targeting ligand, such as a polypeptide hormone or growth factor. ONTAK, which is approved in the U.S. for the treatment of patients with persistent or recurrent CTCL, is a fusion protein consisting of a fragment of diphtheria toxin genetically fused to a part of interleukin-2. In addition to treatment of CTCL, fusion proteins may have utility in oncology, dermatology, infectious diseases, and autoimmune diseases. Seragen has entered into exclusive license agreements with Harvard University and other parties for patents related to fusion protein technology and has been issued six U.S. patents for improvements in the technology licensed from Harvard University.

Academic Collaborations

To date, we have licensed technology from The Salk Institute, Baylor College of Medicine and other academic institutions and developed relationships with key scientists to further the development of our core IR technology.

The Salk Institute of Biological Studies. In 1988, we established an exclusive relationship with The Salk Institute, which is one of the research centers in the area of IR technology. We amended and restated this agreement in April 2002. Under our agreement, we have an exclusive, worldwide license to certain IR technology developed in the laboratory of Dr. Ronald Evans, a Salk professor and Howard Hughes Medical Institute Investigator. Dr. Evans cloned and characterized the first IR in 1985 and is an inventor of the co-transfection assay used by us to screen for IR modulators. Under the agreement, we are obligated to make certain royalty payments based on sales of certain products developed using the licensed technology, as well as certain minimum annual royalty payments and a percentage of milestones and certain other payments received. The agreement also provides that we have the option of buying out future royalty payments as well as milestone and other payment-sharing obligations on a product-by-product basis by paying the Salk a lump sum calculated using a formula in the agreement. In March 2004, we paid the Salk $1.12 million to exercise this buyout option with respect to lasofoxifene, a product under development by Pfizer for the prevention of osteoporosis in postmenopausal women. In December of 2004 Pfizer filed a supplemental NDA for the use of lasofoxifene for the treatment of vaginal atrophy. As a result of the supplemental lasofoxifene NDA filing, we exercised an option in January 2005 to pay The Salk Institute $1.12 million to buy out royalty payments due on future sales of the product in this additional indication. See the discussion above regarding Collaborative Research and Development Programs.

Table of Contents

We have also entered into a consulting agreement with Dr. Evans that continues through February 2008. Dr. Evans serves as Chairman of Ligand s Scientific Advisory Board.

Baylor College of Medicine. In 1990, we established an exclusive relationship with Baylor, which is a center of IR technology. We entered into a series of agreements with Baylor under which we have an exclusive, worldwide license to IR technology developed at Baylor and to future improvements made in the laboratory of Dr. Bert W. O Malley through the life of the related patents. Dr. O Malley is a professor and the Chairman of the Department of Cell Biology at the Baylor College of Medicine and the Director of the Center for Reproductive Biology. He leads IR research at Baylor.

We work closely with Dr. O Malley and Baylor in scientific IR research, particularly in the area of sex steroids and orphan IRs. Under our agreement, we are obligated to make certain royalty payments based on the sales of products developed using the licensed technology. Dr. O Malley is a member of Ligand s Scientific Advisory Board.

In addition to the collaborations discussed above, we also have a number of other consulting, licensing, development and academic agreements by which we strive to advance our technology.

Manufacturing

We currently have no manufacturing facilities and, accordingly, rely on third parties, including our collaborative partners, for commercial or clinical production of any products or compounds. During 2004, each of our major products was manufactured by a single supplier: Elan manufactures AVINZA; Cambrex manufactures ONTAK and Cardinal Health and Raylo manufacture Targretin capsules. In 2004, we entered into contracts with Cardinal Health to provide a second source for AVINZA, and with Hollister-Stier to fill and finish ONTAK. In July 2005, we announced that the FDA approved the Hollister-Stier facility for fill/finish of ONTAK. In August 2005, the FDA approved the production of AVINZA at a Cardinal Health facility which provides a second source of supply, thus diversifying the AVINZA supply chain and increasing production capacity.

Certain raw materials necessary for the commercial manufacturing of our products are custom and must be obtained from a specific sole source. In addition, our finished products are produced by sole source manufacturers. We currently attempt to manage the risk associated with such sole source raw materials and production by actively managing our inventories and supply and production arrangements. We attempt to remain appraised of the financial condition of our suppliers and their ability to continue to supply our raw materials and finished products in an uninterrupted and timely manner. Unavailability of certain materials or the loss of current sources of production could cause an interruption in production and a reduced supply of finished product pending establishment of new sources, or in some cases, implementation of alternative processes. For a discussion of the risks associated with manufacturing, see Risks and Uncertainties.

Quality Assurance

Our success depends in great measure upon customer confidence in the quality of our products and in the integrity of the data that support their safety and effectiveness. The quality of our products arises from our commitment to quality in all aspects of our business, including research and development, purchasing, manufacturing and distribution. Quality assurance procedures have been developed relating to the quality and integrity of our scientific information and production processes.

Control of production processes involves rigid specifications for ingredients, equipment, facilities, manufacturing methods, packaging materials, and labeling. Control tests are made at various stages of production processes and on the final product to assure that the product meets all regulatory requirements and our standards. These tests may involve chemical and physical testing, microbiological testing, preclinical testing, human clinical trials, or a combination of these trials.

Table of Contents

Commercial

In late 1998, we assembled a specialty oncology and human immunodeficiency virus, or HIV, center sales and marketing team to market in the U.S. products developed, acquired or licensed by us. In late 1999, we expanded our U.S. sales force from approximately 20 to approximately 40 sales representatives to support the launch of Targretin capsules and Targretin gel and increase market penetration of ONTAK and Panretin gel. In 2001, we expanded our sales force to approximately 50 sales representatives, including approximately 20 full-time contract sales representatives who focused on the dermatology market. In 2002, to support the launch of AVINZA, we redirected these contract sales representatives to call on high-prescribing pain specialists. Also in 2002, we hired approximately another 30 representatives to call on pain specialists, bringing the total number of representatives selling only AVINZA to approximately 50 representatives. In 2003, we expanded our specialty pain sales force to approximately 70 representatives. In addition, more than 700 Organon sales representatives began promoting AVINZA as a result of the co-promotion agreement we established in early 2003. During 2004, 36 additional Ligand specialty sales representatives were hired to promote AVINZA to top-decile, primary-care physicians. In November of 2004, an AVINZA sales force restructuring was implemented to improve sales call coverage and effectiveness. At the end of 2004, we had approximately 25 sales representatives promoting our in-line oncology products. At August 31, 2005, we had approximately 130 U.S. sales territories.

Effective January 1, 2006, we terminated our agreement with Organon USA Inc. This agreement terminates the AVINZA® co-promotion agreement between the two companies and returns AVINZA rights to Ligand. However. the parties have agreed to continue to cooperate during a transition period ending September 30, 2006 to promote the product. The transition period co-operation includes among other things, a minimum number of product sales calls per quarter - 100,000 for Organon and 30,000 for Ligand with an aggregate of 375,000 and 90,000 respectively for the transition period . See Overview-Ligand Marketed Products AVINZA Co-Promotion Agreement with Organon. In January 2006, 18 Ligand sales representatives previously promoting AVINZA to primary care physicians were redeployed to call on pain specialists and all Ligand primary care territories were eliminated. In connection with this restructuring, 11 primary-care sales representatives were terminated. The AVINZA sales force restructuring was implemented to improve sales call coverage and effectiveness among high prescribing pain specialists.

Internationally, through marketing and distribution agreements with Elan, Ferrer International and Sigma Tau (rights transferred from Alfa Wassermann in October 2005), we have established marketing and distribution capabilities in Europe, as well as Central and South America. In February 2004, Elan and Medeus Pharma Limited (now Zeneus) announced that Zeneus had acquired Elan s European sales and marketing business, and that the acquisition included the marketing and distribution rights to certain Ligand products in Europe. In December 2005, Cephalon, Inc. announced that it had acquired all the outstanding share capital of Zeneus, which will operate as a wholly owned subsidiary of Cephalon.

In the second half of 2004, we entered into fee-for-service agreements (or distribution service agreements) for each of our products, other than Panretin, with the majority of our wholesaler customers. In exchange for a set fee, the wholesalers have agreed to provide us with certain information regarding product stocking and out-movement; agreed to maintain inventory quantities within specified minimum and maximum levels; inventory handling, stocking and management services; and certain other services surrounding the administration of returns and chargebacks. In connection with implementation of the fee-for-service agreements, we no longer offer these wholesalers promotional discounts or incentives and as a result, we expect a net improvement in product gross margins as volumes grow. Additionally, we believe these arrangements will provide lower variability in wholesaler inventory levels and improved management of inventories within and between individual wholesaler distribution centers that we believe will result in a lower level of product returns compared to prior periods.

For the year ended December 31, 2004, shipments to three wholesale distributors each accounted for more than 10% of total shipments and in the aggregate represented 77% of total shipments. These were AmerisourceBergen Corporation, Cardinal Health, Inc., and McKesson Corporation.

Our practices with respect to working capital items are similar to comparable companies in the industry. We accept the return of pharmaceuticals that have reached their expiration date. Our policy for returns allows customers, primarily wholesale distributors, to return our oncology products three months prior to and six months after

86

Table of Contents

expiration. For ONTAK, customers are generally allowed to return product in exchange for replacement ONTAK vials. Our policy for returns of AVINZA allows customers to return the product six months prior to and six months after expiration.

Substantially all of our revenues are attributable to customers in the United States; likewise, substantially all of our long-lived assets are located in the United States.

For further discussion of these items, see below under Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Research and Development Expenses

Research and development expenses were $65.2 million, $66.7 million and $59.1 million in fiscal 2004, 2003 and 2002, respectively, of which approximately 88%, 84% and 75%, respectively, we sponsored, and the remainder of which was funded pursuant to collaborative research and development arrangements.

Competition

Some of the drugs we are developing will compete with existing therapies. In addition, a number of companies are pursuing the development of novel pharmaceuticals that target the same diseases we are targeting. A number of pharmaceutical and biotechnology companies are pursuing IR-related approaches to drug discovery and development. Furthermore, academic institutions, government agencies, and other public and private organizations conducting research may seek patent protection with respect to potentially competing products or technologies and may establish collaborative arrangements with our competitors.

Our marketed products also face competition. The principal products competing with our products targeted at the cutaneous t-cell lymphoma market are Supergen/Abbott s Nipent and interferon, which is marketed by a number of companies, including Schering-Plough s Intron A. Products that compete with AVINZA include Purdue Pharma L.P. s OxyContin and MS Contin and potentially Palladone (launched in early 2005 and subsequently withdrawn from the market), Janssen Pharmaceutica Products, L.P. s Duragesic, aai Pharma s Oramorph SR, Alpharma s Kadian, and generic sustained release morphine sulfate, oxycodone and fentanyl. Many of our existing or potential competitors, particularly large drug companies, have greater financial, technical and human resources than us and may be better equipped to develop, manufacture and market products. Many of these companies also have extensive experience in preclinical testing and human clinical trials, obtaining FDA and other regulatory approvals and manufacturing and marketing pharmaceutical products.

Our competitive position also depends upon our ability to attract and retain qualified personnel, obtain patent protection or otherwise develop proprietary products or processes, and secure sufficient capital resources for the often substantial period between technological conception and commercial sales. For a discussion of the risks associated with competition, see Risks and Uncertainties.

Government Regulation

The manufacturing and marketing of our products, our ongoing research and development activities, and products being developed by our collaborative partners are subject to regulation for safety and efficacy by numerous governmental authorities in the United States and other countries. In the United States, pharmaceuticals are subject to rigorous regulation by federal and various state authorities, including the FDA. The Federal Food, Drug and Cosmetic Act and the Public Health Service Act govern the testing, manufacture, safety, efficacy, labeling, storage, record keeping, approval, advertising and promotion of our products. There are often comparable regulations that apply at the state level. Product development and approval within this regulatory framework takes a number of years and involves the expenditure of substantial resources.

The steps required before a pharmaceutical agent may be marketed in the United States include (1) preclinical laboratory tests, (2) the submission to the FDA of an IND, which must become effective before human clinical trials may commence, (3) adequate and well-controlled human clinical trials to establish the safety and efficacy of the

Table of Contents

drug, (4) the submission of a NDA to the FDA and (5) the FDA approval of the NDA prior to any commercial sale or shipment of the drug. A company must pay a one-time user fee for NDA submissions, and annually pay user fees for each approved product and manufacturing establishment. In addition to obtaining FDA approval for each product, each domestic drug-manufacturing establishment must be registered with the FDA and, in California, with the Food and Drug Branch of California. Domestic manufacturing establishments are subject to pre-approval inspections by the FDA prior to marketing approval, then to biennial inspections, and must comply with current Good Manufacturing Practices (cGMP). To supply products for use in the United States, foreign manufacturing establishments must comply with cGMP and are subject to periodic inspection by the FDA or by regulatory authorities in such countries under reciprocal agreements with the FDA.

For both currently marketed and future products, failure to comply with applicable regulatory requirements after obtaining regulatory approval can, among other things, result in the suspension of regulatory approval, as well as possible civil and criminal sanctions. In addition, changes in existing regulations could have a material adverse effect to us.

For marketing outside the United States before FDA approval to market, we must submit an export permit application to the FDA. We also are subject to foreign regulatory requirements governing human clinical trials and marketing approval for drugs. The requirements relating to the conduct of clinical trials, product licensing, pricing and reimbursement vary widely from country to country and there can be no assurance that we or any of our partners will meet and sustain any such requirements.

We are also increasingly subject to regulation by the states. A number of states now regulate, for example, pharmaceutical marketing practices and the reporting of marketing activities, controlled substances such as our AVINZA product, clinical trials and general commercial practices. We have developed and are developing a number of policies and procedures to ensure our compliance with these state laws, in addition to the federal regulations described above. Significant resources are now required on an ongoing basis to ensure such compliance. For a discussion of the risks associated with government regulations, see Risks and Uncertainties.

Patents and Proprietary Rights

We believe that patents and other proprietary rights are important to our business. Our policy is to file patent applications to protect technology, inventions and improvements to our inventions that are considered important to the development of our business. We also rely upon trade secrets, know-how, continuing technological innovations and licensing opportunities to develop and maintain our competitive position.

As of August 31, 2005, we have filed or participated as licensee in the filing of approximately 65 currently pending patent applications in the United States relating to our technology, as well as foreign counterparts of certain of these applications in many countries. In addition, we own or have licensed rights covered by approximately 377 patents issued or applications, granted or allowed worldwide, including United States patents and foreign counterparts to United States patents. Except for a few patents and applications which are not material to our commercial success, these patents and applications will expire between 2005 and 2021. Our marketed products are expected to have patent protection in the United States and Europe that does not expire until between 2011 and 2017. Subject to compliance with the terms of the respective agreements, our rights under our licenses with our exclusive licensors extend for the life of the patents covering such developments. For a discussion of the risks associated with patent and proprietary rights, see Risks and Uncertainties.

In December 2004, the United States Patent and Trademark Office declared an interference proceeding at our request between a patent application owned by Ligand claiming bexarotene (the active ingredient in our Targretin products) and related technology and an issued patent owned jointly by SRI International and The Burnham Institute. The patent owned jointly by SRI International and The Burnham Institute was exclusively licensed to Ligand in return for a royalty and other terms. In March 2005, we reached a settlement agreement with SRI and Burnham wherein SRI and Burnham agreed to concede priority of the bexarotene claims to Ligand and assign its patent and related rights to Ligand. In return, we will continue to pay to SRI and Burnham a royalty on Bexarotene at a lower rate and would pay the same royalty on any future products that may be covered by the related patents assigned to Ligand. The royalty would be payable for the relevant patent terms, including any additional patent term to which our patent application for bexarotene would be entitled.

88

Table of Contents

Human Resources

As of November 30, 2005, we had 504 full-time employees, of whom 232 were involved directly in scientific research and development activities. Of these employees, approximately 67 hold Ph.D. or M.D. degrees.

Properties

We currently lease and occupy office and laboratory facilities in San Diego, California. These include a 52,800 square foot facility leased through July 2015 and an 82,500 square foot facility which we own through our consolidated subsidiary, Nexus. We believe these facilities will be adequate to meet our near-term space requirements.

Legal Proceedings

Seragen, Inc., our subsidiary, and Ligand, were named parties to Sergio M. Oliver, et al. v. Boston University, et al., a putative shareholder class action filed on December 17, 1998 in the Court of Chancery in the State of Delaware in and for New Castle County, C.A. No. 16570NC, by Sergio M. Oliver and others against Boston University and others, including Seragen, its subsidiary Seragen Technology, Inc. and former officers and directors of Seragen. The complaint, as amended, alleged that Ligand aided and abetted purported breaches of fiduciary duty by the Seragen related defendants in connection with the acquisition of Seragen by Ligand and made certain misrepresentations in related proxy materials and seeks compensatory and punitive damages of an unspecified amount. On July 25, 2000, the Delaware Chancery Court granted in part and denied in part defendants motions to dismiss. Seragen, Ligand, Seragen Technology, Inc. and our acquisition subsidiary, Knight Acquisition Corporation, were dismissed from the action. Claims of breach of fiduciary duty remain against the remaining defendants, including the former officers and directors of Seragen. The hearing on the plaintiffs motion for class certification took place on February 26, 2001. The court certified a class consisting of shareholders as of the date of the acquisition and on the date of the proxy sent to ratify an earlier business unit sale by Seragen. On January 20, 2005, the Delaware Chancery Court granted in part and denied in part the defendants motion for summary judgment. The Court denied plaintiffs motion for summary judgment in its entirety. Trial was scheduled for February 7, 2005. Prior to trial, several of the Seragen director-defendants reached a settlement with the plaintiffs. The trial in this action then went forward as to the remaining defendants and concluded on February 18, 2005. The timing of a decision by the Court and the outcome are unknown. While Ligand and its subsidiary Seragen have been dismissed from the action, such dismissal is subject to a possible subsequent appeal upon any judgment in the action against the remaining parties, as well as possible indemnification obligations with respect to certain defendants.

Beginning in August 2004, several purported class action stockholder lawsuits were filed in the United States District Court for the Southern District of California against the Company and certain of its directors and officers. The actions were brought on behalf of purchasers of the Company s common stock during several time periods, the longest of which runs from July 28, 2003 through August 2, 2004. The complaints generally allege that the Company violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission by making false and misleading statements, or concealing information about the Company s business, forecasts and financial performance, in particular statements and information related to drug development issues and AVINZA inventory levels. These lawsuits have been consolidated and lead plaintiffs appointed. A consolidated complaint was filed by the plaintiffs on March 2005. On September 27, 2005, the court granted the Company s motion to dismiss the consolidated complaint, with leave for plaintiffs to file an amended complaint. In December 2005, the plaintiffs filed an amended complaint. No trial date has been set.

Beginning on or about August 13, 2004, several derivative actions were filed on behalf of the Company by individual stockholders in the Superior Court of California. The complaints name the Company s directors and certain of its officers as defendants and name the Company as a nominal defendant. The complaints are based on the same facts and circumstances as the purported class actions discussed in the previous paragraph and generally allege breach of fiduciary duties, abuse of control, waste and mismanagement, insider trading and unjust enrichment. These actions are in discovery. The court has set a trial date of May 26, 2006.

In October 2005, a shareholder derivative action was filed on behalf of the Company in the United States District Court for the Southern District of California. The complaint names the Company s directors and certain of its

officers as defendants and the Company as a nominal defendant. The action was brought by an individual stockholder. The complaint generally alleges that the defendants falsified Ligand s publicly reported financial results throughout 2002 and 2003 and the first three quarters of 2004 by improperly recognizing revenue on product sales. The complaint generally alleges breach of fiduciary duty by all defendants and requests disgorgement, e.g., under Section 304 of the Sarbanes-Oxley Act of 2002. No trial date has been set.

The Company believes that all of the above actions are without merit and intends to vigorously defend against each of such lawsuits. Due to the uncertainty of the ultimate outcome of these matters, the impact on future financial results is not subject to reasonable estimates.

On December 11, 2001, a lawsuit was filed in the United States District Court for the District of Massachusetts against Ligand by the Trustees of Boston University and other former stakeholders of Seragen. The suit was subsequently transferred to federal district court in Delaware. The complaint alleges breach of contract, breach of the implied covenants of good faith and fair dealing and unfair and deceptive trade practices based on, among other things, allegations that Ligand wrongfully withheld approximately $2.1 million in consideration due the plaintiffs under the Seragen acquisition agreement. This amount had been previously accrued for in the Company s consolidated financial statements in 1998. The complaint seeks payment of the withheld consideration and treble damages. Ligand filed a motion to dismiss the unfair and deceptive trade practices claim. The Court subsequently granted Ligand s motion to dismiss the unfair and deceptive trade practices claim (i.e. the treble damages claim), in April 2003. In November 2003, the Court granted Boston University s motion for summary judgment, and entered judgment for Boston University. In January 2004, the district court issued an amended judgment awarding interest of approximately $0.7 million to the plaintiffs in addition to the approximately $2.1 million withheld. In view of the judgment, the Company restated its consolidated financial statements to record a charge of $0.7 million to Selling, general and administrative expense in the fourth quarter of 2003. In January 2006, the appeals court affirmed the district court s ruling against us. Additional interest on the above amounts of approximately $0.1 million has accrued through January 2006 and was added to the judgment. The withheld amount including interest was paid in February 2006.

In October 2005, a lawsuit was filed in the Court of Chancery in the State of Delaware by Third Point Offshore Fund, Ltd. requesting the Court to order Ligand to hold an annual meeting for the election of directors within 60 days of an order by the Court. Ligand s annual meeting had been delayed as a result of the previously announced restatement. The complaint requested the Court to set a time and place and record date for such annual meeting and establish the quorum for such meeting as the shares present at the meeting, notwithstanding any relevant provisions of Ligand s certificate of incorporation or bylaws. The complaint sought payment of plaintiff s costs and attorney s fees. Ligand agreed on November 11, 2005 to settle this lawsuit and schedule the annual meeting for January 31, 2006. The record date for the meeting is December 15, 2005. On December 2, 2005, Ligand and Third Point also entered into a stockholders agreement under which, among other things, Ligand will expand its board from eight to eleven, elect three designees of Third Point to the new board seats and pay certain of Third Point s expenses, not to exceed approximately $0.5 million, with some conditions. Third Point will not sell its Ligand shares, solicit proxies or take certain other stockholder actions for a minimum of six months and as long as its designees remain on the board.

In connection with the restatement, the SEC instituted a formal investigation concerning the Company s consolidated financial statements. These matters were previously the subject of an informal SEC inquiry. Ligand has been cooperating fully with the SEC and will continue to do so in order to bring the investigation to a conclusion as promptly as possible.

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

Table of Contents

MARKET PRICE OF AND DIVIDENDS ON THE REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Prior to September 7, 2005, our common stock was traded on the NASDAQ National Market tier of the NASDAQ Stock Market under the symbols LGND and LGNDE. Our common stock was delisted from the NASDAQ National Market on September 7, 2005 and currently is quoted on The Pink Sheets under the symbol LGND.

The following table sets forth the high and low intraday sales prices for our common stock on the NASDAQ National Market or The Pink Sheets, as applicable, for the periods indicated:

	Price Range	
	High	**Low**
Year Ended December 31, 2005:		
1st Quarter	$11.20	$ 4.98
2nd Quarter	7.00	4.75
3rd Quarter	10.14	6.86
4th Quarter	11.65	7.95
Year Ended December 31, 2004:		
1st Quarter	$20.94	$13.19
2nd Quarter	24.91	15.82
3rd Quarter	17.38	7.41
4th Quarter	12.97	8.26

As of February 9, 2006, the closing price of our common stock on The Pink Sheets was $12.85.

Holders

At December 31, 2005, there were approximately 1,763 holders of record of the common stock.

Dividends

We have not paid any cash dividends on our common stock to date. We intend to retain any earnings to support the expansion of our business, and we do not anticipate paying cash dividends on any of our securities in the foreseeable future.

Table of Contents

MANAGEMENT

Executive Officers and Directors

The following table sets forth certain information about our executive officers and directors:

Name	Age*	Position
David E. Robinson.	57	Chairman of the Board, President, Chief Executive Officer and Director
Andres F. Negro-Vilar, M.D., Ph.D.	65	Executive Vice President, Research and Development and Chief Scientific Officer
Taylor J. Crouch.	46	Senior Vice President, Technical & Supply Operations and President, International
James J. L Italien, Ph.D.	53	Senior Vice President, Regulatory Affairs and Compliance
Paul V. Maier.	58	Senior Vice President, Chief Financial Officer
William A. Pettit.	56	Senior Vice President, Human Resources and Administration
Warner R. Broaddus.	42	Vice President, General Counsel & Secretary
Eric S. Groves, M.D., Ph.D.	63	Vice President, Project Management
Martin D. Meglasson, Ph.D.	55	Vice President, Discovery Research
Tod G. Mertes.	41	Vice President, Controller and Treasurer
Henry F. Blissenbach (A)(C)(N).	63	Director
Alexander D. Cross, Ph.D. (A).	73	Director
John Groom (C)(N).	67	Director
Irving S. Johnson, Ph.D. (S).	80	Director
John W. Kozarich, Ph.D. (S).	56	Director
Daniel S. Loeb.	43	Director
Carl C. Peck, M.D. (S).	63	Director
Jeffrey R. Perry.	45	Director
Brigette Roberts, M.D.	30	Director
Michael A. Rocca (A).	61	Director

* as of December 15, 2005

(A) Member of the Audit Committee

(C) Member of the Compensation Committee

(N) Member of the Nominating Committee

(S) Member of the Science and Technology Committee

Executive Officers

David E. Robinson has served as President, Chief Executive Officer and a Director since 1991. Since May 1996, Mr. Robinson has also served as Chairman of the Board. Mr. Robinson was Chief Operating Officer at Erbamont, a pharmaceutical company from 1987 to 1990. From 1984 to 1987 Mr. Robinson was President of Adria Laboratories, Erbamont s North American subsidiary. Before joining Erbamont he was employed in various executive positions for more than 10 years by Abbott Laboratories, most recently as Regional Director of Abbott Europe. Mr. Robinson received his B.A. in political science and history from MacQuaire University, Australia and his M.B.A. from the University of New South Wales, Australia. Mr. Robinson is a Director of BIOCOM San Diego, the Biotechnology Industry Organization and a private company.

Andres F. Negro-Vilar, M.D., Ph.D. joined the Company in September 1996 as Senior Vice President, Research, and Chief Scientific Officer, became Senior Vice President, Research and Development and Chief Scientific Officer in December 1999 and was elected Executive Vice President, Research and Development and Chief Scientific Officer in May 2003. Prior to joining the Company, Dr. Negro-Vilar was Vice President of Research and Head of the Women s Health Research Institute for Wyeth-Ayerst Laboratories from 1993 to 1996.

Table of Contents

From 1983 to 1993, Dr. Negro-Vilar served at the National Institute of Environmental Health Sciences of the National Institutes of Health as the Director of Clinical Programs and Chief of the Laboratory of Molecular and Integrative Neurosciences. Dr. Negro-Vilar received an M.D. from the University of Buenos Aires, Argentina, a Ph.D. in physiology from the University of Sao Paulo, Brazil, and a B.S. in science from Belgrano College.

Taylor J. Crouch joined Ligand in May 2005 as Senior Vice President, Operations and President, International and was elected an officer of the Company in July 2005. Prior to joining Ligand, he was President and Chief Operating Officer of Discovery Partners, Inc., a provider of drug discovery technologies, products and services from July 2002 to January 2005. From March 1999 to April 2002, Mr. Crouch was President and Chief Executive Officer at Variagenics, Inc., a pharmacogenomics firm. From January 1991 to March 1999, Mr. Crouch served as Senior Vice President of PAREXEL International Corporation, a contract research organization. Prior to that, he held various positions over eight years with Schering-Plough International and Pfizer. Mr. Crouch received his B.S. in chemical engineering, *cum laude*, from Princeton University and his M.B.A. in international finance and marketing from The University of Chicago. He is also a director of Bruker BioSciences Corp, a public life sciences company.

James J. L Italien, Ph.D. joined the Company in June 2002 as Senior Vice President, Regulatory Affairs and Compliance. Prior to joining Ligand, Dr. L Italien was Vice President, Global Regulatory Affairs at Baxter BioScience, a division of Baxter Healthcare Corporation. From 1994 to 1998, he served at Amylin Pharmaceuticals, Inc. as Senior Director and then as Vice President, Pharmaceutical Development. Dr. L Italien also has served as Director, Quality and Technical Affairs at Ortho Biotech, a Johnson & Johnson Company (1991 to 1994) and as Associate Director, Analytical Development at SmithKline Beecham (1987 to 1991). Dr. L Italien received his Ph.D. in protein biochemistry from Boston University and a B.S. in chemistry from Merrimack College.

Paul V. Maier joined the Company in October 1992 as Vice President, Chief Financial Officer and became Senior Vice President, Chief Financial Officer in November 1996. Prior to joining the Company, Mr. Maier served as Vice President, Finance at DFS West, a division of DFS Group, L.P., a private multinational retailer from October 1990 to October 1992. From February 1990 to October 1990, Mr. Maier served as Vice President and Treasurer of ICN Pharmaceuticals, Inc., a pharmaceutical and biotechnology research products company. Mr. Maier held various positions in finance and administration at SPI Pharmaceuticals, Inc., a publicly held subsidiary of ICN Pharmaceuticals Group, from 1984 to 1988, including Vice President, Finance from February 1984 to February 1987. Mr. Maier received an M.B.A. from Harvard Graduate School of Business and a B.S. from Pennsylvania State University.

William A. Pettit joined the Company in November 1996 as Senior Vice President, Human Resources and Administration. Prior to joining the Company, Mr. Pettit was Senior Vice President, Human Resources at Pharmacia & Upjohn, Inc., a global pharmaceutical and healthcare company, where he was employed from 1986 to 1996. From 1984 to 1986, Mr. Pettit served as Corporate Director, Human Resources at Browning Ferris Industries, a waste services company. From 1975 to 1984, Mr. Pettit served in various positions at Bristol-Myers Company, now Bristol-Myers Squibb Company, including Director, Human Resources. Mr. Pettit received a B.A. in English from Amherst College.

Warner R. Broaddus joined Ligand in November 2001 as Vice President, General Counsel & Secretary. Prior to joining Ligand, Mr. Broaddus served as General Counsel and Secretary of Invitrogen Corporation, a biotechnology reagents & equipment maker, where he was employed from October 1994 to November 2000. In that capacity he had overall responsibility for the company s legal affairs, including intellectual property, securities and corporate governance. From 1986 to 1990, Mr. Broaddus was an analyst for Morgan Stanley & Co. and UBS Securities, Inc. (now UBS Warburg). Mr. Broaddus holds a J.D. from the University of San Diego and a B.S. from the University of Virginia.

Eric S. Groves, M.D., Ph.D. joined Ligand in August 1999 as Vice President, Project Management. From 1994 until joining Ligand, Dr. Groves held a number of positions at Sanofi Pharmaceuticals, most recently as Vice President, Project Direction where he was responsible for the worldwide strategy of and project direction for late-stage Sanofi oncology projects. From May 1991 through October 1994, Dr. Groves had served as Senior Project Director for the research division of Sterling Winthrop Corporation, and served as acting Vice President, Discovery and Clinical Research, Immunoconjugate Division. He was Director, Clinical Research and Development at CETUS

Corporation from 1989 through 1991. Dr. Groves received his B.S. degree from Massachusetts Institute of

Table of Contents

Technology and his Ph.D. in physics from the University of Pennsylvania. He earned his M.D. at the University of Miami and completed an oncology fellowship at the National Cancer Institute.

Martin D. Meglasson, Ph.D. joined the Company in February 2004 as Vice President, Discovery Research. Prior to joining the Company, Dr. Meglasson was Director of Preclinical Pharmacology and the functional leader for research into urology, sexual dysfunction, and neurological diseases at Pharmacia, Inc. from 1998 to 2003. From 1996 to 1998, Dr. Meglasson served as Director of Endocrine and Metabolic Research and functional leader for diabetes and obesity research at Pharmacia & Upjohn. From 1988 to 1996, he was a researcher in the fields of diabetes and obesity at The Upjohn Co. and Assistant Professor, then Adjunct Associate Professor of Pharmacology at the University of Pennsylvania School of Medicine. Dr. Meglasson received his Ph.D. in pharmacology from the University of Houston.

Tod G. Mertes, CPA joined Ligand in May 2001 as Director of Finance and was elected Vice President, Controller and Treasurer of the Company in May 2003. Prior to joining Ligand, Mr. Mertes was Chief Financial Officer at Combio Corporation and prior to Combio spent 12 years with PricewaterhouseCoopers in San Diego, California and Paris, France, most recently as an audit senior manager. Combio subsequently terminated its operations and filed a petition for bankruptcy in 2001. Mr. Mertes is a Certified Public Accountant and received a B.S. in business administration from California Polytechnic State University at San Luis Obispo.

Board of Directors

Henry F. Blissenbach has served as a Director since May 1995 and currently serves as chair of the Board s Compensation Committee and is a member of the Audit and Nominating Committees. Dr. Blissenbach is currently President and Chief Executive Officer of Bioscrip, Inc., a publicly-held specialty drug distribution and pharmacy benefit management company (Bioscrip), a position he has held since March 2005. Mr. Blissenbach previously served as Chairman and Chief Executive Officer and President and Chief Operating Officer of Chronimed, Inc. which he joined in May 1997. Previously, Dr. Blissenbach served as President of Diversified Pharmaceutical Services, a division of United Health Care, from 1992 to 1997 (now GlaxoSmithKline). He earned his Doctor of Pharmacy (Pharm.D.) degree at the University of Minnesota, College of Pharmacy. He has held an academic appointment in the College of Pharmacy, University of Minnesota, since 1981. Dr. Blissenbach currently serves also as a director of a private company.

Alexander D. Cross, Ph.D. has served as a Director of Company since March 1991 and currently serves as a member of the Board s Audit Committee. Dr. Cross has been an independent consultant in the fields of pharmaceuticals and biotechnology since January 1986. Dr. Cross served as President and Chief Executive Officer of Zoecon Corporation, a biotechnology company, from April 1983 to December 1985, and Executive Vice President and Chief Operating Officer from 1979 to 1983. Dr. Cross is a director of Nastech Pharmaceuticals, a publicly-owned company and two private companies. Dr. Cross received his B.Sc., Ph.D. and D.Sc. degrees from the University of Nottingham, England, and is a Fellow of the Royal Society of Chemistry.

John Groom has served as a Director since May 1995 and currently serves as chair of the Board s Nominating Committee and is a member of the Compensation Committee. In 2001, Mr. Groom retired as President and Chief Operating Officer of Elan Corporation, plc (Elan) having served in that capacity since January 1997. Previously, he was President, Chief Executive Officer and a Director of Athena Neurosciences, Inc. from 1987 until its acquisition by Elan in July 1996. From 1960 until 1985, Mr. Groom was employed by Smith Kline & French Laboratories (SK&F), a division of SmithKline Beckman (now GlaxoSmithKline). He held a number of positions at SK&F including President of SK&F International, Vice President, Europe, and Managing Director, United Kingdom. Mr. Groom currently also serves on the Board of Directors of Amarin Corporation, plc, a public company and is also a director of a private company. Mr. Groom is a Fellow of the Association of Certified Accountants (UK).

Irving S. Johnson, Ph.D. has served as a Director since March 1989 and served as a member of the Board s Compensation and Nominating Committees until March 2005. He currently serves as a member of the Board s Science and Technology Committee and on the Scientific Advisory Board of the Company. Dr. Johnson has been an independent consultant in biomedical research to, and has served as director of, a number of companies since 1989 including service on a number of board committees, including audit. Dr. Johnson has also advised both small

and multinational pharmaceutical companies, government and government organizations, institutes and venture capital groups. From 1953 until his retirement in November 1988, Dr. Johnson held various positions with Eli Lilly & Company, a pharmaceutical company, most recently as Vice President of Research from 1973 until 1988. Dr. Johnson holds a Ph.D. in developmental biology from the University of Kansas and a B.S. in chemistry from Washburn Municipal University.

John W. Kozarich, Ph.D. has served as a Director since March 2003 and currently serves as a member of the Board s Science and Technology Committee. Dr. Kozarich is Chairman and President and a Director of ActivX Biosciences, which he joined in January of 2001. ActivX is a wholly-owned subsidiary of KYORIN Pharmaceutical Company, Tokyo, Japan. From 1992 to 2001 Dr. Kozarich was vice president at Merck Research Laboratories, where he was responsible for a number of research programs. Dr. Kozarich is also a biotechnology professor at the Scripps Research Institute, and previously held faculty positions at the University of Maryland and Yale University School of Medicine. Dr. Kozarich earned his B.S. in chemistry from Boston College, his Ph.D. in biological chemistry from the Massachusetts Institute of Technology, and was an NIH postdoctoral fellow at Harvard.

Daniel S. Loeb has served as a director since December 2005. Mr. Loeb is Founder and CEO of Third Point LLC, an investment management firm founded in 1995. Third Point invests both long and short in securities involved in event driven and special situations. In 1994, prior to founding Third Point, Mr. Loeb was Vice President of High Yield sales at Citigroup, and from 1991 to 1993, he was Senior Vice President in the distressed debt department at Jefferies & Co. Mr. Loeb began his career as an Associate in private equity at Warburg Pincus in 1984. Mr. Loeb is also Chairman of the Board of American Restaurant Group and Director of Fulcrum Pharmaceuticals. Mr. Loeb graduated with an A.B. in Economics from Columbia University.

Carl C. Peck, M.D. has served as a Director since May 1997 and currently serves as chair of the Board s Science and Technology Committee. Dr. Peck has been Professor of Pharmacology and Medicine and Director of the Center for Drug Development Science at Georgetown University Medical Center since September 1994. Dr. Peck was Boerhaave Professor of Clinical Drug Research at Leiden University from November 1993 to July 1995. From October 1987 to November 1993, Dr. Peck was Director, Center for Drug Evaluation and Research of the FDA. He held a number of academic positions prior to October 1987, including Professor of Medicine and Pharmacology, Uniformed Services University, from 1982 to October 1987. Dr. Peck holds an M.D. and a B.S., both from the University of Kansas, as well as an honorary doctorate from the University of Uppsala. Dr. Peck is a director of two private companies.

Jeffrey R. Perry has served as a director since December 2005. Mr. Perry is Senior Advisor of Third Point LLC. From September 2003 to January 2005, Mr. Perry was a partner at Kynikos Associates, Ltd. From 2001 to 2003, Mr. Perry was a senior portfolio manager at SAC Capital Advisors. From 1993 to 2001, Mr. Perry was a general partner and co-Director of Research at Zweig-DiMenna Associates, a large New York-based hedge fund. In all, Mr. Perry has been employed in the money management business for 23 years, the last 17 at senior levels at major hedge funds. He graduated Magna Cum Laude from Georgetown University with a B.A. in American Studies.

Brigette Roberts, M.D. has served as a director since December 2005. Dr. Roberts currently covers healthcare investments for Third Point LLC. Prior to joining Third Point in January 2005, she ran a healthcare portfolio at DKR Capital from 2003 to 2004 and previously worked as an associate healthcare analyst at Sturza s Medical Research in 2002 and Thomas Weisel Partners in 2001. Dr. Roberts graduated from Harvard University with a B.A. in Physics and Chemistry. She then attended NYU Medical School, where she graduated with an M.D. and completed one year of general surgical residency.

Michael A. Rocca has served as a Director since April 1999 and currently serves as chair of the Board s Audit Committee. Mr. Rocca was an independent financial consultant from 2000 to 2004 when he retired. Previously he was Senior Vice President and Chief Financial Officer of Mallinckrodt, Inc., a global manufacturer and marketer of specialty medical products, a position he held from April 1994 to October 2000. From 1966 until 1994, Mr. Rocca was employed by Honeywell, Inc., a control technology company. He held a number of positions at Honeywell which included Vice President and Treasurer, Vice President of Finance, Europe, and Vice President and Controller International. Mr. Rocca currently serves on the board of directors of Lawson Software Inc., and St. Jude Medical, Inc., both public companies. Mr. Rocca earned his BBA in accounting from the University of Iowa.

95

Table of Contents

Board Composition and Committees

Our board of directors is currently composed of eleven members, including 10 non-employee members and our current President and Chief Executive Officer, David E. Robinson.

Messrs. Loeb and Perry and Dr. Roberts (the Third Point Designees) were initially elected to the board of directors on December 8, 2005 pursuant to a Stockholders Agreement the Company entered into on December 2, 2005 with Third Point LLC and its affiliated entities. The Third Point Designees were nominated and recommended for election to the board of directors at the January 2006 annual meeting of our stockholders and at such annual meeting were re-elected.

Board Committees

The board of directors has established four committees: an Audit Committee, a Nominating Committee, a Compensation Committee and a Science and Technology Committee. Each committee is described below. The Board has determined that each member of these committees meets the applicable rules and regulations regarding independence and that each member is free of any relationship that would interfere with his or her individual exercise of independent judgment with regard to the Company.

The Audit Committee was established in March 1992 and is primarily responsible for overseeing the Company s accounting and financial reporting processes, auditing of financial statements, systems of internal control, and financial compliance programs. This Committee currently consists of Dr. Cross and Messrs. Blissenbach and Rocca, each of whom is independent as defined under Rule 4350 of the NASDAQ listing standards. The Audit Committee held seven meetings and five telephonic meetings during 2004. The Audit Committee is governed by a written charter approved by the Board of Directors, which was last amended in May 2004 and is attached as Appendix A. After reviewing the qualifications of all current Committee members and any relationship they may have that might affect their independence from the Company, the Board has determined that (i) all current Committee members are independent as that concept is defined under Section 10A of the Exchange Act, (ii) all current Committee members are independent as that concept is defined under the NASDAQ National Market listing standards, (iii) all current Committee members have the ability to read and understand financial statements and (iv) Michael A. Rocca qualifies as an audit committee financial expert. The latter determination is based on a qualitative assessment of Mr. Rocca s level of knowledge and experience based on a number of factors, including his formal education and experience, for example as a chief financial officer of a public company.

The Nominating Committee was established in December 2001 and is responsible for identifying and recommending candidates for director of the Company. The Committee is governed by a written charter which was adopted in 2003 and attached to the Company s proxy statement for the 2004 annual meeting as Appendix B. In addition, a free copy of the Nominating Committee charter may be requested by writing to: Investor Relations, Ligand Pharmaceuticals Incorporated, 10275 Science Center Drive, San Diego, CA 92121. The Committee is chaired by Mr. Groom and its current members are Messrs. Blissenbach and Groom. Each member is an independent director under Rule 4200(a)(15) of the NASDAQ listing standards. The Nominating Committee held two meetings during 2004.

The Nominating Committee considers nominees recommended by stockholders, if submitted in writing to the Secretary at the Company s principal executive offices and accompanied by the author s full name, current address and telephone number. The Committee received no 5% stockholder nominations for the January 2006 annual meeting of our stockholders. The Committee has set no specific minimum qualifications for candidates it recommends, but considers each individual s qualifications, such as high personal integrity and ethics, relevant expertise and professional experience, as a whole. The Committee considers candidates throughout the year and makes recommendations as vacancies occur or the size of the Board expands. Candidates are identified from a variety of sources including recommendations by stockholders, current directors, management, and other parties and the Committee considers all such candidates in the same manner, regardless of source. Under its charter the Committee may retain a paid search firm to identify and recommend candidates but has not done so to date.

The Compensation Committee was established in March 1992 and reviews and approves the Company s compensation policies, sets executive officers compensation and administers the Company s stock option and stock

Table of Contents

purchase plans. This committee is chaired by Mr. Blissenbach and currently consists of Messrs. Blissenbach and Groom. Each member is an independent director under Rule 4200(a)(15) of the NASDAQ listing standards. The Compensation Committee held five meetings and one telephonic meeting and acted by unanimous written consent once during 2004.

The Science & Technology Committee of the Board was established in March 2005 to review the Company s overall research and development strategy, research and development projects, and to advise the Board and the President and Chief Executive Officer of the Company regarding future research and development efforts. The Committee is chaired by Dr. Peck and currently consists of Drs. Peck, Johnson and Kozarich.

Compensation Committee Interlocks and Insider Participation

During fiscal 2004, the Compensation Committee was composed of Messrs. Blissenbach and Groom and Dr. Johnson. Dr. Johnson resigned from the Compensation Committee in March 2005. No member of the Compensation Committee was at any time during the 2004 fiscal year or at any other time an officer or employee of the Company. No executive officer of the Company served on the board of directors or compensation committee of any entity which has one or more executive officers serving as members of the Company s Board of Directors or Compensation Committee.

Director Compensation

Non-employee Board members are paid fees for their Board service and are reimbursed for expenses incurred in connection with such service. Each director receives an annual fee of $10,000, plus $2,500 per day for each Board meeting attended, $1,000 per day for each committee meeting attended on non-Board meeting dates and $500 per day for each Board or committee meeting in which he participates by telephone. In addition, the Audit Committee Chairman receives an annual fee of $15,000 and the Compensation Committee Chairman receives an annual fee of $2,500. Under a commitment with Dr. Johnson, the Company also pays him $4,000 for each day of service as a member of the Scientific Advisory Board or as a consultant to the Company. The Company also reimburses Dr. Johnson for all reasonable and necessary travel and other incidental expense incurred in connection with such duties.

Non-employee Board members are also eligible to participate in the Automatic Option Grant Program in effect under the 2002 Stock Incentive Plan. At the 2004 annual meeting of stockholders, each of Messrs. Blissenbach, Groom and Rocca and Drs. Cross, Johnson, Kozarich and Peck were granted automatically an option to purchase 10,000 shares of common stock with an exercise price of $17.16 per share, the fair market value per share of common stock on the date of their re-election as a non-employee Board member. At their election to the Board on December 8, 2005, Messrs. Loeb and Perry and Dr. Roberts each were granted automatically an option to purchase 20,000 shares of common stock with an exercise price of $11.35 per share, the fair market value on that date. At the 2006 annual meeting of stockholders, each of Messrs. Blissenbach, Groom and Rocca and Drs. Cross, Johnson, Kozarich and Peck were granted automatically an option to purchase 10,000 shares of common stock with an exercise price of $12.40 per share, the fair market value per share of common stock on the date of their re-election as a non-employee Board member.

Each of the options granted under the Automatic Option Grant Program becomes exercisable for all the option shares upon completion of one year of Board service. Each option has a maximum term of 10 years measured from the grant date, subject to earlier termination following the optionee s cessation of Board service. For further information concerning such automatic option grants to directors, please see Automatic Option Grant Program discussion below.

Non-employee directors continuing in office on January 1, 2005 were permitted to elect to apply all or a portion of their 2005 cash fees to the acquisition of a special discounted stock option under the Director Fee Option Grant Program of the 2002 Stock Incentive Plan. On January 3, 2005, in connection with such election the directors listed below were each granted an option for the number of shares shown. The numbers include each director s option grants under this program for 2005.

Table of Contents

2005 Director Fee Option Grants

Name	Option Shares
Henry F. Blissenbach	2,009
Alexander D. Cross, Ph.D	1,841
John Groom	3,683
Irving S. Johnson, Ph.D	1,841
John W. Kozarich, Ph.D	3,683
Carl C. Peck, M.D	1,841

Each option has an exercise price of $3.733 per share, one-third of the fair market value per share of common stock on the grant date, which was $11.20. Accordingly, the fair market value of those shares less the aggregate exercise price was equal to the cash fees for 2005 that such Board member elected to apply to the grant. Each option becomes exercisable in a series of 12 successive equal monthly installments upon the optionee s completion of each month of Board service during the 2005 calendar year. Each option has a maximum term of 10 years measured from the grant date, subject to earlier termination three years following the optionee s cessation of Board service.

The Director Fee Option Grant Program (the Program) is implemented under the 2002 Stock Incentive Plan for each calendar year until otherwise determined by the Compensation Committee. In December 2005, the Compensation Committee suspended the Program for calendar year 2006 due to requirements of state blue sky laws. The Program may resume upon compliance with applicable laws and approval of the Compensation Committee.

Under the Program, each non-employee Board member may elect, prior to the start of each calendar year, to apply all or any portion of the annual fees otherwise payable in cash for his or her period of service on the Board for that year to the acquisition of a special discounted option grant. The option grant is a non-statutory option under the federal tax laws and is automatically made on the first trading day in January in the calendar year for which the director fee election is in effect. The option has a maximum term of 10 years measured from the grant date and an exercise price per share equal to one-third of the fair market value of the option shares on such date. The number of shares subject to each option is determined by dividing the amount of the annual fees applied to the acquisition of that option by two-thirds of the fair market value per share of common stock on the grant date. As a result, the total spread on the option (the fair market value of the option shares on the grant date less the aggregate exercise price payable for those shares) is equal to the portion of the annual fees applied to the acquisition of the option. The dollar amount of the fee subject to the Board member s election each year is equal to his or her annual retainer fee, plus the number of regularly-scheduled Board meetings for that year multiplied by the per Board meeting fee in effect for such year. Under the 2002 Stock Incentive Plan, the current annual dollar amount of the fee that can be applied is $27,500 for each non-employee director, plus $15,000 for the Audit Committee chair or $2,500 for the Compensation Committee chair.

Table of Contents

Our Compensation Committee has approved the issuance of shares of restricted stock to certain of our non-employee directors pursuant to the Stock Issuance Program under the 2002 Plan. The following directors were issued the following number of shares of restricted stock: John W. Kozarich, 2,378 shares; Daniel S. Loeb, 2,378 shares; Carl C. Peck, 2,378 shares; Jeffrey R. Perry, 2,378 shares; Brigette Roberts, M.D., 2,378 shares; and Michael A. Rocca, 3,676 shares. Each such director elected to apply his right to receive all or a portion of his directors fees during 2006 to the acquisition of shares of restricted stock. The purchase price for the shares of restricted stock was equal to $11.56, the fair market value of our common stock on the date of purchase. The number of shares of restricted stock purchased by each director was determined by dividing (1) the dollar amount of the director fees he elected to apply to the acquisition of shares of restricted stock by (2) $11.56. Each such director will no longer have any right to receive payment in cash of the directors fees applied to the purchase of the restricted stock. The shares of restricted stock will be subject to forfeiture in the event a director s service on the Board of Directors terminates for any reason prior to the date on which such shares vest. The shares of restricted stock will vest in 12 successive equal monthly installments upon the director s completion of each calendar month of service on the Board of Directors during 2006, with the first installment vesting on January 31, 2006.

All options previously granted to non-employee directors and outstanding on December 31, 2005 had a cash settlement feature in the event of a Hostile Take-Over/Hostile Tender Offer, as defined under the 2002 Plan and in the option agreements. Under SFAS 123R, this cash settlement feature would have required the Company to reclassify those options as a liability rather than equity, to revalue the options at fair value and to recognize a corresponding expense and reduction in net income in 2006. On December 31, 2005, the Company entered into an amendment with each of its non-employee directors to remove the cash settlement feature in each outstanding option agreement in order to avoid the reclassification of these options and the projected 2006 impact on the Company s financial results.

Executive Compensation

The following table summarizes the compensation earned by the Named Executive Officers, i.e. the Chief Executive and the next four most highly-compensated executive officers, for services rendered in all capacities to the Company and its subsidiaries for the fiscal years ended December 31, 2005, 2004 and 2003:

Table of Contents

SUMMARY COMPENSATION TABLE

		Annual Compensation				
Name and Principal Position	**Year**	**Salary($) (1)**	**Bonus($)**	**Other Annual Compensation ($)(2)**	**Long-Term Compensation Awards Securities Underlying Options/ SARs(#)**	**All Other Compensation($)(3)**
David E. Robinson	2005	666,667	(4)		100,000	2,322
Chairman of the Board,	2004	643,333		188,049	150,000	2,322
President and CEO	2003	623,333	250,000	334,966	175,000	2,322
Andres F. Negro-Vilar	2005	450,000	(4)		35,000	6,858
Executive Vice President,	2004	423,800	70,000	142,987	30,000	3,564
Research and Development and Chief Scientific Officer	2003	407,500	91,750	211,352	75,000	3,564
Paul V. Maier	2005	335,000	(4)		35,000	2,322
Senior Vice President,	2004	304,750		31,665	30,000	2,322
Chief Financial Officer	2003	287,500	63,250	54,268	75,000	2,322
Warner R. Broaddus	2005	286,000	(4)		20,000	526
Vice President, General	2004	238,140	35,000		20,000	493
Counsel and Secretary	2003	220,500	44,100		25,000	461
Tod G. Mertes	2005	240,000	60,000(4)		15,000	468
Vice President, Controller	2004	200,000	30,000		20,000	381
and Treasurer	2003	158,151	40,000		37,500	283

(1) Compensation deferred at the election of the executive, pursuant to the Ligand Pharmaceuticals 401(k) Plan and Ligand Deferred Compensation Plan are included in the year earned.

(2) Amounts represent the value of excess earnings on contributions to the Deferred Compensation Plan that were either paid or for which payment was deferred at the election of the officer. Amounts for the 2005 fiscal year will be determined after the date of this prospectus. Messrs. Broaddus and Mertes do not participate in Ligand s Deferred Compensation Plan.

(3) Amounts represent the value of life insurance premiums.

(4) Bonuses (or additional bonus) to be paid to the Named Executive Officers for services rendered during 2005 will be determined after the date of this prospectus.

Stock Awards. The following table provides information on the option grants made to the Named Executive Officers, i.e. the Chief Executive Officer and the next four most highly-compensated executive officers, during the fiscal year ended December 31, 2005. For all employees (including the executive officers, but excluding the non-employee directors), options to purchase a total of 951,382 shares of stock were granted during the same fiscal

year. No stock appreciation rights were granted to the Named Executive Officers during that fiscal year.

Table of Contents

OPTION/SAR GRANTS IN LAST FISCAL YEAR
Individual Grants

Name	Number of Securities Underlying Options/SARs Granted (#)	% of Total Options/SARs Granted to Employees in Fiscal Year	Exercise or Base Price ($/Sh)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term 5%($)	10%($)
David E. Robinson	100,000	10.5110	7.25	7/5/15	455,949	1,155,463
Andres F. Negro-Vilar	35,000	3.6789	7.25	7/5/15	159,582	404,412
Paul V. Maier	35,000	3.6789	7.25	7/5/15	159,582	404,412
Warner R. Broaddus	20,000	2.1022	7.25	7/5/15	91,190	231,093
Tod G. Mertes	15,000	1.5767	7.25	7/5/15	68,392	173,320

Each option has a maximum term of 10 years measured from such grant date, subject to earlier termination upon the optionee s cessation of service with the Company. The shares subject to each option are only exercisable if vested and will vest 12.5% upon six months of service after grant and after that, in 42 monthly installments. The vesting of the shares subject to the options granted to Mr. Robinson will accelerate in connection with his termination of employment under certain circumstances, including a change in control of the Company. The shares subject to the options granted to the other Named Executive Officers will immediately vest in full in the event their employment were to terminate following certain changes in control of the Company. These arrangements are described below in Employment, Severance and Change of Control Arrangements with Executive Officers.

The Plan Administrator may grant tandem stock appreciation rights in connection with option grants which require the holder to elect between the exercise of the underlying option for shares of common stock and the surrender of such option for a distribution from the Company, payable in cash or shares of common stock, based upon the appreciated value of the option shares.

The exercise price may be paid in cash, in shares of common stock valued at fair market value on the exercise date or through a cashless exercise procedure involving a same-day sale of the purchased shares. The optionee may be permitted, subject to the approval of the plan administrator, to apply a portion of the shares purchased under the option, or to deliver existing shares of common stock, in satisfaction of such tax liability.

The Company does not provide assurance to any executive officer or any other holder of the Company s securities that the actual stock price appreciation over the 10-year option term will be at the assumed 5% and 10% levels or at any other defined level. Unless the market price of the common stock does in fact appreciate over the option term, no value will be realized from the option grants made to the executive officers.

The following table shows information concerning option exercises and holdings for the year ended December 31, 2005 with respect to each of the Named Executive Officers. No stock appreciation rights were exercised by the named Executive Officers during such fiscal year, and no stock appreciation rights were held by them at the end of such fiscal year.

Table of Contents

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

			Number of Securities Underlying Unexercised Options/SARs at December 31, 2005		Value of Unexercised In-the-Money Options/SARs at December 31, 2005	
Name	**Shares acquired on exercise**	**Value realized ($)**	**Exercisable (#)**	**Unexercisable (#)**	**Exercisable ($)**	**Unexercisable ($)**
David E. Robinson	0	0	891,667	158,333	433,167	500,833
Andres Negro-Vilar	0	0	380,875	60,000	349,783	184,000
Paul V. Maier	0	0	325,477	60,000	236,754	184,000
Warner R. Broaddus	0	0	96,667	28,333	31,667	93,833
Tod G. Mertes	0	0	59,844	27,656	41,633	79,492

Value realized on exercise is based upon the market price of the purchased shares on the exercise date less the option exercise price paid for those shares. Value of unexercised in-the-money options is equal to the fair market value of the securities underlying the option at fiscal year-end, $11.15 per share, less the exercise price payable for those securities.

Employment, Severance and Change of Control Arrangements with Named Executive Officers

In May 1996, the Company entered into an employment agreement with Mr. Robinson pursuant to which he is to be employed as President and Chief Executive Officer. This agreement automatically renewed for three years on May 1, 2005, i.e. until May 1, 2008, and will automatically be renewed for successive additional three year terms unless earlier terminated by the Company or Mr. Robinson. During the remainder of the employment term, Mr. Robinson will receive a base salary per year and annual incentive bonuses based upon his performance and the Company s attainment of designated performance goals. If Mr. Robinson s employment is terminated without cause, or if he resigns for specified reasons, such as

a change in position, duties and responsibilities without consent,

a reduction in salary or benefits, or

certain events occurring upon a change in control of the Company,

he will be entitled to a severance payment equal to 24 months of base salary, at the rate in effect for him at the time of such termination, and all of his outstanding options will, except under certain limited circumstances, vest and become exercisable for all the option shares on an accelerated basis in connection with his termination of employment, including a termination following a change in control of the Company.

In September 1996, the Company entered into an employment agreement with Dr. Negro-Vilar pursuant to which he is employed as Executive Vice President, Research and Chief Scientific Officer for an unspecified term. The agreement provides that Dr. Negro-Vilar is an at-will employee. In the event his employment is terminated without cause, he will be entitled to 12 months of salary continuation payments, and all of his outstanding options will immediately vest and become exercisable for all of the option shares.

In September 1992, Ligand entered into an employment agreement with Paul V. Maier pursuant to which Mr. Maier is employed as Senior Vice President and Chief Financial Officer for an unspecified term. The agreement provides that Mr. Maier is an at-will employee. If Mr. Maier s employment is terminated by the Company without cause, he will be entitled to six months base salary.

In December 2005 the Company entered into an agreement with Mr. Mertes that provides for certain severance and retention or stay bonus payments under specified circumstances. If Mr. Mertes employment is involuntarily

Table of Contents

terminated as defined in the agreement, prior to December 31, 2006, Mr. Mertes is entitled to receive a payment equal to 12 months regular salary. If Mr. Mertes remains employed and available for work through December 31, 2006, he is entitled to receive a stay bonus of four months salary. Mr. Mertes may receive all or part of the stay bonus if he is involuntarily terminated in connection with a change of control on or before December 31, 2006.

The Company has entered into an agreement with each employee holding one or more outstanding options under the 2002 Plan, including each of the Named Executive Officers other than Mr. Robinson, pursuant to which such options will automatically vest on an accelerated basis in the event that such individual s employment is terminated following:

an acquisition of the Company by merger or asset sale or

a change in control of the Company effected through a successful tender offer for more than 50% of the Company s outstanding common stock or through a change in the majority of the Board as a result of one or more contested elections for Board membership.

The Company has entered into severance agreements with each of the Named Executive Officers and the other executive officers other than Mr. Robinson pursuant to which such individuals will, in the event their employment is involuntarily terminated in connection with a change in control of the Company, receive a severance benefit equal to

one times the annual rate of base salary in effect for such officer at the time of involuntary termination plus

one times the average of bonuses paid to such officer for services rendered in the two fiscal years immediately preceding the fiscal year of involuntary termination. The severance amount will be payable in 12 monthly installments following the officer s termination of employment.

Employee Benefit and Stock Plans

2002 Stock Incentive Plan

The 2002 Stock Incentive Plan contains four separate equity programs:

the Discretionary Option Grant Program,

the Automatic Option Grant Program,

the Stock Issuance Program, and

the Director Fee Option Grant Program.

The principal features of these programs are described below. The 2002 Plan is administered by the Compensation Committee of the Board. This committee has complete discretion, subject to the provisions of the 2002 Plan, to authorize option grants and direct stock issuances under the 2002 Plan. However, the Board may also appoint a secondary committee of one or more Board members to have separate but concurrent authority to make option grants and stock issuances under those programs to all eligible individuals other than the Company s executive officers and non-employee Board members. The term Plan Administrator, as used in this registration statement, will mean either the Compensation Committee or any secondary committee, to the extent each such entity is acting within the scope of its duties under the 2002 Plan. The Plan Administrator does not exercise any administrative discretion under the Automatic Option Grant or Director Fee Option Grant Program for the non-employee Board members. All grants under those programs are made in strict compliance with the express provisions of each such program.

Table of Contents

Issuable Shares

Since its adoption, a total of 8,325,529 shares of common stock have been reserved for issuance under the 2002 Plan (including shares transferred from the predecessor plan). As of December 31, 2005, options for 7,002,507 shares of common stock were outstanding under the 2002 Plan, 54,914 shares remained available for future option grant or direct issuance, and 5,525,899 shares have been issued under the 2002 Plan.

In no event may any one participant in the 2002 Plan receive options, separately exercisable stock appreciation rights and direct stock issuances for more than one million shares in any calendar year. If an option expires or is terminated for any reason before all its shares are exercised, the shares not exercised will be available for subsequent option grants or stock issuances under the 2002 Plan. Unvested shares issued under the 2002 Plan and subsequently repurchased by or forfeited to the Company will be added back to the number of shares of common stock reserved for issuance under the 2002 Plan. Accordingly, such repurchased or forfeited shares will be available for reissuance through one or more subsequent option grants or direct stock issuances under the 2002 Plan. However, shares subject to any option surrendered or canceled in accordance with the stock appreciation right provisions of the 2002 Plan will reduce on a share-for-share basis the number of shares of common stock available for subsequent grants.

Should any change be made to the common stock issuable under the 2002 Plan by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding common stock as a class without the Company s receipt of consideration, then appropriate adjustments will be made to

- the maximum number and/or class of securities issuable under the 2002 Plan;
- the number and/or class of securities for which any one person may be granted options, separately exercisable stock appreciation rights and direct stock issuances per calendar year under the 2002 Plan;
- the number and/or class of securities for which grants are to be made under the Automatic Option Grant Program to new or continuing non-employee Board members;
- the number and/or class of securities and price per share in effect under each outstanding option; and
- the number and/or class of securities and the exercise price per share in effect under each outstanding option under the 2002 Plan.

Such adjustments to the outstanding options will be effected in a manner which will preclude the enlargement or dilution of rights and benefits under those options.

Eligibility

Officers and employees of the Company and its parent or subsidiaries, whether now existing or subsequently established, non-employee members of the Board and consultants and independent contractors of the Company and its parent and subsidiaries will be eligible to participate in the 2002 Plan.

Discretionary Grant Program

Grants

The Plan Administrator has complete discretion under the Discretionary Option Grant Program to determine which eligible individuals are to receive option grants, the time or times when those grants are to be made, the number of shares subject to each such grant, the status of any granted option as either an incentive stock option or a non-statutory option under the federal tax laws, the vesting schedule (if any) to be in effect for the option grant and the maximum term (up to 10 years) for which any granted option is to remain outstanding.

Table of Contents

Price and Exercisability

Each granted option will have an exercise price per share not less than 100% of the fair market value per share of common stock on the option grant date, and no granted option will have a term in excess of 10 years. The shares subject to each option will generally become exercisable for fully-vested shares in a series of installments over a specified period of service measured from the grant date. However, one or more options may be structured so that they are immediately exercisable for any or all of the option shares. The shares acquired under such immediately-exercisable options will normally be unvested and subject to repurchase by the Company.

The exercise price may be paid in cash or in shares of common stock. Outstanding options may also be exercised through a same-day sale program pursuant to which a designated brokerage firm is to effect an immediate sale of the shares purchased under the option and pay to the Company, out of the sale proceeds available on the settlement date, sufficient funds to cover the exercise price for the purchased shares plus all applicable withholding taxes.

No optionee has any stockholder rights with respect to the option shares until such optionee has exercised the option and paid the exercise price for the purchased shares. Options are generally not assignable or transferable other than by will or the laws of inheritance and, during the optionee s lifetime, the option may be exercised only by such optionee. However, the Plan Administrator may allow non-statutory options to be transferred or assigned during the optionee s lifetime to one or more members of the optionee s immediate family or to a trust established exclusively for one or more such family members or to the optionee s former spouse, to the extent such transfer or assignment is in furtherance of the optionee s estate plan or pursuant to a domestic relations order. The optionee may also designate one or more beneficiaries to automatically receive his or her outstanding options at death.

Termination of Service

Upon cessation of service, the optionee will have a limited period of time in which to exercise his or her outstanding options for any shares in which the optionee is vested at that time. The Plan Administrator has discretion to extend the period following the optionee s cessation of service during which his or her outstanding options may be exercised, up to the date of the option s expiration and/or to accelerate the exercisability or vesting of such options in whole or in part.

Cancellation/Regrant

In April 2003, the Board amended the 2002 Plan to remove the cancellation and regrant provision. Thus the 2002 Plan does not provide for the cancellation and regrant of outstanding options.

Stock Issuance Program

Shares may be sold under the Stock Issuance Program at a price per share not less than their fair market value, payable in cash. Shares may also be issued in consideration of past services without any cash outlay required of the recipient. Shares of common stock may also be issued under the Stock Issuance Program pursuant to share right awards which entitle the recipients to receive those shares upon the attainment of designated performance goals or completion of a specified service period. The Plan Administrator has complete discretion under this program to determine which eligible individuals are to receive such stock issuances or share right awards, the time or times when such issuances or awards are to be made, the number of shares subject to each such issuance or award and the vesting schedule to be in effect for the stock issuance or share rights award.

The shares issued may be fully and immediately vested upon issuance or may vest upon the recipient s completion of a designated service period or upon the Company s attainment of pre-established performance goals. The Plan Administrator has, however, the discretionary authority at any time to accelerate the vesting of any and all unvested shares outstanding under the Stock Issuance Program.

Any unvested shares for which the requisite service requirement or performance objective is not obtained must be surrendered to the Company for cancellation, and the participant will not have any further stockholder rights with respect to those shares. The Company will, however, repay the participant the lower of (i) the cash amount paid for the surrendered shares or (ii) the fair market value of those shares at the time of the participant s cessation of service.

Table of Contents

Outstanding share right awards under the Stock Issuance Program will automatically terminate, and no shares of common stock will actually be issued in satisfaction of those awards, if the performance goals established for such awards are not attained. The Plan Administrator, however, has the discretionary authority to issue shares of common stock in satisfaction of one or more outstanding share right awards as to which the designated performance goals are not attained.

Automatic Option Grant Program

Grants

Under the Automatic Option Grant Program, eligible non-employee Board members receive a series of option grants over their period of Board service. Each individual who first becomes a non-employee Board member at any time on or after the effective date receives an option grant for 20,000 shares of common stock on the date such individual joins the Board, provided such individual has not been in the prior employ of the Company. In addition, on the date of each annual stockholders meeting held after the effective date, each non-employee Board member who is to continue to serve as a non-employee Board member (including individuals who joined the Board prior to the effective date) is automatically granted an option to purchase 10,000 shares of common stock, provided such individual has served on the Board for at least six months. There is no limit on the number of such 10,000-share option grants any one eligible non-employee Board member may receive over his or her period of continued Board service, and non-employee Board members who have previously been in the Company s employ are eligible to receive one or more such annual option grants over their period of Board service.

Option Terms

Each automatic grant has an exercise price per share equal to the fair market value per share of common stock on the grant date and has a maximum term of 10 years. The shares subject to each automatic option grant (whether the initial grant or an annual grant) fully vest and become exercisable upon the completion of one year of Board service measured from the grant date. Additionally, the shares subject to each automatic option grant immediately vest in full upon certain changes in control or ownership of the Company or upon the optionee s death or disability while a Board member. Each option granted under the program remains exercisable for vested shares until the earlier of (i) the expiration of the 10-year option term or (ii) the expiration of the 3-year period measured from the date of the optionee s cessation of Board service.

Director Fee Option Grant Program

The Director Fee Option Grant Program is implemented for each calendar year until otherwise determined by the Plan Administrator. Under the Director Fee Option Grant Program, each non-employee Board member may elect, prior to the start of each calendar year, to apply all or any portion of the annual fees otherwise payable in cash for his or her period of service on the Board for that year to the acquisition of a special discounted option grant. The option grant is a non-statutory option under the federal tax laws and is automatically made on the first trading day in January in the calendar year for which the director fee election is in effect. The option has a maximum term of 10 years measured from the grant date and an exercise price per share equal to one-third of the fair market value of the option shares on such date. The number of shares subject to each option is determined by dividing the amount of the annual fees applied to the acquisition of that option by two-thirds of the fair market value per share of common stock on the grant date. As a result, the total spread on the option (the fair market value of the option shares on the grant date less the aggregate exercise price payable for those shares) is equal to the portion of the annual fees applied to the acquisition of the option. The dollar amount of the fee subject to the Board member s election each year is equal to his or her annual retainer fee, plus the number of regularly-scheduled Board meetings for that year multiplied by the per Board meeting fee in effect for such year. Under the 2002 Plan, the current annual dollar amount of the fee that can be applied is $27,500 for each non-employee director, plus $15,000 for the Audit Committee chair or $2,500 for the Compensation Committee chair.

The option is exercisable in a series of 12 successive equal monthly installments upon the optionee s completion of each month of Board service in the calendar year for which the fee election is in effect, subject to full and immediate acceleration upon certain changes in control or ownership of the Company or upon the optionee s death or disability while a Board member. Each option granted under the program remains exercisable for vested shares

Table of Contents

until the earlier of (i) the expiration of the 10-year option term or (ii) the expiration of the 3-year period measured from the date of the optionee s cessation of Board service.

The options granted in 2005 under the Program are subject to Section 409A of the Internal Revenue Code of 1986, as amended, and the Treasury regulations thereunder (the Code). Each such option that is outstanding on December 31, 2005 was amended to provide that such option will be either a) exercised on or before March 15, 2006 or b) automatically exercisable for 2 ½ months following the first to occur of (1) the director s death or disability, (2) the director s separation from service with the Company, within the meaning of Section 409A of the Code, (3) a change in the ownership or effective control of the Company, or in the ownership of a substantial portion of the assets of the Company, within the meaning of Section 409A of the Code, or (4) January 2, 2015. All other terms of such options will remain the same.

The Board has approved an amendment to the 2002 Plan to bring the Director Fee Option Grant Program into compliance with Section 409A of the Code. Such amendment provides that the options granted pursuant to the Director Fee Option Grant Program will be automatically exercised upon the first to occur of (1) the director s death or disability, (2) the director s separation from service with the Company, within the meaning of Section 409A of the Code, (3) a change in the ownership or effective control of the Company, or in the ownership of a substantial portion of the assets of the Company, within the meaning of Section 409A of the Code, or (4) the tenth anniversary of the date of grant or it may be exercised only on or before March 15, 2006 and, if not exercised by that date, will be automatically exercised on March 15, 2006. All other terms of the Program will remain in effect. Non-employee Board members elected, prior to December 31, 2005, whether to participate in the Program during 2006 in the event the Program is reinstated during 2006.

General Plan Provisions

Valuation

For all valuation purposes under the 2002 Plan, the fair market value per share of common stock on any date is deemed equal to the closing selling price per share on that date. If there is no reported selling price for such date, then the fair market value per share is the closing selling price on the last preceding date for which such quotation exists.

Vesting Acceleration

In the event that the Company is acquired by merger or asset sale, each outstanding option under the Discretionary Option Grant Program which is not to be assumed by the successor corporation will automatically accelerate in full, and all unvested shares under the Discretionary Option Grant and Stock Issuance Programs will immediately vest, except to the extent the Company s repurchase rights with respect to those shares are to be assigned to the successor corporation. The Plan Administrator has complete discretion to grant one or more options under the Discretionary Option Grant Program which will become fully exercisable for all the option shares in the event those options are assumed in the acquisition and the optionee s service with the Company or the acquiring entity is involuntarily terminated within a designated period (not to exceed 18 months) following such acquisition.

The vesting of outstanding shares under the Stock Issuance Program may be accelerated upon similar terms and conditions. The Plan Administrator also has the authority to grant options which will immediately vest upon an acquisition of the Company, whether or not those options are assumed by the successor corporation.

The Plan Administrator is also authorized under the Discretionary Option Grant and Stock Issuance Programs to grant options and to structure repurchase rights so that the shares subject to those options or repurchase rights will immediately vest in connection with a change in ownership or control of the Company (whether by successful tender offer for more than 50% of the outstanding voting stock or by a change in the majority of the Board by reason of one or more contested elections for Board membership). Such accelerated vesting may occur either at the time of such change in ownership or control or upon the subsequent involuntary termination of the individual s service within a designated period (not to exceed 18 months) following such change in ownership or control.

The shares subject to each option under the Automatic Option Grant and Director Fee Option Grant Programs immediately vest upon (i) an acquisition of the Company by merger or asset sale, (ii) the successful completion of a

Table of Contents

tender offer for more than 50% of the Company s outstanding voting stock or (iii) a change in the majority of the Board effected through one or more contested elections for Board membership.

The acceleration of vesting in the event of a change in the ownership or control of the Company may be seen as an anti-takeover provision and may have the effect of discouraging a merger proposal, a takeover attempt or other efforts to gain control of the Company.

Stock Appreciation Rights

The Plan Administrator is authorized to issue tandem stock appreciation rights in connection with option grants made under the Plan. Tandem stock appreciation rights, which may be granted under the Discretionary Option Grant Program, provide the holders with the right to surrender their options for an appreciation distribution from the Company equal in amount to the excess of (a) the fair market value of the vested shares of common stock subject to the surrendered option over (b) the aggregate exercise price payable for those shares. Such appreciation distribution may, at the discretion of the Plan Administrator, be made in cash or in shares of common stock.

Amendment and Termination

The Board may amend or modify the 2002 Plan at any time, subject to any required stockholder approval pursuant to applicable laws and regulations. Unless sooner terminated by the Board, the 2002 Plan will terminate on the *earlier* of

March 7, 2012 or

the termination of all outstanding options in connection with certain changes in control or ownership of the Company.

2002 Employee Stock Purchase Plan

Share Reserve and Plan Administration

Since its adoption in 2002, a total of 510,248 shares of common stock have been reserved for issuance under the 2002 ESPP. This total includes 35,248 shares transferred from the previous (1992) employee stock purchase plan. As of December 31, 2005, 362,738 shares of common stock had been issued under the 2002 ESPP, and 147,510 shares are available for future issuance.

Should any change be made to our outstanding common stock by reason of any stock dividend, stock split, exchange or combination of shares or other similar change affecting the outstanding common stock as a class without the Company s receipt of consideration, appropriate adjustments will be made to

the class and maximum number of securities issuable over the term of the 2002 ESPP,

the class and maximum number of securities purchasable per participant on any purchase date and

the class and number of securities and the price per share in effect under each outstanding purchase right.

Such adjustments are designed to preclude the dilution or enlargement of rights and benefits under the 2002 ESPP.

The 2002 ESPP is administered by the Compensation Committee of the Board of Directors (the Plan Administrator). As Plan Administrator, the committee has full authority to administer the 2002 ESPP, including the authority to interpret and construe any provision of the 2002 ESPP.

Offering Periods and Purchase Rights

Common stock is offered for purchase under the 2002 ESPP through a series of successive offering periods, each with a maximum duration (not to exceed 24 months) specified by the Plan Administrator prior to the start date.

Table of Contents

At the time a participant joins the offering period, he or she is granted a purchase right to acquire shares of common stock at quarterly intervals over the remainder of that offering period. Each participant may authorize periodic payroll deductions in any multiple of 1% (up to a maximum of 10%) of his or her total cash earnings to be applied to the acquisition of common stock at quarterly intervals. The purchase dates occur on the last business days of March, June, September and December of each year, and all payroll deductions collected from the participant for the three month period ending with each such quarterly purchase date are automatically applied to the purchase of common stock on that date provided the participant remains an eligible employee and does not withdraw from the 2002 ESPP prior to that date.

A participant may withdraw from the 2002 ESPP at any time, and his or her accumulated payroll deductions will, at the participant s election, either be applied to the purchase of shares on the next quarterly purchase date or be refunded immediately.

A participant s purchase right immediately terminates upon his or her cessation of employment or loss of eligible employee status. Any payroll deductions which the participant may have made for the quarterly period in which such cessation of employment or loss of eligibility occurs are refunded and are not applied to the purchase of common stock.

No participant has any stockholder rights with respect to the shares covered by his or her purchase rights until the shares are actually purchased on the participant s behalf. No adjustment is made for dividends, distributions or other rights for which the record date is prior to the date of such purchase. No purchase rights are assignable or transferable by the participant, and the purchase rights are exercisable only by the participant.

Purchase Price

The purchase price of the common stock acquired on each quarterly purchase date is equal to 85% of the *lower* of

the fair market value per share of common stock on the start date of the offering period in which the individual is enrolled or

the fair market value on the quarterly purchase date.

Eligibility and Participation

Any individual who has been employed continuously for at least three months on a basis under which he or she is regularly expected to work for more than 20 hours per week and more than five months per calendar year in the employ of the Company or any participating parent or subsidiary corporation (including any corporation which subsequently becomes a parent or subsidiary during the term of the 2002 ESPP) is eligible to participate in the 2002 ESPP. An individual who is an eligible employee on the start date of any offering period may join that offering period at that time or on any subsequent quarterly entry date (the first business day in January, April, July and October each year) within that offering period. An individual who first becomes an eligible employee after such start date may join the offering period on any quarterly entry date within that offering period on which he or she is an eligible employee. An employee may participate in only one offering period at a time.

Should the fair market value per share of common stock on any quarterly purchase date within an offering period be less than the fair market value per share on the start date of that offering period, then the participants in that offering period will, immediately following the purchase of shares on their behalf on such quarterly purchase date, be automatically transferred from that offering period and enrolled in the new offering period beginning on the next business day.

Special Limitations

The 2002 ESPP imposes certain limitations upon a participant s rights to acquire common stock, including the following limitations:

Table of Contents

Purchase rights granted to a participant may not permit such individual to purchase more than $25,000 worth of common stock (valued at the time each purchase right is granted) for each calendar year those purchase rights are outstanding at any time.

Purchase rights may not be granted to any individual if such individual would, immediately after the grant, own or hold outstanding options or other rights to purchase, stock possessing 5% or more of the total combined voting power or value of all classes of stock of the Company or any of its affiliates.

No participant may purchase more than 1,330 shares of common stock on any one purchase date.

The Plan Administrator has the discretionary authority to increase or decrease the per participant and total participant purchase limitations as of the start date of any new offering period under the 2002 ESPP, with the new limits to be in effect for that offering period and each subsequent offering period.

Change in Ownership

Should the Company be acquired by merger, sale of substantially all of its assets or sale of securities representing more than 50% of the total combined voting power of the Company s outstanding securities, then all outstanding purchase rights will automatically be exercised immediately prior to the effective date of such acquisition. The purchase price will be equal to 85% of the *lower* of

the fair market value per share of common stock on the start date of the offering period in which the individual is enrolled at the time such acquisition occurs or

the fair market value per share of common stock immediately prior to such acquisition.

The limitation on the maximum number of shares purchasable in total by all participants on any one purchase date is applicable to any purchase date attributable to such an acquisition.

Share Proration

Should the total number of shares of common stock which are to be purchased under outstanding purchase rights on any particular date exceed the number of shares then available for issuance under the 2002 ESPP, the Plan Administrator shall make a pro rata allocation of the available shares on a uniform and nondiscriminatory basis, and the payroll deductions of each participant, to the extent in excess of the aggregate purchase price payable for the common stock prorated to such individual, would be refunded to such participant.

Amendment and Termination

The 2002 ESPP will terminate upon the earlier of

the last business day in June 2012 or

the date on which all purchase rights are exercised in connection with a change in ownership of the Company.

The Board may terminate, suspend or amend the 2002 ESPP at any time. However, the Board may not, without stockholder approval,

increase the number of shares issuable under the 2002 ESPP,

alter the purchase price formula so as to reduce the purchase price, or

modify the requirements for eligibility to participate in the plan.

Table of Contents

CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

In 1996, the Board adopted a shareholders rights plan (the Rights Plan) which provides for a dividend distribution of one preferred share purchase right (a Right) on each outstanding share of our common stock. Each Right entitles stockholders to buy 1/1000th of a share of Ligand Series A Participating Preferred Stock at an exercise price of $100, subject to adjustment. In September 2002, the Board amended the Rights Plan, reducing from 20% to 10% the trigger percentage of outstanding shares which, if acquired, would permit the rights to be exercised. Generally, the Rights become exercisable following the tenth day after a person or group announces acquisition of 10% or more of the common stock, or announces commencement of a tender offer, the consummation of which would result in ownership by the person or group of 10% or more of the common stock. In connection with our September 1998 agreements with Elan, we amended the Rights Plan to provide that the Rights would not become exercisable by reason of Elan s (i) beneficial ownership on or before November 9, 2005 of up to 25% of the Common Stock or (ii) beneficial ownership after November 9, 2005 of a percentage of our common stock equal to its beneficial ownership on that date, to the extent such ownership exceeds 10%. These provisions related to Elan s ownership were removed by an amendment to the Rights Plan in March 2004, following Elan s divestiture in 2003 of all of its Ligand stock. In December 2005, the Board approved an amendment to the Rights Plan providing that shares of the Company s common stock acquired by Third Point LLC, its affiliates or associates (Third Point) solely as a result of service as members of the Company s Board of Directors, including without limitation, the option for each designee to purchase 20,000 shares of common stock which was automatically granted on the date of such designee s initial election, would not operate to trigger the distribution of rights under the Rights Plan.

Certain holders of the common stock, and the common stock issuable upon exercise of warrants and other convertible securities, are entitled to registration rights with respect to such stock.

We have entered into employment agreements with each of Messrs. Robinson, Maier and Negro-Vilar and a severance and retention bonus agreement with Mr. Mertes. We have separate severance agreements with each of the Named Executive Officers and the other executive officers, except Mr. Robinson. Please see Employment, Severance and Change of Control Arrangements with Executive Officers above for more details regarding these agreements.

In October 2002 the Company engaged RNV Associates, Inc. a corporation controlled by Rosa Negro-Vilar, the spouse of Dr. Negro-Vilar, for clinical development consulting services. The contract was renewed for one year in October 2003 and again in October 2004 and was terminated in January 2005. During 2004, Rosa Negro-Vilar received aggregate payments of $154,001. The contract and renewals were reviewed and approved by the Audit Committee.

In June 2002, Ligand entered into an agreement with Mr. L Italien that provided for a one-time sign-on bonus of $85,000 that was paid in 2003. In May 2003, Ligand entered into an agreement with Mr. Aliprandi that provided for a minimum bonus for 2003 of $73,000. Upon his retirement in April 2005, the Company entered into a one-year consulting contract with Mr. Aliprandi under which he is paid a per-day fee plus expenses. Aggregate fees under the contract may not exceed $101,000. The contract was reviewed and ratified by the Audit Committee. In May 2005 in connection with his appointment, the Company entered into an agreement with Mr. Crouch whereby he receives an initial annual salary of $310,000, participates in the management bonus plan with a minimum payout of $100,000 in 2006, was awarded an option to purchase 120,000 shares at fair market value on the date of grant and received a $40,000 sign-on bonus.

Pursuant to a Stockholders Agreement dated December 2, 2005 among the Company and Third Point, the Company agreed to reimburse Third Point LLC, which is controlled by director Daniel S. Loeb and employs directors Brigette Roberts, M.D. and Jeffrey R. Perry, up to $475,000 of its actual out-of-pocket costs incurred prior to the date of the Agreement directly related to certain matters listed in the agreement and connected to a proxy contest previously announced by Third Point LLC, subject to certain conditions described in the agreement.

Our bylaws provide that the Company will indemnify its directors and executive officers and may indemnify its other officers, employees and other agents to the fullest extent permitted by the Delaware General Corporation Law. The Company is also empowered under its bylaws to enter into indemnification contracts with its directors and

Table of Contents

officers and to purchase insurance on behalf of any person whom it is required or permitted to indemnify. Pursuant to this provision, the Company has entered into indemnity agreements with each of its directors and officers.

In addition, the Company s certificate of incorporation provides that to the fullest extent permitted by Delaware law, the Company s directors will not be liable for monetary damages for breach of the directors fiduciary duty of care to the Company and its stockholders. This provision in the Certificate of Incorporation does not eliminate the duty of care, and in appropriate circumstances equitable remedies such as an injunction or other forms of non-monetary relief would remain available under Delaware law. Each director will continue to be subject to liability for breach of the director s duty of loyalty to the Company, for acts or omissions not in good faith or involving intentional misconduct or knowing violations of law, for acts or omissions that the director believes to be contrary to the best interests of the Company or its stockholders, for any transaction from which the director derived an improper personal benefit, for acts or omissions involving a reckless disregard for the director s duty to the Company or its stockholders when the director was aware or should have been aware of a risk of serious injury to the Company or its stockholders, for acts or omissions that constitute an unexcused pattern of inattention that amounts to an abdication of the director s duty to the Company or its stockholders, for improper transactions between the director and the Company and for improper distributions to stockholders and loans to directors and officers. This provision also does not affect a director s responsibilities under any other laws, such as the federal securities laws or state or federal environmental laws.

All future transactions between the Company and its officers, directors, principal stockholders and affiliates will be approved by the Audit Committee or a majority of the independent and disinterested members of the Board of Directors.

Table of Contents

PRINCIPAL STOCKHOLDERS

The following table shows, based on information we have, the beneficial ownership of the Company s common stock as of December 31, 2005, by

all persons who are beneficial owners of 5% or more of the Company s common stock,

each director and nominee for director,

the Named Executive Officers and

all current directors and executive officers as a group.

Unless otherwise indicated, each of the stockholders has sole voting and investment power with respect to the shares beneficially owned, subject to community property laws, where applicable. Percentage of ownership is based on 74,133,908 shares of common stock outstanding on December 31, 2005. Shares of common stock underlying options and convertible notes includes options which are currently exercisable or will become exercisable and convertible notes which are currently convertible or will become convertible within 60 days after December 31, 2005, are deemed outstanding for computing the percentage of the person or group holding such options, but are not deemed outstanding for computing the percentage of any other person or group. The address for individuals for whom an address is not otherwise indicated is 10275 Science Center Drive, San Diego, CA 92121. The information set forth below is based on filings made under Section 13(d) or 13(g) of the Exchange Act and may not include information about stockholders owning more than 5% who have not filed under such sections.

Beneficial Owner	Number of Shares Beneficially Owned	Shares Beneficially Owned via Options, Warrants or Convertible Notes	Percent of Class Owned
Third Point LLC(1) 390 Park Avenue New York, NY 10022	7,375,000		9.95%
Dorset Management/David M. Knott(2) 485 Underhill Blvd., Ste. 205 Syosset, NY 11791-3419	7,261,662		9.80%
Orbimed Advisors LLC(3) 767 Third Avenue, 30th Floor New York, NY 10017	6,384,824		8.61%
Vanguard Horizon Funds(4) P.O. Box 2600 V26 Valley Forge, PA 19482	5,220,900		7.04%
Barclays Global Investors NA(5) 45 Fremont St., 17th Floor San Francisco, CA 94105	4,719,605		6.37%

Table of Contents

Beneficial Owner	Number of Shares Beneficially Owned	Shares Beneficially Owned via Options, Warrants or Convertible Notes	Percent of Class Owned
Janus Capital Management LLC(6) 100 Fillmore Street 2nd Floor Denver, CO 80206-4923	4,418,275		5.96%
Maverick Capital Ltd. (7) 300 Crescent Court, 18th Floor Dallas, TX 75201	3,761,431		5.07%
Harvest Management LLC(8) 600 Madison Ave New York, NY 10022	3,960,638	1,052,938	5.27%
Glenview Capital Management(9) 399 Park Avenue, Floor 39 New York, NY 10022	3,704,800		5.00%
Henry F. Blissenbach	101,241	96,241	*
Alexander D. Cross	128,491	91,847	*
John Groom	121,259	105,022	*
Irving S. Johnson	111,006	88,077	*
John W. Kozarich	41,446	36,446	*
Daniel S. Loeb(1)	7,375,000		9.95%
Carl C. Peck	109,181	103,181	*
Jeffrey R. Perry(1)	7,375,000		9.95%
Brigette Roberts, M.D.(1)	7,375,000		9.95%
Michael A. Rocca	82,799	74,799	*
David E. Robinson	1,325,467	913,542	1.77%
Andres F. Negro-Vilar	396,339	389,106	*

Paul V. Maier	433,729	333,706	*
Warner R. Broaddus	104,271	100,625	*
Tod G. Mertes	66,107	63,594	*
Directors and executive officers as a group (20 persons)	10,908,583	2,902,217	14.16%

* Less than 1%

(Footnotes continued on next page.)

Table of Contents

(1) Pursuant to a Schedule 13D/A filed December 2, 2005 by Third Point LLC which reported shared voting and dispositive power over 7,375,000 shares. On December 8, 2005, upon their election to the board of directors of the Company, each of Messrs. Loeb and Perry and Dr. Roberts were granted automatically an option to purchase 20,000 shares of common stock with an exercise price of $11.35 per share, the fair market value on that date. The options to purchase such shares shall become fully vested and exercisable upon Messrs. Loeb and Perry and Dr. Roberts completion of a one-year period of continued service on the Board of Directors measured from the grant date, December 8, 2005.

(2) Pursuant to a Schedule 13G/A filed December 2, 2005 by David M. Knott which reported sole voting power over 6,273,956 shares, shared voting power over 882,074 shares, sole dispositive power over 6,780,077 shares and shared dispositive power over 481,585 shares.

(3) Pursuant to a Schedule 13G/A filed February 14, 2005 by Orbimed Advisors LLC which reported shared voting and dispositive power over 6,384,824 shares.

(4) Pursuant to a Schedule 13G filed February 11, 2005 by Vanguard Horizon Funds which reported sole voting power over 5,220,900 shares.

(5) Pursuant to a Schedule 13G filed February 14, 2005 by Barclays Global Investors NA, which reported group aggregate sole voting power over 4,427,746 shares and dispositive power over 4,719,605 shares.

(6) Pursuant to a Schedule 13G filed February 15, 2005 by Janus Capital Management LLC, which reported sole voting and dispositive power over 4,418,275 shares.

(7) Pursuant to a Schedule 13G filed February 14, 2005 by Maverick Capital Ltd. which reported shared voting and dispositive power over 3,761,431 shares.

(8) Pursuant to a Schedule 13G filed December 6, 2005 by Harvest Management LLC, which reported shared voting and dispositive power over 2,907,700 shares of Common Stock and 1,052,938 shares of common stock underlying convertible notes.

(9) Pursuant to a Schedule 13G filed September 9, 2005 by Glenview Capital Management LLC, which reported share voting and dispositive power over 3,704,800 shares.

Table of Contents

DESCRIPTION OF CAPITAL STOCK

The authorized capital stock of Ligand consists of 200,000,000 shares of Common Stock, $0.001 par value per share, and 5,000,000 shares of Preferred Stock, $0.001 par value per share (Preferred Stock). At December 31, 2005, there were 74,133,908 shares of Common Stock outstanding.

Common Stock

The holders of Common Stock are entitled to one vote for each share held of record on all matters submitted to a vote of the stockholders. Subject to preferences that may be applicable to any outstanding Preferred Stock, holders of Common Stock are entitled to receive ratably such dividends as may be declared by the Board of Directors of Ligand out of funds legally available. See Price Range of Common Stock and Dividend Policy. In the event of liquidation, dissolution or winding up of Ligand, holders of Common Stock are entitled to share ratably in all assets remaining after payment of liabilities and the liquidation preference of any outstanding Preferred Stock. Holders of Common Stock have no preemptive rights and no right to cumulate votes in the election of directors. There are no redemption or sinking fund provisions applicable to the Common Stock. All outstanding shares of Common Stock are fully paid and nonassessable.

Preferred Stock

The Board of Directors of Ligand has the authority to issue the Preferred Stock in one or more series and to fix the designation, powers, preferences, rights, qualifications, limitations and restrictions of the shares of each such series, including the dividend rights, dividend rate, conversion rights, voting rights, rights and terms of redemption (including sinking fund provisions), liquidation preferences and the number of shares constituting any such series,without any further vote or action by the stockholders. The rights and preferences of Preferred Stock may in all respects be superior and prior to the rights of the Common Stock. The issuance of the Preferred Stock could decrease the amount of earnings and assets available for distribution to holders of Common Stock or adversely affect the rights and powers, including voting rights, of the holders of the Common Stock and could have the effect of delaying, deferring or preventing a change in control of Ligand.

In connection with the adoption of the Shareholder Rights Plan, the Company s Board of Directors designated 1,600,000 shares of Series A Participating Preferred Stock, none of which are outstanding as of the date of this Prospectus.

Registration Rights

As of December 31, 2005, pursuant to the Amended and Restated Registration Rights Agreement, dated as of June 29, 2000, as amended through such date (the Registration Rights Agreement), the holders of approximately 565,782 shares of common stock issuable upon exercise of outstanding warrants are entitled to specified rights with respect to the registration of the outstanding shares of common stock and the shares of Common Stock issuable upon exercise of such warrants or conversion of such notes (the Registrable Securities). Under the Registration Rights Agreement, subject to certain exceptions, each holder of Registrable Securities may cause Ligand to register such holder s Registrable Securities on Form S-3 (Form S-3 Registration) provided the Registrable Securities the holder proposes to sell have an aggregate market value of at least $500,000. Ligand is not obligated to effect more than two Form S-3 Registrations within any 12-month period. In the case where a Form S-3 Registration is not available to Ligand, a holder may cause Ligand, subject to specified exceptions, to use its best efforts to register the holder s Registrable Securities for public resale (Public Resale Registration), subject to an underwriter s marketing limitation, if any; provided however, that the shares of Registrable Securities the holder proposes to sell must have an anticipated aggregate offering price of more than $1,500,000 net of underwriting discounts and commissions. Ligand is not obligated to effect more than one Public Resale Registration within any six month period. In addition, whenever Ligand proposes to register any of its securities under the Securities Act (a Company Registration), or any holder of Registrable Securities causes Ligand to register its shares, whether in a S-3 Registration or in a Public Resale Registration, all holders of Registrable Securities are entitled to notice of such registration and to include their Registrable Securities in such registration, subject to certain restrictions, including any proposed underwriter s right to limit the number of shares included in such registration. Ligand is required to bear all registration expenses in connection with the first S-3 Registration and Public Resale Registration requested by a holder and all Company

Table of Contents

Registrations. All selling expenses related to securities registered by the holders are required to be paid by the holders on a pro rata basis. Ligand is required to indemnify certain of the holders of such Registrable Securities and the underwriters for such holders, if any, under certain circumstances.

Under certain conditions, registration rights may be transferred to a transferee of Registrable Securities who, after such transfer, holds at least 50,000 shares of the Registrable Securities. Registration rights granted under the Registration Rights Agreement may be amended or waived (either generally or in a particular instance and either retroactively or prospectively) only with the written consent of Ligand and the holders of a majority of the Registrable Securities then outstanding, although additional holders may be amended without such consent of the holders.

Registration rights granted to each holder under the Registration Rights Agreement, subject to certain exceptions, terminate on the earlier of (a) the later of December 31, 1999 or, with respect to an aggregate of approximately 565,782 shares issuable upon exercise of warrants issued after June 1, 1994, two years after such exercise or (b) the date after which all shares of Registrable Securities held by such holder may be immediately sold under Rule 144(k) of the Securities Act.

Delaware Law and Certain Charter Provisions

Ligand is subject to the provisions of Section 203 of the Delaware General Corporate Law, an anti-takeover law. In general, the statute prohibits a publicly held Delaware corporation from engaging in a business combination with an interested stockholder for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. For purposes of Section 203, a business combination includes a merger, asset sale, or other transaction resulting in a financial benefit to the interested stockholder, and an interested stockholder is a person who, together with affiliates and associates, owns (or within three years prior, did own) 15% or more of the corporation s voting stock.

The holders of Common Stock are currently entitled to one vote for each share held of record on all matters submitted to a vote of the stockholders other than the election of directors and are not entitled to demand cumulative voting. The absence of cumulative voting may have the effect of limiting the ability of minority stockholders to effect changes in the Board of Directors and, as a result, may have the effect of deterring hostile takeovers or delaying or preventing changes in control or management of Ligand.

Ligand s Certificate of Incorporation contains the Fair Price Provision that requires the approval of the holders of 66 2/3% of Ligand s voting stock as a condition to a merger or certain other business transactions with, or proposed by, a holder of 15% or more of Ligand s voting stock (an Interested Stockholder), except in cases where a majority of the Continuing Directors (as defined below) approve the transaction or certain minimum price criteria and other procedural requirements are met. A Continuing Director is a director originally elected upon incorporation of Ligand or a director who is not an Interested Stockholder or affiliated with an Interested Stockholder or whose nomination or election to the Board of Directors of Ligand is recommended or approved by a majority of the Continuing Directors. The minimum price criteria are recommended or approved by a majority of the Continuing Directors. The minimum price criteria generally require that, in a transaction in which stockholders are to receive payments, holders of Common Stock must receive a value equal to the highest price paid by the Interested Stockholder for Common Stock during the prior two years, and that such payment be made in cash or in the type of consideration paid by the Interested Stockholder for the greatest portion of its shares. Ligand s Board of Directors believes that the Fair Price Provision helps assure that all of Ligand s stockholders will be treated similarly if certain kinds of business combinations are effected. However, the Fair Price Provision may make it more difficult to accomplish certain transactions that are opposed by the incumbent Board of Directors and that could be beneficial to stockholders.

The Certificate of Incorporation also requires that any action required or permitted to be taken by stockholders of Ligand must be effected at a duly called annual or special meeting of stockholders and may not be effected by a consent in writing. In addition, Ligand s Bylaws provide that special meetings of the stockholders may be called by the president and shall be called by the president or secretary at the written request of a majority of the Board of Directors, or at the written request of stockholders owning at least 10% of Ligand s capital stock. The Bylaws also provide that the authorized number of directors may be changed by resolution of the Board of Directors or by the

Table of Contents

stockholders at the annual meeting of the stockholders. These provisions may have the effect of deterring hostile takeovers or delaying changes in control or management of Ligand.

Stockholder Rights Plan

In 1996, the Board adopted the Rights Plan which provides for a dividend distribution of one Right on each outstanding share of our common stock. Each Right entitles stockholders to buy 1/1000th of a share of Ligand Series A Participating Preferred Stock at an exercise price of $100, subject to adjustment. In September 2002, the Board amended the Rights Plan, reducing from 20% to 10% the trigger percentage of outstanding shares which, if acquired, would permit the rights to be exercised. Generally, the Rights become exercisable following the tenth day after a person or group announces acquisition of 10% or more of the common stock, or announces commencement of a tender offer, the consummation of which would result in ownership by the person or group of 10% or more of the common stock. In connection with our September 1998 agreements with Elan, we amended the Rights Plan to provide that the Rights would not become exercisable by reason of Elan s (i) beneficial ownership on or before November 9, 2005 of up to 25% of the Common Stock or (ii) beneficial ownership after November 9, 2005 of a percentage of our common stock equal to its beneficial ownership on that date, to the extent such ownership exceeds 10%. These provisions related to Elan s ownership were removed by an amendment to the Rights Plan in March 2004, following Elan s divestiture in 2003 of all of its Ligand stock. In December 2005, the Board approved an amendment to the Rights Plan providing that shares of the Company s common stock acquired by Third Point LLC, its affiliates or associates (Third Point) solely as a result of service as members of the Company s Board of Directors, including without limitation, the option for each designee to purchase 20,000 shares of common stock which was automatically granted on the date of such designee s initial election, would not operate to trigger the distribution of rights under the Rights Plan.

Transfer Agent and Registrar

The transfer agent and registrar for the Common Stock is Mellon Investor Services LLC.

Delaware Anti-Takeover Statute

We are subject to Section 203 of the Delaware General Corporation Law which prohibits persons deemed interested stockholders from engaging in a business combination with a Delaware corporation for three years following the date these persons become interested stockholders. Generally, an interested stockholder is a person who, together with affiliates and associates, owns, or within three years prior to the determination of interested stockholder status did own, 15% or more of a corporation s voting stock. Generally, a business combination includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the interested stockholder. The existence of this provision may have an anti-takeover effect with respect to transactions not approved in advance by the board of directors.

Limitations of Liability and Indemnification Matters

We have adopted provisions in our amended and restated certificate of incorporation that limit the liability of our directors for monetary damages for breach of their fiduciary duties, except for liability that cannot be eliminated under the Delaware General Corporation Law. Delaware law provides that directors of a corporation will not be personally liable for monetary damages for breach of their fiduciary duties as directors, except liability for any of the following:

- any breach of their duty of loyalty to the corporation or the stockholder;
- acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law;
- unlawful payments of dividends or unlawful stock repurchases or redemptions as provided in Section 174 of the Delaware General Corporation Law; or
- any transaction from which the director derived an improper personal benefit.

Table of Contents

This limitation of liability does not apply to liabilities arising under the federal securities laws and does not affect the availability of equitable remedies such as injunctive relief or rescission.

Our amended and restated certificate of incorporation and our bylaws also provide that we shall indemnify our directors and executive officers and may indemnify our other officers and employees and other agents to the fullest extent permitted by law. We believe that indemnification under our bylaws covers at least negligence and gross negligence on the part of indemnified parties. Our bylaws also permit us to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions in this capacity, regardless of whether our bylaws would permit indemnification.

We have entered into separate indemnification agreements with our directors and executive officers, in addition to indemnification provided for in our charter documents. These agreements, among other things, provide for indemnification of our directors and executive officers for expenses, judgments, fines and settlement amounts incurred by this person in any action or proceeding arising out of this person s services as a director or executive officer or at our request. We believe that these provisions and agreements are necessary to attract and retain qualified persons as directors and executive officers.

Nasdaq National Market Listing

We are currently quoted on The Pink Sheets LLC and have applied to have our common stock approved for quotation on the Nasdaq National Market under the symbol LGND.

Table of Contents

SELLING STOCKHOLDERS

The following table sets forth information with respect to the selling stockholders and the shares of our common stock that they may offer and sell under this prospectus. Each of the selling stockholders named below acquired the shares of common stock upon exercise of options previously granted to them as an employee, director or consultant of Ligand or as restricted stock granted to them as a director of Ligand, in each case under the terms of our 2002 Plan.

The following table sets forth with respect to each selling stockholder, based upon information available to us as of December 31, 2005 and as adjusted to reflect the issuance of shares to certain of the directors listed below effective January 4, 2005 which shares are to be sold in this offering, the number of shares of common stock owned, the number of shares of common stock registered by this prospectus and the number and percent of outstanding shares of common stock that will be owned after the sale of the registered shares of common stock assuming the sale of all of the registered shares of common stock. We calculated beneficial ownership according to Rule 13d-3 of the Exchange Act. Except as set forth in the table, none of the selling stockholders has, or within the past three years has had, any position, office or other material relationship with us or any of our predecessors or affiliates.

Because the selling stockholders may sell all or some portion of the shares of common stock beneficially owned by them, only an estimate (assuming the selling stockholder sells all of the shares offered hereby) can be given as to the number of shares of common stock that will be beneficially owned by the selling stockholders after this offering. In addition, the selling stockholders may have sold, transferred or otherwise disposed of, or may sell, transfer or otherwise dispose of, at any time or from time to time since the dates on which they provided the information regarding the shares of common stock beneficially owned by them, all or a portion of the shares of common stock beneficially owned by them in transactions exempt from the registration requirements of the Securities Act.

Name	Number of Shares Beneficially Owned	Number of Shares Registered	Number of Shares Owned After the Offering	
			Number	Percent
Ronald M. Evans, Ph.D.(1)	212,117	15,000	197,117	*
John Groom(2)	121,259	16,237	105,022	*
Osvaldo Humberto Viveros(3)	6,736	2,625	4,111	*
Daniel S. Loeb(2)	7,377,378	2,378(4)	7,375,000	9.95
Jeffrey R. Perry(2)	7,377,378	2,378(4)	7,375,000	9.95
Brigette Roberts, M.D.(2)	7,377,378	2,378(4)	7,375,000	9.95
Carl C. Peck(2)	111,559	2,378(4)	109,181	*
Micahel A. Rocca(2)	86,475	3,676(4)	82,799	*
John W. Kozarich(2)	43,824	2,378(4)	41,446	*

* less than one percent.

(1) For a discussion of Dr. Evan s relationship with Ligand, please see Business Academic Collaborations The Salk Institute of Biological Studies.

(2) Each of these individuals is a member of Ligand s Board of Directors. Please see Management and Certain Relationships and Related Party Transactions for a discussion of the relationship between each of these individuals and Ligand.

(3) Former employee of Ligand.

(4) These shares are subject to forfeiture in the event the holder s service on Ligand s Board of Directors terminates for any reason. This forfeiture restriction lapses in 12 successive equal installments based on the holder s continued service on Ligand s Board of Directors during calendar year 2006.

Table of Contents

PLAN OF DISTRIBUTION

Who may sell and applicable restrictions. The selling stockholders will be offering and selling all shares offered and sold under this prospectus. Alternatively, the selling stockholders may from time to time offer the shares through brokers, dealers or agents that may receive compensation in the form of discounts, commissions or concessions from the selling stockholders and/or the purchasers of the shares for whom they may act as agent. In effecting sales, broker-dealers that are engaged by the selling stockholders may arrange for other broker-dealers to participate. The selling stockholders and any brokers, dealers or agents who participate in the distribution of the shares may be deemed to be underwriters within the meaning of Section 2(11) of the Securities Act. Any profits on the sale of the shares by them and any discounts, commissions or concessions received by any broker, dealer or agent might be deemed to be underwriting discounts and commissions under the Securities Act. To the extent the selling stockholders may be deemed to be underwriters, the selling stockholders may be subject to certain statutory liabilities, including, but not limited to, Sections 11, 12 and 17 of the Securities Act and Rule 10b-5 under the Exchange Act.

Manner of sales. The selling stockholders will act independently of us in making decisions with respect to the timing, manner and size of each sale. Sales may be made over the Nasdaq National Market or other over-the-counter markets. The shares may be sold at then prevailing market prices, at prices related to prevailing market prices or at negotiated prices. Selling stockholders may also resell all or a portion of the shares in open market transactions in reliance upon Rule 144 under the Securities Act, provided they meet the criteria and conform to the requirements of this rule. The selling stockholders may decide not to sell any of the shares offered under this prospectus, and selling stockholders may transfer, devise or gift these shares by other means.

Prospectus delivery. Because selling stockholders may be deemed to be underwriters within the meaning of Section 2(11) of the Securities Act, they will be subject to the prospectus delivery requirements of the Securities Act. At any time a particular offer of the shares is made, a revised prospectus or prospectus supplement, if required, will be distributed which will set forth:

- the name of the selling stockholder and of any participating underwriters, broker-dealers or agents;
- the aggregate amount and type of shares being offered;
- the price at which the shares were sold and other material terms of the offering;
- any discounts, commissions, concessions and other items constituting compensation from the selling stockholders and any discounts, commissions or concessions allowed or paid to dealers; and
- that any participating broker-dealers did not conduct any investigation to verify the information set out or incorporated in this prospectus by reference.

The prospectus supplement or a post-effective amendment will be filed with the Commission to reflect the disclosure of additional information with respect to the distribution of the shares. In addition, if we receive notice from a selling stockholder that a donee or pledgee intends to sell more than 500 shares, a supplement to this prospectus will be filed.

Expenses associated with registration. We have agreed to pay the expenses of registering the shares under the Securities Act, including registration and filing fees, printing and duplication expenses, administrative expenses and legal and accounting fees. Each selling stockholder will pay its own brokerage and legal fees, if any.

Suspension of this offering. We may suspend the use of this prospectus if we learn of any event that causes this prospectus to include an untrue statement of a material fact or to omit to state a material fact required to be stated in the prospectus or necessary to make the statements in the prospectus not misleading in the light of the circumstances them existing. If this type of event occurs, a prospectus supplement or post-effective amendment, if required, will be distributed to each selling stockholder.

Table of Contents

LEGAL MATTERS

The validity of the securities offered by this prospectus will be passed upon for us by Latham & Watkins LLP, San Diego, California.

EXPERTS

The consolidated financial statements and schedules and management s assessment of the effectiveness of internal control over financial reporting included in this prospectus and in the registration statement have been audited, by BDO Seidman, LLP, an independent registered public accounting firm, to the extent and for the periods set forth in their reports appearing elsewhere herein and in the registration statement, and are included in reliance upon such reports given upon the authority of said firm as experts in auditing and accounting. BDO Seidman, LLP s report relating to the effectiveness of internal control over financial reporting included an adverse opinion as to the effectiveness of internal control over financial reporting.

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Deloitte & Touche LLP, certified public accountants, which had served as the Company s principal independent auditors since October 31, 2000, resigned their engagement effective August 5, 2004. Auditor s reports issued by Deloitte & Touche LLP on the Company s consolidated financial statements for the Company s fiscal year ended December 31, 2003 contained no adverse opinion or disclaimer of opinion, nor was modified as to uncertainty, audit scope, or accounting principles. The Company was informed by Deloitte & Touche LLP that its action was not related to any disagreements on matters of accounting principles or practices, financial statement disclosure or auditing scope or procedures. During the fiscal year ended December 31, 2003, and the subsequent interim periods preceding the resignation of Deloitte & Touche LLP, there were no disagreements with Deloitte & Touche LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which, if not resolved to Deloitte & Touche LLP s satisfaction, would have caused Deloitte & Touche LLP to make reference to the subject matter of the disagreement in its reports on the consolidated financial statements for such years. No events required to be reported under Item 304(a) (1) (v) of the SEC s Regulation S-K occurred during the Company s fiscal year ended December 31, 2003, or the subsequent interim periods preceding the resignation of Deloitte & Touche LLP. On September 27, 2004, the Company appointed BDO Seidman, LLP as its independent registered public accounting firm to replace Deloitte & Touche LLP.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have filed with the Securities and Exchange Commission a registration statement on Form S-1 under the Securities Act of 1933, as amended, with respect to the shares of our common stock offered hereby. This prospectus does not contain all of the information set forth in the registration statement and the exhibits and schedules thereto. Some items are omitted in accordance with the rules and regulations of the SEC. For further information with respect to us and the common stock offered hereby, we refer you to the registration statement and the exhibits and schedules filed therewith or incorporated therein by reference. Statements contained in this prospectus as to the contents of any contract, agreement or any other document are summaries of the material terms of this contract, agreement or other document. With respect to each of these contracts, agreements or other documents filed as an exhibit to the registration statement or incorporated therein by reference, reference is made to the exhibits for a more complete description of the matter involved. A copy of the registration statement, and the exhibits and schedules thereto, may be inspected without charge at the public reference facilities maintained by the SEC at the SEC S Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference facility. The SEC maintains a web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC. The address of the SEC s website is http://www.sec.gov.

We are also subject to the informational requirements of the Exchange Act and are required to file annual and quarterly reports, proxy statements and other information with the Commission. You can inspect and copy reports and other information filed by us with the Commission at the Commission s Public Reference Room at 100 F Street,

Table of Contents

N.E., Washington, D.C. 20549. You may also obtain information on the operation of the Public Reference Room by calling the Commission at 1-800-SEC-0300. The Commission also maintains an Internet site at http:\\www.sec.gov that contains reports, proxy and information statements regarding issuers, including us, that file electronically with the Commission.

CONTROLS AND PROCEDURES

The Company is required to maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in its reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to management, including the Company s Chief Executive Officer (CEO) and Chief Financial Officer (CFO) as appropriate, to allow timely decisions regarding required disclosure.

In connection with the preparation of the Form 10-Q for the period ended September 30, 2005 and the Form 10-K for the year ended December 31, 2004, management, under the supervision of the CEO and CFO, conducted an evaluation of disclosure controls and procedures. Based on that evaluation, the CEO and CFO concluded that the Company s disclosure controls and procedures were not effective as of the aforementioned periods due to the material weaknesses described in the Company s management report on internal control over financial reporting as outlined below. As of September 30, 2005, the material weaknesses identified below have not been fully remediated.

As previously disclosed, management identified the following material weaknesses in connection with its assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2004:

The Company did not have effective controls and procedures to ensure that revenues, including sales of its products and the practice it followed regarding the replacement of expired products, were recognized in accordance with generally accepted accounting principles. With respect to product sales, the Company did not have the ability to make reasonable estimates of returns which preclude the Company from recognizing revenue at the time of domestic product shipment of AVINZA, ONTAK, Targretin capsules, and Targretin gel. As a result, shipments made to wholesalers for these products did not meet the revenue recognition criteria of SFAS 48 Revenue Recognition When Right of Return Exists and Staff Accounting Bulletin (SAB) No. 101 Revenue Recognition as amended by SAB 104.

The Company s controls and procedures intended to prevent shipping of short-dated products (i.e. products shipped within six months of expiration) to its wholesalers were not operating effectively which resulted in the shipment of ONTAK during 2004 to wholesalers within six months of product expiration. The shipment of short-dated product subsequently resulted in significant product returns/replacements.

The Company did not have adequate records and documentation supporting the decisions made and the accounting for past transactions. This material weakness resulted from the fact that the Company did not have sufficient controls surrounding the preparation and maintenance of adequate contemporaneous records and documentation.

The Company did not have adequate manpower in its accounting and finance department and has a lack of sufficient qualified accounting personnel to identify and resolve complex accounting issues in accordance with generally accepted accounting principles. This material weakness contributed to the following errors in accounting, among others: (1) revenue recognition and related gross to net sales adjustments and cost of goods (products) sold, (2) revenues received under our agreement with Royalty Pharma, (3) warrants issued in connection with the X-Ceptor transaction, (4) the classification of the Elan shares in connection with the Company s purchase obligation relating to the November 2002 restructuring of the AVINZA license agreement with Elan and the shares of stock issued to Pfizer in connection with the Pfizer Settlement Agreement, (5) accrual of interest in connection with the Seragen litigation, and (6) the calculation of contractual annual rent increases.

Table of Contents

The Company did not have sufficient controls over accrued liability estimates in the proper accounting periods (i.e., accruals and cut-off). This material weakness caused errors in accounting relating to (1) estimation of accruals for clinical trials, bonuses to employees, and other miscellaneous accrued liabilities, and (2) royalty payments made to technology partners.

The Company did not have adequate financial reporting and close procedures. This material weakness resulted from the fact that the Company did not have sufficient controls in place nor trained personnel to adequately prepare and review documentation and schedules necessary to support its financial reporting and period-end close procedures.

As described below, the Company has implemented or plans to implement, the following measures to remediate the material weaknesses described above.

Revenue Recognition.

During the second and third quarters of 2005, the Company s finance and accounting department, with the assistance of outside expert consultants, developed accounting models to recognize sales of its products, except Panretin, under the sell-through revenue recognition method in accordance with generally accepted accounting principles. In connection with the development of these models, the Company also implemented a number of new and enhanced controls and procedures to support the sell-through revenue recognition accounting models. These controls and procedures include approximately 35 models used in connection with the sell-through revenue recognition method including related contra-revenue models, and demand reconciliations to support and assess the reasonableness of the data and estimates, which includes information and estimates obtained from third-parties, required for sell-through revenue recognition.

The Company s commercial operations department is additionally implementing a number of improvements that will further enhance the controls surrounding the recognition of product revenue. These include the development of an information operations system that will provide management with a greater amount of reliable, timely data including product movement, demand and inventory levels. The department is also adding additional personnel to review, analyze and report this information.

During the second and third quarters of 2005, the accounting and finance department established procedures surrounding the month-end close process to ensure that the information and estimates necessary for reporting product revenues under the sell-through method to facilitate a timely period-end close were available.

The Company will hire an expert manager on revenue recognition who will be responsible for managing all aspects of the Company s revenue recognition accounting, sell-through revenue recognition models and supporting controls and procedures. The Company expects that this position will be filled during the first quarter of 2006 or as soon as possible thereafter. However, until this position is filled, the Company will continue to use outside expert consultants to fulfill this function.

A training program for employees and consultants involved in the revenue recognition accounting was developed and took place during the fourth quarter of 2005. In 2006, additional training will be provided on a regular and periodic basis and updated as considered necessary.

Shipments of Short-Dated Product.

During the second quarter of 2005, the Company s internal audit department conducted a detailed audit of the controls, policies and procedures surrounding, and the personnel responsible for, the shipment of the Company s products. This internal audit resulted in recommended remediation actions that were subsequently implemented in the second and third quarters of 2005 by the Company s technical and supply operations department, including:

- A review of all existing policies and procedures surrounding the shipment of the Company s products. In connection with this review a number of enhancements were made to the existing policies and procedures including daily review and reconciliation of the Company s inventory report to the third

party vendor s inventory report for verification of the distribution date and expiration date and daily review of third party vendor s sales report for verification that all products shipped had appropriate dating. These review procedures are now performed by a senior-level staff person in the Company s supply operations department.

- Each of the Company s employees involved in the shipment of product received training regarding the controls and procedures surrounding the shipment of product. Additional training will be provided on a regular and periodic basis and updated as considered necessary to reflect any changes in the Company s or its customers business practices or activities.

- Management also ensured that its third-party vendor responsible for product inventories, shipping and logistics is aware and understands all applicable controls and procedures surrounding product shipment and the requirement to prepare and maintain appropriate documentation for all such product transactions. The third-party vendor has instituted controls in its accounting system to prevent the shipment of product that is not within the Company s shipping policies.

Record Keeping and Documentation.

The Company has implemented improved procedures for analyzing, reviewing, and documenting the support for significant and complex transactions. Documentation for all complex transactions is now maintained by the Corporate Controller. Additionally, an internal policy entitled Documentation of Accounting Decisions was issued during the fourth quarter of 2005.

The Company s accounting and finance and legal departments developed a formal internal policy during the fourth quarter of 2005 entitled Documentation of Accounting Decisions, regarding the preparation and maintenance of contemporaneous documentation supporting accounting transactions and contractual interpretations. The formal policy provides for enhanced communication between the Company s finance and legal personnel.

The Company s internal audit department will also routinely audit the adequacy of the Company s internal record keeping and documentation.

Accounting Personnel.

During the second quarter of 2005, the Company hired a second internal auditor reporting to the Company s Director of Internal Audit. The Company s Director of Internal Audit resigned effective December 2, 2005. In December 2005, the Company retained a nationally recognized external consulting firm to assist the Company with the managing its Internal Audit Department and overseeing the Company s ongoing Sarbanes-Oxley Rule 404 compliance effort until a permanent replacement for the Company s Director of Internal Audit is hired.

During the second, third, and fourth quarters of 2005, the Company engaged expert accounting consultants to assist the Company s accounting and finance department with a number of activities including the management and implementation of controls surrounding the Company s new sell-through revenue recognition models, the administration of existing controls and procedures, preparation of the Company s SEC filings and the documentation of complex accounting transactions.

The Company will hire additional senior accounting personnel who are certified public accountants including a Director of Accounting and, as discussed above, a Director of Internal Audit and a Manager of Revenue Recognition. The Director of Accounting, Director of Internal Audit, and the Manager of Revenue Recognition positions are targeted to be filled during the first quarter of 2006, or as soon as possible thereafter. Until all such positions are filled, the Company will continue to use outside expert accounting consultants to fulfill such functions.

The Company continues to consider alternatives for organizational or responsibility changes which it believes may be necessary to attract additional senior accounting personnel who are certified public accountants or have recent public accounting firm experience.

Table of Contents

Accruals and Cut-off. During 2004 and continuing into 2005, the following controls and procedures were implemented in the accounting and finance department.

Developed monthly review procedures to review applicable documentation for supporting period-end accruals.

Developed quarterly review procedures to review invoices to ensure that such invoices were properly accounted for in the correct period.

Completed training of accounting and finance personnel to explain accrual methodologies and supporting documentation requirements. A training update session for all finance department employees and consultants involved in preparing and reviewing period-end accruals took place during the fourth quarter of 2005. Additional training will be provided on a regular basis and updated as considered necessary to reflect changes in the Company s accounting system.

The Company s internal audit department will perform periodic reviews and audits of the Company s controls surrounding accruals and cut-off.

Financial Statement Close Procedures.

The Company has designed and implemented process improvements concerning the Company s financial reporting and close procedures. A training session for all finance department employees and consultants involved in the financial statement close process took place during the fourth quarter of 2005. Additionally, an ongoing periodic training update/program has been implemented to conduct training sessions on a regular quarterly basis to provide training to its finance and accounting personnel to review procedures for timely and accurate preparation and management review of documentation and schedules to support the Company s financial reporting and period-end close procedures. As discussed above, the additional management personnel to be hired into the department will also help ensure that all documentation necessary for the financial reporting and period end close procedures are properly prepared and reviewed.

Report of Independent Registered Public Accounting Firm

We have audited management s assessment, included in the accompanying Management s Report on Internal Control over Financial Reporting, that Ligand Pharmaceuticals Incorporated and Subsidiaries (the Company) did not maintain effective internal control over financial reporting as of December 31, 2004, because of the effect of the material weaknesses related to the lack of controls and procedures to ensure that revenues are recognized in accordance with generally accepted accounting principles, the lack of controls and procedures to prevent the shipping of short-dated products, the lack of adequate record keeping and documentation of past transactional accounting decisions, the lack of adequate manpower and insufficient qualified accounting personnel to identify and resolve complex accounting issues, the lack of controls over accruals and cut-offs, and the lack of adequate financial reporting and close procedures, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

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

Table of Contents

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

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

A material weakness is a significant control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management s assessment as of December 31, 2004: Management identified deficiencies in the Company s internal controls and procedures to ensure that revenues are recognized in accordance with generally accepted accounting principles, the lack of controls and procedures to prevent the shipping of short-dated products, the lack of adequate record keeping and documentation of past transactional accounting decisions, the lack of adequate manpower and insufficient qualified accounting personnel to identify and resolve complex accounting issues, the lack of controls over accruals and cut-off, and the lack of adequate financial reporting and close procedures. These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2004 consolidated financial statements, and this report does not affect our report dated November 11, 2005, on those consolidated financial statements.

In our opinion, management s assessment that Ligand Pharmaceuticals Incorporated and subsidiaries did not maintain effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on COSO. Also, in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, Ligand Pharmaceuticals Incorporated and subsidiaries has not maintained effective internal control over financial reporting as of December 31, 2004, based on COSO.

We do not express an opinion or other any form of assurance on management s statements referring to the remediation steps taken after December 31, 2004.

/s/ BDO Seidman LLP
Costa Mesa, California
November 11, 2005

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 49,588	$ 92,310
Short-term investments	24,202	20,182
Accounts receivable, net	24,378	30,847
Current portion of inventories, net	6,868	7,155
Other current assets	12,672	17,713
Total current assets	117,708	168,207
Restricted investments	1,826	2,378
Long-term portion of inventories, net	8,007	4,617
Property and equipment, net	22,638	23,647
Acquired technology and product rights, net	150,271	127,443
Other assets	5,597	6,174
Total assets	$ 306,047	$ 332,466
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	$ 9,809	$ 17,352
Accrued liabilities	53,737	43,908
Current portion of deferred revenue, net	158,224	152,528
Current portion of equipment financing obligations	2,488	2,604
Current portion of long-term debt	337	320
Total current liabilities	224,595	216,712
Long-term debt	166,834	167,089
Long-term portion of deferred revenue, net	4,279	4,512
Long-term portion of equipment financing obligations	3,361	4,003
Other long-term liabilities	3,047	3,122
Total liabilities	402,116	395,438
Commitments and contingencies		
Common stock subject to conditional redemption; 997,568 shares issued and outstanding at September 30, 2005 and December 31, 2004	12,345	12,345
Stockholders deficit:		

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, 73,133,715 and 72,970,670 shares issued at September 30, 2005 and December 31, 2004 respectively	73	73
Additional paid-in capital	720,943	719,952
Accumulated other comprehensive (loss) income	(182)	229
Accumulated deficit	(828,337)	(794,660)
	(107,503)	(74,406)
Treasury stock, at cost; 73,842 shares	(911)	(911)
Total stockholders deficit	(108,414)	(75,317)
	$ 306,047	$ 332,466

See accompanying notes.

Table of Contents

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004 (Restated)	2005	2004 (Restated)
Revenues:				
Product sales	$ 42,584	$ 31,934	$ 119,364	$ 86,172
Collaborative research and development and other revenues	2,172	4,838	8,176	10,289
Total revenues	44,756	36,772	127,540	96,461
Operating costs and expenses:				
Cost of products sold	9,807	9,819	31,539	27,082
Research and development	12,911	16,747	42,170	50,830
Selling, general and administrative	17,787	17,311	57,151	50,132
Co-promotion	7,766	8,501	22,472	22,232
Total operating costs and expenses	48,271	52,378	153,332	150,276
Loss from operations	(3,515)	(15,606)	(25,792)	(53,815)
Other income (expense):				
Interest income	483	255	1,325	694
Interest expense	(3,172)	(3,145)	(9,329)	(9,320)
Other, net	(60)	1	173	3
Total other expense, net	(2,749)	(2,889)	(7,831)	(8,623)
Loss before income taxes	(6,264)	(18,495)	(33,623)	(62,438)
Income tax expense	(17)	(3)	(54)	(37)
Net loss	$ (6,281)	$ (18,498)	$ (33,677)	$ (62,475)
Basic and diluted per share amounts:				
Net loss	$ (0.08)	$ (0.25)	$ (0.46)	$ (0.85)
Weighted average number of common shares	74,041,204	73,845,613	73,998,594	73,635,562

See accompanying notes.

Table of Contents

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

	Nine Months Ended September 30,	
	2005	**2004 (Restated)**
Operating activities		
Net loss	$ (33,677)	$ (62,475)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of acquired technology and license rights	10,376	8,209
Depreciation and amortization of property and equipment	2,779	2,397
Non-cash development milestone		(1,956)
Amortization of debt issuance costs	775	724
Gain on sale of investment	(171)	
Other	79	88
Changes in operating assets and liabilities:		
Accounts receivable, net	6,469	(11,556)
Inventories, net	(3,103)	(3,111)
Other current assets	5,041	(2,576)
Accounts payable and accrued liabilities	2,286	11,202
Other liabilities	(24)	42
Deferred revenue, net	5,463	35,594
Net cash used in operating activities	(3,707)	(23,418)
Investing activities		
Purchases of short-term investments	(28,253)	(26,178)
Proceeds from sale of short-term investments	24,748	27,237
(Increase) decrease in restricted investments	(170)	4,558
Purchases of property and equipment	(1,770)	(2,843)
Payment to buy-down ONTAK royalty obligation	(33,000)	
Capitalized portion of payment of lasofoxifene royalty rights	(558)	
Other, net	165	(324)
Net cash (used in) provided by investing activities	(38,838)	2,450
Financing activities		
Principal payments on equipment financing obligations	(2,147)	(1,973)
Proceeds from equipment financing arrangements	1,390	3,849
Repayment of long-term debt	(238)	(218)
Net proceeds from issuance of common stock	912	6,300
Decrease in other long-term liabilities	(94)	
Net cash (used in) provided by financing activities	(177)	7,958
Net decrease in cash and cash equivalents	(42,722)	(13,010)

Cash and cash equivalents at beginning of period	92,310	59,030
Cash and cash equivalents at end of period	$ 49,588	$ 46,020
Supplemental disclosure of cash flow information		
Interest paid	$ 5,569	$ 5,633

See accompanying notes.

Table of Contents

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 Form 10-Q 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, 2005 and 2004 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 elsewhere in this Registration Statement on Form S-1.

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).

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.

Loss Per Share. Net loss per share is computed using the weighted average number of common shares outstanding. Basic and diluted net 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. Potential common shares, the shares that would be issued upon the conversion of convertible notes and the exercise of outstanding warrants and stock options, were 32.6 million and 32.4 million at September 30, 2005 and December 31, 2004, respectively.

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

Under its 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. However, 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, the Company believes the estimated fair value of these indemnification agreements is minimal and has no liabilities recorded for these agreements as of September 30, 2005 and December 31, 2004.

The Company enters into indemnification provisions under its agreements with other companies in its ordinary course of business, typically with business partners, contractors, customers and landlords. Under these provisions the Company generally indemnifies and holds harmless the indemnified party for direct losses suffered or incurred by the indemnified party as a result of the Company s activities or, in some cases, as a result of the indemnified party s activities under the agreement. The maximum potential amount of future payments the Company could be required to

make under these indemnification provisions is unlimited. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of September 30, 2005 and December 31, 2004.

Table of Contents

Accounting for Stock-Based Compensation. The Company accounts for stock-based compensation in accordance with Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees,* and FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation*.

On January 31, 2005, Ligand accelerated the vesting of certain unvested and out-of-the-money stock options previously awarded to the executive officers and other employees under the Company s 1992 and 2002 stock option plans which had an exercise price greater than $10.41, the closing price of the Company s stock on that date. Options to purchase approximately 1.3 million shares of common stock (of which approximately 450,000 shares were subject to options held by the executive officers) were accelerated. Options held by non-employee directors were not accelerated.

Holders of incentive stock options (ISOs) within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, were given the election to decline the acceleration of their options if such acceleration would have the effect of changing the status of such option for federal income tax purposes from an ISO to a non-qualified stock option. In addition, the executive officers plus other members of senior management agreed that they will not sell any shares acquired through the exercise of an accelerated option prior to the date on which the exercise would have been permitted under the option s original vesting terms. This agreement does not apply to a) shares sold in order to pay applicable taxes resulting from the exercise of an accelerated option or b) upon the officers retirement or other termination of employment.

The purpose of the acceleration was to eliminate any future compensation expense the Company would have otherwise recognized in its statement of operations with respect to these options upon the implementation of the Financial Accounting Standard Board statement Share-Based Payment (SFAS 123R).

In accordance with SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure,* the following table summarizes the Company s results on a pro forma basis as if it had recorded compensation expense based upon the fair value at the grant date for awards under these plans consistent with the methodology prescribed under SFAS No. 123, *Accounting for Stock-Based Compensation* for the three and nine months ended September 30, 2005 and 2004 (in thousands, except for net loss per share information):

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004 (Restated)	2005	2004 (Restated)
Net loss, as reported	$ (6,281)	$ (18,498)	$ (33,677)	$ (62,475)
Stock-based employee compensation expense included in reported net loss				
Less total stock-based compensation expense determined under fair value based method for all awards	(723)	(2,159)	(2,261)	(5,627)
Less total stock-based compensation expense determined under fair value based method for options accelerated in January 2005 (1)			(12,455)	
Net loss, pro forma	$ (7,004)	$ (20,657)	$ (48,393)	$ (68,102)
Basic and diluted per share amounts:				
Net loss per share as reported	$ (0.08)	$ (0.25)	$ (0.46)	$ (0.85)
Net loss per share pro forma	$ (0.09)	$ (0.28)	$ (0.65)	$ (0.92)

(1) Represents pro-forma unrecognized expense for accelerated options as of the date of acceleration.

The fair value for these options was estimated at the dates 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,	
	2005	2004 (Restated)	2005	2004 (Restated)
Risk free interest rate	4.2%	3.4%	4.2%	3.4%
Dividend yield				
Volatility	73%	76%	73%	76%
Weighted average expected life	5 years	5 years	5 years	5 years

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company s employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The following is a summary of the Company s stock option plan activity:

	Shares	Weighted average exercise price	Options exercisable at period end	Weighted average exercise price
Balance at December 31, 2004	6,714,069	$ 12.11	4,320,643	$ 11.68

Granted	731,613		7.10		
Exercised	(106,600)		6.27		
Canceled	(421,327)		10.40		
Balance at September 30, 2005	6,917,755	$	11.78	5,690,322	$ 12.61

Table of Contents

Accounts Receivable. Accounts receivable consist of the following (in thousands)

	September 30, 2005	December 31, 2004
Trade accounts receivable	$ 10,340	$ 25,860
Due from finance company	15,079	6,084
Less: allowances	(1,041)	(1,097)
	$ 24,378	$ 30,847

Inventories. Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. Inventories consist of the following (in thousands):

	September 30, 2005	December 31, 2004
Raw materials	$ 1,422	$ 1,855
Work-in process	8,626	2,302
Finished goods	6,560	8,642
Less: inventory reserves	(1,733)	(1,027)
	14,875	11,772
Less: current portion	(6,868)	(7,155)
Long-term portion of inventories, net	$ 8,007	$ 4,617

In 2005, the Company completed a multi-year process of transferring its filling and finishing of ONTAK from Eli Lilly and Company (Lilly) to Hollister-Stier. In anticipation of this transfer, the Company used Lilly to fill and finish, in 2003, a higher than normal number of ONTAK lots each of which required a forward dating determination. ONTAK otherwise has a shelf life projection of approximately 4 years. If commercial and clinical usage of these lots does not approximate the estimated pattern of usage as determined for purposes of dating, the Company could be required to write-off the value of one or more of these lots. In this regard, as of September 30, 2005, approximately $0.5 million of ONTAK finished goods inventory was written off due to the Company s updated assessment in December of 2005 of the timing of certain clinical trials. As of December 31, 2004 and December 31, 2003, total ONTAK inventory amounted to approximately $7.9 million and $6.1 million, respectively, of which $4.8 million and $4.1 million is classified as long-term, respectively.

During 2005, the Company also manufactured a higher than normal amount of drug substance (bexarotene) for Targretin capsules in the event the Company s NSCLC clinical trials were successful. As further discussed in Note 5, the trials did not meet their endpoints of improved overall survival and projected two year survival. The Company believes, however, that the additional manufactured bexarotene, which has a shelf life projection of approximately 10 years, will be fully used for ongoing production of the Company s marketed products, Targretin capsules and Targretin gel. As of December 31, 2004 and December 31, 2003, total Targretin capsules inventory amounted to approximately $1.6 million and $ million, respectively, of which $0.5 million and $ million is classified as long-term, respectively.

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

	September 30,	December 31,

	2005	2004
Deferred royalty cost	$ 5,195	$ 9,363
Deferred cost of products sold	3,635	4,784
Prepaid insurance	346	1,024
Prepaid other	2,630	2,102
Other	866	440
	$ 12,672	$ 17,713

Table of Contents

Other Assets. Other assets consist of the following (in thousands):

	September 30, 2005	December 31, 2004
Prepaid royalty buyout, net (1)	$ 2,938	$ 2,584
Debt issue costs, net	2,456	3,231
Other	203	359
	$ 5,597	$ 6,174

(1) In January 2005, Ligand paid The Salk Institute $1.1 million to exercise an option to buy out milestone payments, other payment-sharing obligations and royalty payments due on future sales of lasofoxifene for vaginal atrophy. This payment resulted from a supplemental lasofoxifene new drug application filing in the United States (NDA) by Pfizer. As the Company had previously sold rights to Royalty Pharma AG of approximately 50% of any royalties to be received from Pfizer for sales of lasofoxifene, it recorded approximately 50% of the

payment made to The Salk Institute, approximately $0.6 million, as development expense in the first quarter of 2005. The balance of approximately $0.5 million was capitalized and will be amortized over the period any such royalties are received from Pfizer for the vaginal atrophy indication.

Amortization of debt issues costs was $0.3 million and $0.2 million for the three months ended September 30, 2005 and 2004 and $0.8 million and $0.7 million for the nine months ended September 30, 2005 and 2004, respectively. Estimated annual amortization of these assets in each of the years in the period from 2005 through 2007 is approximately $1.1 million.

Acquired Technology and Product Rights. In accordance with SFAS No. 142, *Goodwill and Other Intangibles,* the Company amortizes intangible assets with finite lives in a manner that reflects the pattern in which the economic benefits of the assets are consumed or otherwise used up. If that pattern cannot be reliably determined, the assets are amortized using the straight-line method.

Acquired technology and product rights as of September 30, 2005 include payments totaling $33.0 million to Lilly in exchange for the elimination of the Company s ONTAK royalty obligations in 2005 and a reduced reverse-tiered royalty scale on ONTAK sales in the U.S. thereafter. See Note 4 Royalty Agreements (Note 4). Amounts paid to Lilly in connection with the royalty restructuring were capitalized and are being amortized over the remaining patent life, which is approximately 10 years and represents the period estimated to be benefited, using the greater of the straight-line method or the expense determined on the tiered royalty schedule as set forth in Note 4. Other acquired technology and product rights represent payments related to the Company s acquisition of ONTAK and license rights for AVINZA. Because the Company cannot reliably determine the pattern in which the economic benefits of the acquired technology and products rights are realized, acquired technology and product rights are amortized on a straight-line basis over 15 years, which approximated the remaining patent life at the time the assets were acquired and otherwise represents the period estimated to be benefited. Specifically, the Company is amortizing its ONTAK asset through June 2014 which is approximate to the expiration date of its U.S. patent of December 2014. The AVINZA asset is being amortized through November 2017, the expiration of its U.S. patent. Acquired technology and product rights consist of the following (in thousands):

	September 30, 2005	December 31, 2004
AVINZA	$ 114,437	$ 114,437
Less accumulated amortization	(21,818)	(16,096)
	92,619	98,341

ONTAK	78,312	45,312
Less accumulated amortization	(20,660)	(16,210)
	57,652	29,102
	$ 150,271	$ 127,443

Amortization of acquired technology and product rights was $3.5 million and $10.2 million for the three and nine months ended September 30, 2005, respectively, and $2.7 million and $8.0 million for the same 2004 periods, respectively. Estimated annual amortization in each of the years in the period from 2006 through 2009 is approximately $14.0 million and a total of $90.7 million thereafter.

Deferred Revenue, Net. Under the sell-through revenue recognition method, the Company does not recognize revenue upon shipment of product to the wholesaler. For these shipments, the Company invoices the wholesaler, records deferred revenue at gross invoice sales

Table of Contents

price, and classifies the inventory held by the wholesaler (and subsequently held by retail pharmacies as in the case of AVINZA) as deferred cost of goods sold within other current assets. Deferred revenue is presented net of deferred cash and other discounts. Other deferred revenue reflects certain collaborative research and development payments and the sale of certain royalty rights.

The composition of deferred revenue, net is as follows (in thousands):

	September 30, 2005	December 31, 2004
Deferred product revenue	$ 158,452	$ 153,632
Other deferred revenue	5,373	5,574
Deferred discounts	(1,322)	(2,166)
Deferred revenue, net	$ 162,503	$ 157,040
Current, net	$ 158,224	$ 152,528
Long term, net	$ 4,279	$ 4,512
Deferred product revenue, net (1)		
Current	$ 157,130	$ 151,466
Long term		$
Other deferred revenue		
Current	$ 1,094	$ 1,062
Long term	$ 4,279	$ 4,512

(1) Deferred product revenue does not include other gross to net revenue adjustments made when the Company reports net product sales. Such adjustments include Medicaid rebates, managed health care rebates, and government

chargebacks, which are included in accrued liabilities in the accompanying consolidated financial statements.

Accrued Liabilities. Accrued liabilities consist of the following (in thousands):

	September 30, 2005	December 31, 2004
Allowances for loss on returns, rebates, chargebacks, other discounts, ONTAK end-customer and Panretin product returns	$ 18,412	$ 16,151
Co-promotion	14,733	7,845
Distribution services	2,585	3,693
Compensation	4,983	4,324
Royalties	2,397	5,134
Seragen purchase liability	2,838	2,838
Interest	3,493	1,164
Other	4,296	2,759
	$ 53,737	$ 43,908

Table of Contents

The following summarizes the activity in the accrued liability accounts related to allowances for loss on returns, rebates, chargebacks, other discounts, ONTAK end-customer and Panretin product returns:

	September 30, 2005	September 30, 2004 (Restated)
Balance beginning of period:	$ 16,151	$ 9,196
Provision for ONTAK end-customer and Panretin returns	2,360	1,948
Returns	(2,853)	(1,397)
Net change ONTAK end-customer and Panretin returns	(493)	551
Provision for losses on returns due to changes in prices	4,380	3,034
Charges	(3,281)	(2,536)
Net change losses on returns	1,099	498
Provision for Medicaid rebates	15,215	9,792
Payments	(14,335)	(5,714)
Net change Medicaid rebates	880	4,078
Provision for chargebacks	4,263	2,784
Payments	(4,573)	(2,494)
Net change chargebacks	(310)	290
Provision for managed care rebates and other contract discounts	7,362	3,736
Payments	(6,273)	(2,161)
Net change managed care rebates and other contract discounts	1,089	1,575
Provision for other discounts		6,321
Payments	(4)	(5,643)
Net change other discounts	(4)	678

Balance end of period:	$ 18,412	$ 16,866

Long-term Debt. Long-term debt consists of the following (in thousands):

	September 30, 2005	December 31, 2004
6% Convertible Subordinated Notes	$ 155,250	$ 155,250
Note payable to bank	11,921	12,159
	167,171	167,409
Less current portion	(337)	(320)
Long-term debt	$ 166,834	$ 167,089

Table of Contents

Condensed Changes in Stockholders Deficit. Condensed changes in stockholders deficit for the nine months ended September 30, 2005 are as follows (in thousands, except share data):

	Common stock		Additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulated deficit	Treasury stock		Total stockholders (deficit)
	Shares	Amount				Shares	Amount	
Balance at December 31, 2004	72,970,670	$ 73	$ 719,952	$ 229	$ (794,660)	(73,842)	$ (911)	$ (75,317)
Issuance of common stock	163,045		991					991
Unrealized loss on available-for-sale securities				(512)				(512)
Reclassification adjustment for loss on sale of available-for-sale securities				143				143
Foreign currency translation adjustments				(42)				(42)
Net loss					(33,677)			(33,677)
Balance at September 30, 2005	73,133,715	$ 73	$ 720,943	$ (182)	$ (828,337)	(73,842)	$ (911)	$ (108,414)

Comprehensive Loss. Comprehensive loss represents net loss 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 loss, 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 loss (income) as a separate component of stockholders deficit. Comprehensive loss is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004 (Restated)	2005	2004 (Restated)
Net loss as reported	$ (6,281)	$ (18,498)	$ (33,677)	$ (62,475)
Unrealized gain (loss) on available-for-sale securities	108	9	(512)	(45)
Reclassification adjustment for loss on sale of available-for-sale securities	143		143	
Foreign currency translation adjustments	(13)	(5)	(42)	(12)
Comprehensive loss	$ (6,043)	$ (18,494)	$ (34,088)	$ (62,532)

The components of accumulated other comprehensive (loss) income are as follows (in thousands):

	September 30, 2005	December 31, 2004
Net unrealized holding gain on available-for-sale securities	$ (70)	$ 299
Net unrealized loss on foreign currency translation	(112)	(70)
	$ (182)	$ 229

Net Product Sales. The Company s domestic net product sales for AVINZA, ONTAK, Targretin capsules and Targretin gel, are determined on a sell-through basis less allowances for rebates, chargebacks, discounts, and losses to be incurred on returns from wholesalers resulting from increases in the selling price of the Company s products. We recognize revenue for Panretin upon shipment to wholesalers as our wholesaler customers only stock minimal amounts of Panretin, if any. As such, wholesaler orders are considered to approximate end-customer demand for the product. Revenues from sales of Panretin are net of allowances for rebates, chargebacks, returns and discounts. For international shipments of our product, revenue is recognized upon shipment to our third-

Table of Contents

party international distributors. In addition, the Company incurs certain distributor service agreement fees related to the management of its product by wholesalers. These fees have been recorded within net product sales. For ONTAK, the Company also has established reserves for returns from end customers (i.e. other than wholesalers) after sell-through revenue recognition has occurred.

A summary of the revenue recognition policy used for each of our products and the expiration of the underlying patents for each product is as follows:

	Method	Revenue Recognition Event	Patent Expiration
AVINZA	Sell-through	Prescriptions	November 2017
ONTAK	Sell-through	Wholesaler out-movement	December 2014
Targretin capsules	Sell-through	Wholesaler out-movement	October 2016
Targretin gel	Sell-through	Wholesaler out-movement	October 2016
Panretin	Sell-in	Shipment to wholesaler	August 2016
International	Sell-in	Shipment to international distributor	February 2011 through April 2013

For the three months ended September 30, 2005 and 2004, net product sales recognized under the sell-through method represented 97% and 96% of total net product sales and net product sales recognized under the sell-in method represented 3% and 4%, respectively. For the nine months ended September 30, 2005 and 2004, net product sales recognized under the sell-through method represented 96% of total net product sales and net product sales recognized under the sell-in method represented 4% of total net product sales in 2005 and 2004.

The Company s total net product sales for the three months ended September 30, 2005 were $42.6 million compared to $31.9 million for the same 2004 period. Total net product sales for the nine months ended September 30, 2005 were $119.4 million compared to $86.2 million for the same 2004 period. A comparison of sales by product is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004 (Restated)	2005	2004 (Restated)
AVINZA	$ 29,909	$ 20,004	$ 79,367	$ 47,458
ONTAK	7,370	7,013	24,173	24,290
Targretin capsules	4,394	3,929	13,080	11,482
Targretin gel and Panretin gel	911	988	2,744	2,942
Total product sales	$ 42,584	$ 31,934	$ 119,364	$ 86,172

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. 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 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.

Table of Contents

The composition of collaborative research and development and other revenues is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Collaborative research and development	$ 894	$ 1,988	$ 2,618	$ 6,307
Development milestones and other	1,278	2,850	5,558	3,982
	$ 2,172	$ 4,838	$ 8,176	$ 10,289

Reclassifications. Certain reclassifications have been made to amounts included in the condensed consolidated balance sheet as of December 31, 2004 to conform to the current year presentation.

2. Restatement of Previously Issued Consolidated Financial Statements

As described elsewhere in this registration statement on Form S-1, the Company has restated its consolidated financial statements for the first three quarters of 2004. These condensed consolidated financial statements include restated quarterly information for the three and nine months ended September 30, 2004.

Set forth below is a summary of the significant determinations regarding the restatement addressed in the course of the restatement that affected the Company s consolidated financial statements for the three and nine months ended September 30, 2004.

Revenue Recognition. The restatement corrects the recognition of revenue for transactions involving each of the Company s products that did not satisfy all of the conditions for revenue recognition contained in SFAS 48 Revenue Recognition When Right of Return Exists (SFAS 48) and Staff Accounting Bulletin (SAB) No. 101 Revenue Recognition , as amended by SAB 104 (hereinafter referred to as SAB 104). The Company s products impacted by this restatement are the domestic product shipments of AVINZA, ONTAK, Targretin capsules, and Targretin gel. Management determined that based upon SFAS 48 and SAB 104 it did not have the ability to make reasonable estimates of future returns because there was (i) a lack of sufficient visibility into the wholesaler and retail distribution channels; (ii) an absence of historical experience with similar products; (iii) increasing levels of inventory in the wholesale and retail distribution channels as a result of increasing demand of the Company s new products among other factors; and (iv) a concentration of a few large distributors. As a result, the Company could not make reliable and reasonable estimates of returns which precluded it from recognizing revenue at the time of product shipment, and therefore such transactions were restated using the sell-through method. The restatement of product revenue under the sell-through method required the correction of other accounts whose balances were largely based upon the prior accounting policy. Such accounts include gross to net sales adjustments and cost of goods (products) sold. Gross to net sales adjustments include allowances for returns, rebates, chargebacks, discounts, and promotions, among others. Cost of product sold includes manufacturing costs and royalties.

The restatement did not affect the revenue recognition of Panretin or the Company s international product sales. For Panretin, the Company s wholesalers only stock minimal amounts of product, if any. As such, wholesaler orders are considered to approximate end-customer demand for the product. For international sales, the Company s products are sold to third-party distributors, for which the Company has had minimal returns. For these sales, the Company believes that it has met the SFAS 48 and SAB 104 criteria for recognizing revenue.

Specific models were developed for: AVINZA, including a separate model for each dosage strength (a retail-stocked product for which the sell-through revenue recognition event is prescriptions as reported by a third party data provider, IMS Health Incorporated, or IMS); Targretin capsules and gel (for which revenue recognition is based on wholesaler out-movement as reported by IMS); and ONTAK (for which revenue recognition is based on wholesaler out-movement as reported to the Company by its wholesalers as the product is generally not stocked in pharmacies). Separate models were also required for each of the adjustments associated with the gross to net sales adjustments and cost of goods sold. The Company also developed separate demand reconciliations for each product to assess the reasonableness of the third party information described above.

Under the sell-through method used in the restatement and on a going-forward basis, the Company does not recognize revenue upon shipment of product to the wholesaler. For these shipments, the Company invoices the wholesaler, records deferred revenue at gross invoice sales price less estimated cash discounts and, for ONTAK, end-customer returns, and classifies the inventory held by the wholesaler as deferred cost of goods sold within other current assets. Additionally, for royalties paid to technology partners based on product shipments to wholesalers, the Company records the cost of such royalties as deferred royalty expense within other

current assets. Royalties paid to technology partners are deferred as the Company has the right to offset royalties paid for product later returned against subsequent royalty obligations. Royalties for which the Company does not have the ability to offset (for example, at the end of the contracted royalty period) are expensed in the period the royalty obligation becomes due. The Company recognizes revenue when inventory is sold through (as discussed below), on a first-in first-out (FIFO) basis. Sell-through for AVINZA is considered to be at the prescription level or at the time of end user consumption for non-retail prescriptions. Thus, changes in wholesaler or retail pharmacy inventories of AVINZA do not affect the Company s product revenues. Sell-through for ONTAK, Targretin capsules, and Targretin gel is considered to be at the time the product moves from the wholesaler to the wholesaler s customer. Changes in wholesaler inventories for all the Company s products, including product that the wholesaler returns to the Company for credit, do not affect product revenues but will be reflected as a change in deferred product revenue.

The Company s revenue recognition is subject to the inherent limitations of estimates that are based on third-party data, as certain-third party information is itself in the form of estimates. Accordingly, the Company s sales and revenue recognition under the sell-through method reflect the Company s estimates of actual product sold through the distribution channel. The estimates by third parties include inventory levels and customer sell-through information the Company obtains from wholesalers which currently account for a large percentage of the market demand for its products. The Company also uses third-party market research data to make estimates where time lags prevent the use of actual data. Certain third-party data and estimates are validated against the Company s internal product movement information. To assess the reasonableness of third-party demand (i.e. sell-through) information, the Company prepares separate demand reconciliations based on inventory in the distribution channel. Differences identified through these demand reconciliations outside an acceptable range are recognized as an adjustment to the third-party reported demand in the period those differences are identified. This adjustment mechanism is designed to identify and correct for any material variances between reported and actual demand over time and other potential anomalies such as inventory shrinkage at wholesalers or retail pharmacies.

As a result of the Company s adoption of the sell-through method, it recognized deferred revenue and a corresponding reduction to net product sales in the amount of $12.8 million and $30.2 million for the three and nine months ended September 30, 2004, respectively. Revenue which has been deferred will be recognized as the product sells through in future periods as discussed above.

Sale of Royalty Rights. In March 2002, the Company entered into an agreement with Royalty Pharma AG (Royalty Pharma) to sell a portion of its rights to future royalties from the net sales of three selective estrogen receptor modulator (SERM) products now in late stage development with two of the Company s collaborative partners, Pfizer Inc. and American Home Products Corporation, now known as Wyeth, in addition to the right, but not the obligation, to acquire additional percentages of the SERM products net sales on future dates by giving the Company notice. When the Company entered into the agreement with Royalty Pharma and upon each subsequent exercise of its options to acquire additional percentages of royalty payments to the Company, the Company recognized the consideration paid to it by Royalty Pharma as revenue.

The Company determined that a portion of the revenue recognized under the Royalty Pharma agreement should have been deferred since Pfizer and Wyeth each had the right to offset a portion of future royalty payments for, and to the extent of, amounts previously paid to the Company for certain development milestones. As of September 30, 2004, approximately $1.2 million was recorded as deferred revenue in connection with the offset rights by the Company s collaborative partners, Pfizer and Wyeth. The amounts associated with the offset rights against future royalty payments will be recognized as revenue upon receipt of future royalties from the respective partners or upon determination that no such future royalties will be forthcoming. Additionally, the Company determined to defer a portion of such revenue as it relates to the value of the options sold to Royalty Pharma until Royalty Pharma exercised such options or upon the expiration of the options. As of September 30, 2004, the value of outstanding options recorded as deferred revenue was $0.1 million. This amount was subsequently recognized as revenue in the fourth quarter of 2004 when the underlying options were cancelled in connection with Royalty Pharma s purchase of an additional 1.625% royalty on future sales of the SERM products.

Buy-Out of Salk Royalty Obligation. In March 2004, the Company paid The Salk Institute $1.1 million in connection with the Company s exercise of an option to buy out milestone payments, other payment-sharing

obligations and royalty payments due on future sales of lasofoxifene, a product under development by Pfizer, for the prevention of osteoporosis in postmenopausal women, for which a new drug application (NDA) was expected to be filed in 2004. At the time of the Company s exercise of its buyout right, the payment was accounted for as a prepaid royalty asset to be amortized on a straight-line basis over the period for which the Company had a contractual right to the lasofoxifene royalties. This payment was included in other assets on the Company s consolidated balance sheet at September 30, 2004. Pfizer filed the NDA for lasofoxifene with the United States Food and Drug Administration in the third quarter of 2004. Because the NDA had not been filed at the time the Company exercised its buyout right, the Company

determined in the course of the restatement that the payment should have been expensed. Accordingly, the Company corrected such error and recognized the Salk payment as development expense for the three months ended March 31, 2004.

Pfizer Settlement Agreement. In April 1996, the Company and Pfizer entered into a settlement agreement with respect to a lawsuit filed in December 1994 by the Company against Pfizer. In connection with a collaborative research agreement the Company entered into with Pfizer in 1991, Pfizer purchased shares of the Company s common stock. Under the terms of the settlement agreement, at the option of either the Company or Pfizer, milestone and royalty payments owed to the Company can be satisfied by Pfizer by transferring to the Company shares of the Company s common stock at an exchange ratio of $12.375 per share. At the time of the settlement, the Company accounted for the prior issuance of common stock to Pfizer as equity on its consolidated balance sheet.

In conjunction with the restatement, the remaining common stock issued and outstanding to Pfizer following the settlement was reclassified as common stock subject to conditional redemption (between liabilities and equity) in accordance with Emerging Issue Task Force Topic D-98, Classification and Measurement of Redeemable Securities (EITF D-98), which was issued in July 2001.

EITF D-98 requires the security to be classified outside of permanent equity if there is a possibility of redemption of securities that is not solely within the control of the issuer. Since Pfizer has the option to settle with Company s shares milestone and royalties payments owed to the Company, the Company determined that such factors indicated that the redemptions were not within the Company s control, and accordingly, EITF D-98 was applicable to the treatment of the common stock issued to Pfizer. This adjustment totaling $14.6 million only had an effect on the balance sheet classification, not on the consolidated statements of operations. In the third quarter of 2004, Pfizer elected to pay a $2.0 million milestone payment due the Company in stock and subsequently tendered approximately 181,000 shares to the Company. The Company retired such shares in September 2004 and common stock subject to conditional redemption was reduced by approximately $2.3 million.

Seragen Litigation. On December 11, 2001, a lawsuit was filed in the United States District Court for the District of Massachusetts against the Company by the Trustees of Boston University and other former stakeholders of Seragen. The suit was subsequently transferred to federal district court in Delaware. The complaint alleges breach of contract, breach of the implied covenants of good faith and fair dealing and unfair and deceptive trade practices based on, among other things, allegations that the Company wrongfully withheld approximately $2.1 million in consideration due the plaintiffs under the Seragen acquisition agreement. This amount had been previously accrued for in the Company s consolidated financial statements in 1998. The complaint seeks payment of the withheld consideration and treble damages. The Company filed a motion to dismiss the unfair and deceptive trade practices claim. The Court subsequently granted the Company s motion to dismiss the unfair and deceptive trade practices claim (i.e. the treble damages claim), in April 2003. In November 2003, the Court granted Boston University s motion for summary judgment, and entered judgment for Boston University. In January 2004, the district court issued an amended judgment awarding interest of approximately $0.7 million to the plaintiffs in addition to the approximately $2.1 million withheld. The Court award of interest was previously not accrued. Although the Company has appealed the judgment in this case as well as the award of interest and the calculation of damages, in view of the judgment, the Company revised its consolidated financial statements in the fourth quarter of 2003 to record a charge of $0.7 million.

Other. In conjunction with the restatement, the Company also made other adjustments and reclassifications to its accounting for various other errors, in various years, including, but not limited to: (1) a correction to the Company s estimate of the accrual for clinical trials; (2) corrections to estimates of other accrued liabilities; (3) royalty payments made to technology partners; (4) straight-line recognition of rent expense for contractual annual rent increases; and (5) corrections to estimates of future obligations and bonuses to employees.

The following tables reconcile the Company s consolidated financial condition and results of operations from the previously reported consolidated financial statements to the restated consolidated financial statements at and for the three and nine months ended September 30, 2004.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
(in thousands, except share and per share data)
(unaudited)

	For the three months ended September 30, 2004	For the nine months ended September 30, 2004
Net loss, as previously reported:	$ (6,789)	$ (34,144)
Adjustments to net loss (increase) decrease:		
Product sales:		
Net product sales (a)	(12,842)	(30,184)
Other (b)	50	9
Sale of royalty rights, net (c)	67	67
Cost of products sold:		
Product cost (d)	163	1,263
Royalties (d)	1,029	1,415
Research and development:		
Reclassification (e)	1,221	3,417
Salk-buyout (f)		(1,120)
Patent expense (g)		(238)
Other (b)	12	117
Selling, general and administrative:		
Reclassification (e)	(1,221)	(3,417)
Legal expense (h)		373
Other (b)	(200)	(101)
Interest:		
Factoring arrangement (i)	(238)	(238)
Other (b)	12	68
Other, net:		
Factoring arrangement (i)	238	238
Income taxes (j)	3	37
Income tax expense (j)	(3)	(37)
Net loss, as restated	$ (18,498)	$ (62,475)
Per Share Data		
As previously reported:		
Basic and diluted net loss per share	$ (0.09)	$ (0.46)
Weighted average number of common shares	73,845,613	73,635,562
As restated:		

Basic and diluted net loss per share	$ (0.25)	$ (0.85)
Weighted average number of common shares	73,845,613	73,635,562

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following:

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(b) To reflect other adjustments and reclassifications.

(c) To reflect the recognition of revenue previously deferred in regard to the sale of royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties.

(e) To reclassify expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general

and administrative expense.

(f) To expense the payment to The Salk Institute to buy-out the Company s royalty obligation on lasofoxifene in March 2004.

(g) To correct patent expense. (h) To correct legal expense. (i) To reclassify interest and factoring expenses incurred under a factoring arrangement.

(j) To reclassify income taxes related to international operations.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	September 30, 2004			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 46,020			$ 46,020
Short-term investments	34,387			34,387
Accounts receivable, net	30,583	$ (162)(a)	$ 36(a)	30,457
Current portion of inventories, net	11,355	4,035(b)(l)	66(a)(l)	7,386
Other current assets	2,985	13,223(a)(c)	2,729(a)(c)	18,937
Total current assets	125,330	9,026	2,831	137,187
Restricted investments	1,656			1,656
Long-term portion of inventories, net		4,250(l)	(45)(l)	4,205
Property and equipment, net	23,844			23,844
Acquired technology and product rights, net	129,852	260(a)(d)		130,112
Other assets	7,977	(1,208) (a)(e)		6,769
	$ 288,659	$ 12,328	$ 2,786	$ 303,773
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 16,719	$ 1(a)	$ 68(a)	$ 16,788
Accrued liabilities	49,527	(298) (a)(f)	(3,308) (a)(f)	45,921
Current portion of deferred revenue, net	2,352	121,473(g)	17,720(g)	141,545
Current portion of equipment financing obligations	2,617			2,617
Current portion of long-term debt	314			314
Total current liabilities	71,529	121,176	14,480	207,185
Long-term debt	167,171			167,171
Long-term portion of deferred revenue, net	2,043	1,173(h)		3,216
Long-term portion of equipment financing obligations	4,087			4,087
Other long-term liabilities	2,870	288(i)	15(i)	3,173
Total liabilities	247,700	122,637	14,495	384,832

Common stock subject to conditional redemption		14,595(j)	(2,250) (k)	12,345
Stockholders equity (deficit):				
Common stock	74	(1) (j)		73
Additional paid-in capital	731,841	(14,540) (a)(j)	2,250(k)	719,551
Accumulated other comprehensive loss	(123)			(123)
Accumulated deficit	(689,922)	(110,363)	(11,709)	(811,994)
	41,870	(124,904)	(9,459)	(92,493)
Treasury stock	(911)			(911)

Refer to the explanation of adjustments on the next page.

Table of Contents

	September 30, 2004			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
Total stockholders equity (deficit)	40,959	(124,904)	(9,459)	(93,404)
	$ 288,659	$ 12,328	$ 2,786	$ 303,773

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) To reverse replacement reserve.

(c) Cumulative effect of prior period adjustments includes $13,276 related to the change to the sell-through revenue recognition method (deferred royalties $8,704; deferred cost of products sold $4,572). Current quarter adjustments include $2,654 related to the change to the sell-through revenue recognition method (deferred royalties $2,486; deferred cost of products sold $168).

(d) To correct accumulated amortization expense related to ONTAK acquired technology $357.

(e) To expense the payment to The Salk Institute to buy-out the Company s royalty obligation on lasofoxifene $(1,120).

(f) Cumulative effect of prior period adjustments includes $(3,056) related to the change to the sell-through revenue recognition method (product cost $(2,652); royalties $(404)); to correct bonus expense $(201); to reclassify Seragen acquisition liability from other long-term liabilities $2,100; to accrue interest on Seragen acquisition liability $739. Current quarter adjustments include $(3,349) related to the change to the sell-through revenue recognition method (product cost $(4,806); royalties $1,457).

(g) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(h) To reflect the deferral of a portion of the sale of royalty rights to Royalty Pharma.

(i) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,388; to reclassify the Seragen acquisition liability to accrued liabilities $(2,100). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $15.

(j)

To reclassify from equity the Company s issuance of common stock subject to conditional redemption to Pfizer, in connection with the Pfizer settlement agreement in accordance with EITF D-98 $(14,595) common stock $(1), additional paid-in capital $(14,594).

(k) To reflect Pfizer s redemption of shares in connection with the achievement of a milestone in accordance with the Pfizer settlement agreement.

(l) To reclassify portion of inventory not expected to be used within one year to long-term.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended September 30, 2004		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 44,726	$ (12,792)(a)(b)	$ 31,934
Sale of royalty rights, net		67(c)	67
Collaborative research and development and other revenues	4,771		4,771
Total revenues	49,497	(12,725)	36,772
Operating costs and expenses:			
Cost of products sold	11,011	(1,192) (d)	9,819
Research and development	17,980	(1,233) (b)(e)	16,747
Selling, general and administrative	15,890	1,421(b)(e)	17,311
Co-promotion	8,501		8,501
Total operating costs and expenses	53,382	(1,004)	52,378
Loss from operations	(3,885)	(11,721)	(15,606)
Other income (expense):			
Interest income	255		255
Interest expense	(2,919)	(226) (b)(f)	(3,145)
Other, net	(240)	241(b)(f)(g)	1
Total other expense, net	(2,904)	15	(2,889)
Loss before income taxes	(6,789)	(11,706)	(18,495)
Income tax expense		(3) (g)	(3)
Net loss	$ (6,789)	$ (11,709)	$ (18,498)
Basic and diluted per share amounts:			

Net loss	$ (0.09)	$ (0.25)
Weighted average number of common shares	73,845,613	73,845,613

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(12,842).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the recognition of revenue previously deferred in regard to the sale of royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $(163), royalties $(1,029).

(e) To reclassify $1,221 of expenses incurred for the technology transfer and validation effort related to the second source of

supply for AVINZA from research and development expense to selling, general and administrative expense.

(f) To reclassify $238 of interest and factoring expenses incurred under a factoring arrangement from other, net to interest expense.

(g) To reclassify income taxes related to international operations $3.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Nine Months Ended September 30, 2004		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 116,347	$ (30,175)(a)(b)	$ 86,172
Sale of royalty rights, net		67(c)	67
Collaborative research and development and other revenues	10,222		10,222
Total revenues	126,569	(30,108)	96,461
Operating costs and expenses:			
Cost of products sold	29,760	(2,678) (b)(d)	27,082
Research and development	53,006	(2,176) (b)(e)(g)(h)	50,830
Selling, general and administrative	46,987	3,145(b)(e)(i)	50,132
Co-promotion	22,232		22,232
Total operating costs and expenses	151,985	(1,709)	150,276
Loss from operations	(25,416)	(28,399)	(53,815)
Other income (expense):			
Interest income	694		694
Interest expense	(9,150)	(170) (b)(f)	(9,320)
Other, net	(272)	275(f)(j)	3
Total other expense, net	(8,728)	105	(8,623)
Loss before income taxes	(34,144)	(28,294)	(62,438)
Income tax expense		(37) (j)	(37)
Net loss	$ (34,144)	$ (28,331)	$ (62,475)
Basic and diluted per share amounts:			

Net loss	$ (0.46)	$ (0.85)
Weighted average number of common shares	73,635,562	73,635,562

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(30,184).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the recognition of revenue previously deferred in regard to the sale of royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $(1,263); royalties $(1,415).

(e) To reclassify $3,417 of expenses incurred for the technology transfer and validation effort related to the

second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(f) To reclassify $238 of interest and factoring expenses incurred under a factoring arrangement from other, net to interest expense.

(g) To expense the payment to The Salk Institute to buy out the Company s royalty obligation on lasofoxifene in March 2004 $1,120.

(h) To correct patent expense $238.

(i) To reflect legal expense in the proper accounting period $(373).

(j) To reclassify income taxes related to international operations $37.

Table of Contents

3. Accounts Receivable Factoring Arrangement

During 2003, the Company entered into a one-year accounts receivable factoring arrangement under which eligible accounts receivable are sold without recourse to a finance company. The agreement was renewed for a one-year period in the second quarter of 2004 and again in the second quarter of 2005 through December 2007. Commissions on factored receivables are paid to the finance company based on the gross receivables sold, subject to a minimum annual commission. Additionally, the Company pays interest on the net outstanding balance of the uncollected factored accounts receivable at an interest rate equal to the JPMorgan Chase Bank prime rate. The Company continues to service the factored receivables. The servicing expenses for the three and nine months ended September 30, 2005 and 2004 were not material. There were no material gains or losses on the sale of such receivables. The Company accounts for the sale of receivables under this arrangement in accordance with SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*.

The agreement requires the Company to provide its consolidated financial statements to the finance company within 120 days after year-end. Because the Company was unable to complete its restated consolidated financial statements within 120 days, it was in default of this requirement. A waiver of this financial reporting covenant, however, has been granted through December 31, 2005. The Company subsequently completed its restated consolidated financial statements and provided such financial statements to the finance company in November 2005.

As of September 30, 2005 and December 31, 2004, the Company had received cash of $23.5 million and $17.2 million, respectively, under the factoring arrangement for the sale of trade receivables that were outstanding as of such dates. The gross amount due from the finance company at September 30, 2005 and December 31, 2004 was $15.1 million and $6.1 million, respectively.

4. Royalty Agreements

Restructuring of ONTAK Royalty

In November 2004, Ligand and Eli Lilly and Company (Lilly) agreed to amend their ONTAK royalty agreement to add options in 2005 that if exercised would restructure Ligand s royalty obligations on net sales of ONTAK. Under the revised agreement, Ligand and Lilly each obtained two options. Ligand s options, exercisable in January 2005 and April 2005, provided for the buy down of a portion of the Company s ONTAK royalty obligation on net sales in the United States for total consideration of $33.0 million. Lilly also had two options exercisable in July 2005 and October 2005 to trigger the same royalty buy-downs for total consideration of up to $37.0 million dependent on whether Ligand exercised one or both of its options.

Ligand s first option, providing for a one-time payment of $20.0 million to Lilly in exchange for the elimination of Ligand s ONTAK royalty obligations in 2005 and a reduced reverse-tiered royalty scale on ONTAK sales in the U.S. thereafter, was exercised and paid in January 2005. The second option which provides for a one-time payment of $13.0 million to Lilly in exchange for the elimination of royalties on ONTAK net sales in the U.S. in 2006 and a reduced reverse-tiered royalty thereafter was exercised and paid in April 2005. Additionally, beginning in 2007 and throughout the remaining ONTAK patent life (2014), Ligand will pay no royalties to Lilly on U.S. sales up to $38.0 million. Thereafter, Ligand would pay royalties to Lilly at a rate of 20% on net U.S. sales between $38.0 million and $50.0 million; at a rate of 15% on net U.S. sales between $50.0 million and $72.0 million; and at a rate of 10% on net U.S. sales in excess of $72.0 million. As of September 30, 2005, the option payments totaling $33.0 million were capitalized and are being amortized over the remaining ONTAK patent life of approximately 10 years, which represents the period estimated to be benefited, using the greater of the straight-line method or the expense determined based on the tiered royalty schedule set forth above. In accordance with SFAS No. 142, *Goodwill and Other Intangibles,* the Company amortizes intangible assets with finite lives in a manner that reflects the pattern in which the economic benefits of the assets are consumed or otherwise used up. If that pattern cannot be reliably determined, the assets are amortized using the straight-line method.

Table of Contents

Pfizer Collaboration Lasofoxifene

In August 2004, Pfizer submitted an NDA to the FDA for lasofoxifene 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 lasofoxifene for the treatment of vaginal atrophy which remains pending at the FDA. Lasofoxifene is also being developed by Pfizer for the treatment of osteoporosis. Lasofoxifene is a product that resulted from the Company s collaboration with Pfizer and upon which the Company will receive royalties if the product is approved by the FDA and subsequently marketed by Pfizer.

Salk Payment

In January 2005, Ligand paid The Salk Institute $1.1 million to exercise an option to buy out milestone payments, other payment-sharing obligations and royalty payments due on future sales of lasofoxifene for vaginal atrophy. This payment resulted from a supplemental lasofoxifene NDA filing by Pfizer. As the Company had previously sold rights to Royalty Pharma AG of approximately 50% of any royalties to be received from Pfizer for sales of Lasofoxifene, it recorded approximately 50% of the payment made to The Salk Institute, approximately $0.6 million, as development expense in the first quarter of 2005. The balance of approximately $0.5 million was capitalized and will be amortized over the period any such royalties are received from Pfizer for the vaginal atrophy indication.

Settlement of Patent Interference

In March 2005, Ligand announced that it reached a settlement agreement in a recent patent interference action initiated by Ligand against two patents owned by The Burnham Institute and SRI International, but exclusively licensed to Ligand. The Company believes the settlement strengthens its intellectual property position for bexarotene, the active ingredient in the Targretin products. The settlement also reduces the royalty rate on those products while extending the royalty payment term to SRI/Burnham.

Under the agreement, Burnham will have a research-only sublicense to conduct basic research under the assigned patents and Ligand will have an option on the resulting products and technology. In addition, Burnham and SRI agreed to accept a reduction in the royalty rate paid to them on U.S. sales of Targretin under an earlier agreement. The aggregate royalty rate owed to SRI and Burnham by Ligand will be reduced from 4% to 3% of net sales and the term of the royalty payments extended from 2012 to 2016. If the patent issued on the pending Ligand patent application is extended beyond 2016, the royalty rate would be reduced to 2% and paid for the term of the longest Ligand patent covering bexarotene.

5. Targretin Capsules

In March 2005, the Company announced that the final data analysis for Targretin capsules in non-small cell lung cancer (NSCLC) showed that the trials did not meet their endpoints of improved overall survival and projected two year survival. The Company is continuing to analyze the data and apply it to the continued development of Targretin capsules in NSCLC.

6. AVINZA Co-Promotion

In February 2003, Ligand and Organon Pharmaceuticals USA Inc. (Organon) announced that they had entered into an agreement for the co-promotion of AVINZA. Under the terms of the agreement, Organon committed to a specified minimum number of primary and secondary product calls delivered to certain high prescribing physicians and hospitals beginning in March 2003. Organon s compensation is structured as a percentage of net sales based on Ligand s standard accounting principles and generally accepted accounting principles (GAAP), which pays Organon for their efforts and also provides Organon an economic incentive for performance and results. In exchange, Ligand pays Organon a percentage of AVINZA net sales based on the following schedule:

Annual Net Sales of AVINZA	% of Incremental Net Sales Paid to Organon by Ligand
$0-150 million	30%
$150-300 million	40%

$300-425 million	50%
> $425 million	45%

Through the announcement of the restatement, Ligand calculated and paid Organon s compensation according to its prior application of GAAP and its prior standard accounting principles. The restatement corrects the recognition of revenue for transactions

Table of Contents

involving AVINZA that did not satisfy all of the conditions for revenue recognition contained in SFAS 48 and SAB 104. Shipments made to wholesalers for AVINZA did not meet the revenue recognition criteria under GAAP and such transactions were restated using the sell-through method as opposed to the sell-in method previously used.

Under the sell-through method, Ligand does not recognize revenue upon shipment of AVINZA to the wholesaler. As a result, Ligand believes it has overpaid Organon under the terms of the agreement by approximately $2.5 million through September 30, 2005. Ligand has notified Organon regarding the overpayment and its intention to apply such overpayment to future amounts due under the co-promotion agreement calculated under GAAP and its standard accounting principles. Organon has expressed its disagreement with this position and Ligand is currently in discussions with Organon. While the discussions continue, the payments made and under discussion are reflected in Ligand s consolidated financial statements as co-promotion expense. Therefore, the consolidated financial statements included herein do not recognize the overpayment pending resolution of the matter. Until this matter is resolved, Ligand will continue to account for co-promotion expense based on net sales determined using the sell-in method.

7. Litigation

Seragen, Inc., our subsidiary, and Ligand, were named parties to Sergio M. Oliver, et al. v. Boston University, et al., a putative shareholder class action filed on December 17, 1998 in the Court of Chancery in the State of Delaware in and for New Castle County, C.A. No. 16570NC, by Sergio M. Oliver and others against Boston University and others, including Seragen, its subsidiary Seragen Technology, Inc. and former officers and directors of Seragen. The complaint, as amended, alleged that Ligand aided and abetted purported breaches of fiduciary duty by the Seragen related defendants in connection with the acquisition of Seragen by Ligand and made certain misrepresentations in related proxy materials and seeks compensatory and punitive damages of an unspecified amount. On July 25, 2000, the Delaware Chancery Court granted in part and denied in part defendants motions to dismiss. Seragen, Ligand, Seragen Technology, Inc. and our acquisition subsidiary, Knight Acquisition Corporation, were dismissed from the action. Claims of breach of fiduciary duty remain against the remaining defendants, including the former officers and directors of Seragen. The hearing on the plaintiffs motion for class certification took place on February 26, 2001. The court certified a class consisting of shareholders as of the date of the acquisition and on the date of the proxy sent to ratify an earlier business unit sale by Seragen. On January 20, 2005, the Delaware Chancery Court granted in part and denied in part the defendants motion for summary judgment. The Court denied plaintiffs motion for summary judgment in its entirety. Trial was scheduled for February 7, 2005. Prior to trial, several of the Seragen director-defendants reached a settlement with the plaintiffs. The trial in this action then went forward as to the remaining defendants and concluded on February 18, 2005. The timing of a decision by the Court and the outcome are unknown. While Ligand and its subsidiary Seragen have been dismissed from the action, such dismissal is subject to a possible subsequent appeal upon any judgment in the action against the remaining parties, as well as possible indemnification obligations with respect to certain defendants.

On December 11, 2001, a lawsuit was filed in the United States District Court for the District of Massachusetts against Ligand by the Trustees of Boston University and other former stakeholders of Seragen. The suit was subsequently transferred to federal district court in Delaware. The complaint alleges breach of contract, breach of the implied covenants of good faith and fair dealing and unfair and deceptive trade practices based on, among other things, allegations that Ligand wrongfully withheld approximately $2.1 million in consideration due the plaintiffs under the Seragen acquisition agreement. This amount had been previously accrued for in the Company s consolidated financial statements in 1998. The complaint seeks payment of the withheld consideration and treble damages. Ligand filed a motion to dismiss the unfair and deceptive trade practices claim. The Court subsequently granted Ligand s motion to dismiss the unfair and deceptive trade practices claim (i.e. the treble damages claim), in April 2003. In November 2003, the Court granted Boston University s motion for summary judgment, and entered judgment for Boston University. In January 2004, the district court issued an amended judgment awarding interest of approximately $0.7 million to the plaintiffs in addition to the approximately $2.1 million withheld. In view of the judgment, the Company recorded a charge of $0.7 million to Selling, general and administrative expense in the fourth quarter of 2003. The Company continues to believe that the plaintiff s claims are without merit and has appealed the judgment in this case as well as the award of interest and the calculation of damages. The appeal has been fully briefed and was argued in June 2005 and the parties are awaiting the court s decision. The likelihood of success on appeal is unknown.

Beginning in August 2004, several purported class action stockholder lawsuits were filed in the United States District Court for the Southern District of California against the Company and certain of its directors and officers. The actions were brought on behalf of purchasers of the Company s common stock during several time periods, the longest of which runs from July 28, 2003 through August 2, 2004. The complaints generally allege that the Company violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission by making false and misleading statements, or concealing information about the Company s business, forecasts and financial performance, in particular statements and information related to

Table of Contents

drug development issues and AVINZA inventory levels. These lawsuits have been consolidated and lead plaintiffs appointed. A consolidated complaint was filed by the plaintiffs on March 2005. On September 27, 2005, the court granted the Company s motion to dismiss the consolidated complaint, with leave for plaintiffs to file an amended complaint within 30 days. No trial date has been set.

Beginning on or about August 13, 2004, several derivative actions were filed on behalf of the Company by individual stockholders in the Superior Court of California. The complaints name the Company s directors and certain of its officers as defendants and name the Company as a nominal defendant. The complaints are based on the same facts and circumstances as the purported class actions discussed in the previous paragraph and generally allege breach of fiduciary duties, abuse of control, waste and mismanagement, insider trading and unjust enrichment. These actions are in discovery. The court has set a trial date of May 26, 2006.

In October 2005, a shareholder derivative action was filed on behalf of the Company in the United States District Court for the Southern District of California. The complaint names the Company s directors and certain of its officers as defendants and the Company as a nominal defendant. The action was brought by an individual stockholder. The complaint generally alleges that the defendants falsified Ligand s publicly reported financial results throughout 2002 and 2003 and the first three quarters of 2004 by improperly recognizing revenue on product sales. The complaint generally alleges breach of fiduciary duty by all defendants and requests disgorgement, e.g., under Section 304 of the Sarbanes-Oxley Act of 2002. No trial date has been set.

The Company believes that all of the above actions are without merit and intends to vigorously defend against each of such lawsuits. Due to the uncertainty of the ultimate outcome of these matters, the impact on future financial results is not subject to reasonable estimates.

In October 2005, a lawsuit was filed in the Court of Chancery in the State of Delaware by Third Point Offshore Fund, Ltd. requesting the Court to order Ligand to hold an annual meeting for the election of directors within 60 days of an order by the Court. Ligand s annual meeting had been delayed as a result of the previously announced restatement. The complaint requested the Court to set a time and place and record date for such annual meeting and establish the quorum for such meeting as the shares present at the meeting, notwithstanding any relevant provisions of Ligand s certificate of incorporation or bylaws. The complaint sought payment of plaintiff s costs and attorney s fees. Ligand agreed on November 11, 2005 to settle this lawsuit and schedule the annual meeting for January 31, 2006. The record date for the meeting is December 15, 2005. On December 2, 2005, Ligand and Third Point also entered into a stockholders agreement under which, among other things, Ligand will expand its board from eight to eleven, elect three designees of Third Point to the new board seats and pay certain of Third Point s expenses, not to exceed approximately $0.5 million, with some conditions. Third Point will not sell its Ligand shares, solicit proxies or take certain other stockholder actions for a minimum of six months and as long as its designees remain on the board.

In connection with the restatement, the SEC instituted a formal investigation concerning the Company s consolidated financial statements. These matters were previously the subject of an informal SEC inquiry.

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

8. Purchase of Nexus Equity VI LLC

As of March 31, 2004, the Company leased one of its corporate office buildings from Nexus Equity VI LLC (Nexus), a limited liability company in which Ligand held a 1% ownership interest. Nexus had been first consolidated as of December 31, 2003 by the Company in accordance with FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51.*

In April 2004, the Company exercised its right to acquire the portion of Nexus that it did not own. The acquisition resulted in Ligand s assumption of the existing loan against the property and payment to Nexus other shareholder of approximately $0.6 million.

9. New Accounting Pronouncements

In March 2004, the Financial Accounting Standards Board (FASB) approved the consensus reached on the Emerging Issues Task Force (EITF) Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments (EITF 03-1).* EITF 03-1 provides guidance for identifying impaired investments

and new disclosure requirements for investments that

Table of Contents

are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF 03-1; however the disclosure requirements remain effective for annual periods ending after June 15, 2004. The Company does not believe the impact of adopting EITF 03-1 will be significant to its overall results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123R (revised 2004), *Share-Based Payment (SFAS 123R)*. SFAS 123R replaced SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), and superseded Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). In March 2005, the U.S. Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107 (SAB 107), which expresses views of the SEC staff regarding the interaction between SFAS 123R and certain SEC rules and regulations, and provides the staff s views regarding the valuation of share-based payment arrangements for public companies. SFAS 123R will require compensation cost related to share-based payment transactions to be recognized in the financial statements. SFAS 123R required public companies to apply SFAS 123R in the first interim or annual reporting period beginning after June 15, 2005. In April 2005, the SEC approved a new rule that delays the effective date, requiring public companies to apply SFAS 123R in their next fiscal year, instead of the next interim reporting period, beginning after June 15, 2005. As permitted by SFAS 123, the Company elected to follow the guidance of APB 25, which allowed companies to use the intrinsic value method of accounting to value their share-based payment transactions with employees. SFAS 123R requires measurement of the cost of share-based payment transactions to employees at the fair value of the award on the grant date and recognition of expense over the requisite service or vesting period. SFAS 123R requires implementation using a modified version of prospective application, under which compensation expense of the unvested portion of previously granted awards and all new awards will be recognized on or after the date of adoption. SFAS 123R also allows companies to adopt SFAS 123R by restating previously issued statements, basing the amounts on the expense previously calculated and reported in their pro forma footnote disclosures required under SFAS 123. The Company will adopt SFAS 123R in the first interim period of fiscal 2006 and is currently evaluating the impact that the adoption of SFAS 123R will have on its results of operations and financial position.

In November 2004, the FASB issued SFAS No. 151, *Inventory Pricing* (SFAS 151). SFAS 151 amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). This statement requires that those items be recognized as current-period charges. In addition, SFAS 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The impact of the adoption of SFAS No. 151 is not expected to have a material impact on the Company s consolidated statements of operations or consolidated balance sheets.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*, to address the measurement of exchanges of nonmonetary assets. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, and replaces it with an exception for nonmonetary exchanges that do not have commercial substance. This statement specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The impact of the adoption of SFAS No. 153 did not have a material impact on the Company s consolidated statements of operations or consolidated balance sheets.

In May 2005, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 154, *Accounting Changes and Error Corrections* (SFAS 154). SFAS 154 requires retrospective application to prior-period financial statements of changes in accounting principles, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also redefines restatement as the revising of previously issued financial statements to reflect the correction of an error. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

10. NASDAQ Delisting

The Company s common stock was delisted from the NASDAQ National Market on September 7, 2005. Unless and until the Company s common stock is relisted on NASDAQ, its common stock is expected to be quoted on the Pink

Sheets. The quotation of the Company s common stock on the Pink Sheets may reduce the price of the common stock and the levels of liquidity available to the Company s stockholders. In addition, the quotation of the Company s common stock on the Pink Sheets may materially adversely affect the Company s access to the capital markets, and the limited liquidity and reduced price of its common stock could materially adversely affect the Company s ability to raise capital through alternative financing sources on terms acceptable to the Company or at all. Stocks that are quoted on the Pink Sheets are no longer eligible for margin loans, and a company quoted on the Pink Sheets cannot avail itself of federal preemption of state securities or blue sky laws, which adds substantial compliance costs to securities issuances, including pursuant to employee option plans, stock purchase plans and private or public offerings of securities. The

Table of Contents

Company s delisting from the NASDAQ National Market and quotation on the Pink Sheets may also result in other negative implications, including the potential loss of confidence by suppliers, customers and employees, the loss of institutional investor interest and fewer business development opportunities.

11. Commitment

As of March 31, 2005, the Company entered into a consulting agreement with Dr. Ronald Evans, a Salk professor and Howard Hughes Medical Institute investigator, that continues through February 2008. The agreement provides for certain cash payments and a grant of stock options. Dr. Evans serves as a Chairman of Ligand s Scientific Advisory Board.

12. Subsequent Events

Bylaws Amendment

On November 8, 2005, the Board of Directors of the Company approved an amendment to the Company s Bylaws clarifying the Company s advance notice requirement for a stockholder who wishes to bring business before an annual meeting of stockholders. The amended bylaw provides that, in the event the annual meeting date has been changed by more than 30 days from the date contemplated in the previous year s proxy statement, stockholder proposals for the annual meeting must be received no later than 20 days after the earlier of the date on which (i) notice of the date of the annual meeting was mailed to stockholders or (ii) public disclosure of the date of the meeting was made to stockholders. Previously the bylaws stated that the time for receipt of such proposals was a reasonable time before the solicitation is made.

Amended and Restated Research, Development and License Agreement with Wyeth

On December 1, 2005, the Company entered into an Amended and Restated Research, Development and License Agreement with Wyeth (formerly American Home Products Corporation). Under the previous agreement, effective September 2, 1994 as amended January 16, 1996, May 24, 1996, September 2, 1997 and September 9, 1999 (collectively the Prior Agreement), Wyeth and the Company engaged in a joint research and development effort to discover and/or design small molecule compounds which act through the estrogen and progesterone receptors and to develop pharmaceutical products from such compounds. Wyeth sponsored certain research and development activities to be carried out by the Company and Wyeth may commercialize products resulting from the joint research and development subject to certain milestone and royalty payments. The Amended and Restated Agreement does not materially change the prior rights and obligations of the parties with respect to Wyeth compounds, currently in development, e.g. bazedoxifene, in late stage development for osteoporosis.

The parties agreed to amend and restate the Prior Agreement principally to better define, simplify and clarify the universe of research compounds resulting from the research and development efforts of the parties, combine and clarify categories of those compounds and related milestones and royalties and resolve a number of milestone payment issues that had arisen. Among other things, the Amended and Restated Agreement calls for Wyeth to pay Ligand $1.8 million representing the difference between amounts paid under the old compound categories versus the amounts due under the new, single category.

Stockholders Agreement

On December 2, 2005, the Company and Third Point Offshore Fund, Ltd. (Third Point) entered into a stockholders agreement under which, among other things, the Company will expand its board from eight to eleven, elect three designees of Third Point to the new board and pay certain of Third Point s expenses, not to exceed approximately $0.5 million, with some conditions. Third Point will not sell its Ligand shares, solicit proxies or take certain other stockholders actions for a minimum of six months and as long as its designees remain on the board. See Note 7. Litigation.

Table of Contents

Report of Independent Registered Public Accounting Firm

We have audited the accompanying consolidated balance sheets of Ligand Pharmaceuticals Incorporated and subsidiaries as of December 31, 2004 and 2003 and the related consolidated statements of operations, stockholders equity (deficit), and cash flows for each of the years in the three year period ended December 31, 2004. We have also audited the schedules listed in the accompanying Item 16(b). These consolidated financial statements and schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and schedules based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ligand Pharmaceuticals Incorporated and subsidiaries as of December 31, 2004 and 2003 and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the schedules present fairly, in all material respects, the information set forth therein.

We also have audited in accordance with the standards of Public Company Accounting Oversight Board (United States), the effectiveness of Ligand Pharmaceuticals Incorporated and subsidiaries internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated November 11, 2005 expressed an unqualified opinion on management s assessment of internal control over financial reporting and an adverse opinion on the effectiveness of internal control over financial reporting.

As described in Note 2, the Company has restated its previously issued consolidated financial statements as of December 31, 2003 and for each of the years in the two year period ended December 31, 2003.

/s/ BDO Seidman, LLP
Costa Mesa, California
November 11, 2005

Table of Contents

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

	December 31, 2004	December 31, 2003 (Restated)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 92,310	$ 59,030
Short-term investments; $9,204 restricted at December 31, 2003	20,182	40,004
Accounts receivable, net	30,847	18,901
Current portion of inventories, net	7,155	5,634
Other current assets	17,713	16,361
Total current assets	168,207	139,930
Restricted investments	2,378	1,656
Long-term portion of inventories, net	4,617	2,846
Property and equipment, net	23,647	23,501
Acquired technology and product rights, net	127,443	138,117
Other assets	6,174	7,996
	$ 332,466	$ 314,046
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	$ 17,352	$ 18,841
Accrued liabilities	43,908	32,667
Current portion of deferred revenue, net	152,528	105,719
Current portion of equipment financing obligations	2,604	2,184
Current portion of long-term debt	320	295
Total current liabilities	216,712	159,706
Long-term debt	167,089	167,408
Long-term portion of equipment financing obligations	4,003	2,644
Long-term portion of deferred revenue, net	4,512	3,448
Other long-term liabilities	3,122	3,799
Total liabilities	395,438	337,005
Commitments and contingencies		
Common stock subject to conditional redemption; 997,568 and 1,179,386 shares issued and outstanding at December 31, 2004 and 2003, respectively	12,345	14,595
Stockholders deficit:		
Convertible preferred stock, $0.001 par value; 5,000,000 shares authorized; none issued	¾	¾
	73	72

Common stock, $0.001 par value; 200,000,000 shares and 130,000,000 shares authorized at December 31, 2004 and 2003, respectively; 72,970,670 and 72,085,399 shares issued and outstanding at December 31, 2004 and 2003, respectively		
Additional paid-in capital	719,952	712,870
Accumulated other comprehensive income (loss)	229	(66)
Accumulated deficit	(794,660)	(749,519)
	(74,406)	(36,643)
Treasury stock, at cost; 73,842 shares	(911)	(911)
Total stockholders deficit	(75,317)	(37,554)
	$ 332,466	$ 314,046

See accompanying notes to these consolidated financial statements.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share data)

	Year Ended December 31,		
	2004	2003 (Restated)	2002 (Restated)
Revenues:			
Product sales	$ 120,335	$ 55,324	$ 30,326
Sale of royalty rights, net	31,342	11,786	17,600
Collaborative research and development and other revenues	11,835	14,008	23,843
Total revenues	163,512	81,118	71,769
Operating costs and expenses:			
Cost of products sold	39,804	26,557	14,738
Research and development	65,204	66,678	59,060
Selling, general and administrative	65,798	52,540	41,825
Co-promotion	30,077	9,360	
Total operating costs and expenses	200,883	155,135	115,623
Loss from operations	(37,371)	(74,017)	(43,854)
Other income (expense):			
Interest income	1,096	783	1,086
Interest expense	(12,338)	(11,142)	(6,295)
Debt conversion expense			(2,015)
Other, net	3,705	(10,034)	(1,135)
Total other expense, net	(7,537)	(20,393)	(8,359)
Loss before income taxes and cumulative effect of a change in accounting principle	(44,908)	(94,410)	(52,213)
Income tax expense	(233)	(56)	(44)
Loss before cumulative effect of a change in accounting principle	(45,141)	(94,466)	(52,257)
Cumulative effect of changing method of accounting for variable interest entity (Note 3)		(2,005)	
Net loss	$ (45,141)	$ (96,471)	$ (52,257)
Basic and diluted per share amounts:			
Loss before cumulative effect of a change in accounting principle	$ (0.61)	$ (1.33)	$ (0.76)
Cumulative effect of changing method of accounting for variable interest entity		(0.03)	

Net loss	$ (0.61)	$ (1.36)	$ (0.76)
Weighted average number of common shares	73,692,987	70,685,234	69,118,976
Pro forma amounts assuming the changed method of accounting for variable interest entity is applied retroactively (Note 3):			
Net loss		$ (94,352)	$ (52,456)
Basic and diluted net loss per share		$ (1.34)	$ (0.76)

See accompanying notes to these consolidated financial statements.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)
(in thousands, except share data)

	Common stock		Additional paid-in	Deferred	Accumulated other comprehensive income	Accumulated	Treasury stock		Total stockholders equity	Comprehensive
	Shares	Amount	capital	expense	(loss)	deficit	Shares	Amount	(deficit)	loss
Balance at January 1, 2002, as originally reported	60,164,840	$ 60	$ 529,374	$ (692)	$ 14	$ (585,720)	(73,842)	$ (911)	$ (57,875)	
Cumulative effect of restatement adjustments	(1,179,386)	(1)	(14,594)	692		(15,071)			(28,974)	
Balance at January 1, 2002, as restated	58,985,454	59	514,780		14	(600,791)	(73,842)	(911)	(86,849)	
Issuance of common stock	11,357,316	12	163,894						163,906	
Effect of common stock repurchase agreement	(2,222,222)	(2)	(15,865)						(15,867)	
Unrealized losses on available-for-sale securities					(63)				(63)	$ (63)
Stock-based compensation			49						49	
Foreign currency translation adjustments					6				6	6
Net loss						(52,257)			(52,257)	(52,257)
Balance at December 31, 2002, as restated	68,120,548	69	662,858		(43)	(653,048)	(73,842)	(911)	8,925	$ (52,314)
Issuance of common stock	3,964,851	3	49,447						49,450	
Unrealized losses on available-for-sale securities					(62)				(62)	(62)
Stock-based compensation			565						565	
					39				39	39

Foreign currency translation adjustments									
Net loss					(96,471)			(96,471)	(96,471)
Balance at December 31, 2003, as restated	72,085,399	72	712,870	(66)	(749,519)	(73,842)	(911)	(37,554)	$ (96,494)
Issuance of common stock	885,271	1	6,618					6,619	
Effect of common stock redemption			294					294	
Income tax benefits of stock option deductions			81					81	
Unrealized gains on available-for-sale securities				282				282	$ 282
Stock-based compensation			89					89	
Foreign currency translation adjustments				13				13	13
Net loss					(45,141)			(45,141)	(45,141)
Balance at December 31, 2004	72,970,670	$ 73	$ 719,952	$	$ 229	$ (794,660)	(73,842)	$ (911)	$ (75,317)	$ (44,846)

See accompanying notes to these consolidated financial statements.

Table of Contents

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

	Year Ended December 31,		
	2004	2003 (Restated)	2002 (Restated)
Operating activities			
Net loss	$ (45,141)	$ (96,471)	$ (52,257)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Cumulative effect of change in accounting principle		2,005	
Amortization of acquired technology and royalty and license rights	10,946	10,961	4,139
Depreciation and amortization of property and equipment	3,355	2,451	3,176
Non-cash development milestone	(1,956)		
Amortization of debt discount and issuance costs	974	916	1,408
Write-off of X-Ceptor purchase right		8,990	
Gain on sale of equity investment	(3,705)		
Equity in loss of affiliate		981	1,141
Debt conversion expense			2,015
Other	89	565	37
Changes in operating assets and liabilities:			
Accounts receivable, net	(11,946)	(6,478)	275
Inventories	(3,292)	(3,489)	(639)
Other current assets	(1,352)	(1,388)	(11,185)
Accounts payable and accrued liabilities	9,753	24,156	3,947
Other liabilities	156	151	165
Deferred revenue	47,873	56,963	20,888
Net cash provided by (used in) operating activities	5,754	313	(26,890)
Investing activities			
Purchases of short-term investments	(26,322)	(28,026)	(13,934)
Proceeds from sale of short-term investments	40,464	10,053	18,054
Decrease (increase) in restricted investments	9,204	10,384	(18,874)
Purchases of property and equipment	(3,604)	(2,783)	(3,161)
Payment for AVINZA ® royalty rights		(4,133)	(101,304)
Payment to extend X-Ceptor purchase right			(5,000)
Other, net	(131)	270	100
Net cash provided by (used in) investing activities	19,611	(14,235)	(124,119)
Financing activities			
Principal payments on equipment financing obligations	(2,650)	(2,468)	(2,923)
Proceeds from equipment financing arrangements	4,429	1,114	2,884
Net proceeds from issuance of common stock and warrants	6,619	49,451	70,755
Repurchase of common stock		(15,867)	
(Decrease) increase in other long-term liabilities	(189)	(101)	1,000

Repayment of long-term debt	(294)		(50,717)
Net proceeds from issuance of convertible notes			150,092
Net cash provided by financing activities	7,915	32,129	171,091
Net increase in cash and cash equivalents	33,280	18,207	20,082
Cash and cash equivalents at beginning of year	59,030	40,823	20,741
Cash and cash equivalents at end of year	$ 92,310	$ 59,030	$ 40,823
Supplemental disclosure of cash flow information			
Interest paid	$ 10,468	$ 9,948	$ 4,118
Supplemental schedule of non-cash investing and financing activities			
Receipt and retirement of common stock in settlement of Pfizer development milestone	1,956		
Receipt of Exelixis, Inc. common stock upon sale of equity investment in X-Ceptor	3,908		
Conversion of zero coupon convertible senior notes to common stock			86,135
Issuance of common stock and notes for acquired technology and license rights			5,000

See accompanying notes to these consolidated financial statements.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The Company and its Business

Ligand Pharmaceuticals Incorporated, a Delaware corporation (the Company or Ligand), discovers, develops and markets drugs that address patients critical unmet medical needs in the areas of cancer, pain, men s and women s health or hormone-related health issues, skin diseases, osteoporosis, blood disorders and metabolic, cardiovascular and inflammatory diseases. Ligand s drug discovery and development programs are based on proprietary gene transcription technology, primarily related to Intracellular Receptors, also known as IRs, a type of sensor or switch inside cells that turns genes on and off. The 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).

The Company currently markets five products in the United States: AVINZA, for the relief of chronic, moderate to severe pain which was launched in June 2002; ONTAK, for the treatment of patients with persistent or recurrent CTCL; Targretin capsules, for the treatment of CTCL in patients who are refractory to at least one prior systemic therapy; Targretin gel, for the topical treatment of cutaneous lesions in patients with early stage CTCL; and Panretin gel, for the treatment of Kaposi s sarcoma in AIDS patients. In Europe, Ligand has marketing authorizations for Panretin gel and Targretin capsules and is currently marketing these products under arrangements with local distributors. In April 2003, the Company withdrew its ONZAR (ONTAK in the U.S.) marketing authorization application in Europe for its first generation product. It was Ligand s assessment that the cost of the additional clinical and technical information requested by the European Agency for the Evaluation of Medicinal Products (or EMEA) for the first generation product would be better spent on acceleration of the second generation ONTAK development. The Company expects to resubmit the ONZARä application with the second generation product in 2006 or early 2007.

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 Ligand 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 need for additional financing to complete its research and development programs and commercialize its technologies and to finance its existing debt. For example, as of December 31, 2004, the Company has outstanding $155.3 million in 6% Convertible Subordinated Notes that mature in November 2007 (See Note 10). The Company has incurred significant losses since its inception. At December 31, 2004, the Company s accumulated deficit was $794.7 million. The Company expects to continue to incur substantial additional research and development expenses, including continued increases in personnel and costs related to preclinical testing and clinical trials. The Company also expects that sales and marketing expenses related to product sales will continue to increase as product revenues continue to grow.

The Company believes that patents and other proprietary rights are important to its business. The Company s 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.

2. Restatement of Previously Issued Consolidated Financial Statements

The Company has restated its consolidated financial statements as of and for the years ended December 31, 2003 and 2002, and as of and for the first three quarters of 2004 and for the quarters of 2003.

Set forth below is a summary of the determinations regarding the restatement and additional matters addressed in the course of the restatement.

Table of Contents

Revenue Recognition. The restatement corrects the recognition of revenue for transactions involving each of the Company s products that did not satisfy all of the conditions for revenue recognition contained in SFAS 48 and SAB 104. The Company s products impacted by this restatement are the domestic product shipments of AVINZA, ONTAK, Targretin capsules, and Targretin gel. Management determined that based upon SFAS 48 and SAB 104 it did not have the ability to make reasonable estimates of future returns because there was (i) a lack of sufficient visibility into the wholesaler and retail distribution channels; (ii) an absence of historical experience with similar products; (iii) increasing levels of inventory in the wholesale and retail distribution channels as a result of increasing demand of the Company s new products among other factors; and (iv) a concentration of a few large distributors. As a result, the Company could not make reliable and reasonable estimates of returns which precluded it from recognizing revenue at the time of product shipment, and therefore such transactions must be restated using the sell-through method. The restatement of product revenue under the sell-through method requires the correction of other accounts whose balances are largely based upon the prior accounting policy. Such accounts include gross to net sales adjustments and cost of goods (products) sold. Gross to net sales adjustments include allowances for returns, rebates, chargebacks, discounts, and promotions, among others. Cost of product sold includes manufacturing costs and royalties.

The restatement did not affect the revenue recognition of Panretin or the Company s international product sales. For Panretin, our wholesalers only stock minimal amounts of product, if any. As such, wholesaler orders are considered to approximate end-customer demand for the product. For international sales, our products are sold to third-party distributors, for which we have had minimal returns. For these sales, the Company believes it has met the SFAS 48 and SAB 104 criteria for recognizing revenue.

Specific models were developed for: AVINZA, including a separate model for each dosage strength (a retail-stocked product for which the sell-through revenue recognition event is prescriptions as reported by a third party data provider, IMS Health Incorporated, or IMS); Targretin capsules and gel (for which revenue recognition is based on wholesaler out-movement as reported by IMS); and ONTAK (for which revenue recognition is based on wholesaler out-movement as reported to the Company by its wholesalers as the product is generally not stocked in pharmacies). Separate models were also required for each of the adjustments associated with the gross to net sales adjustments and cost of goods sold. The Company also developed separate demand reconciliations for each product to assess the reasonableness of the third party information described above which was used in the restatement and will be used on a going-forward basis.

Under the sell-through method used in the restatement and to be used on a going-forward basis, the Company does not recognize revenue upon shipment of product to the wholesaler. For these shipments, the Company invoices the wholesaler, records deferred revenue at gross invoice sales price less estimated cash discounts and, for ONTAK, end-customer returns, and classifies the inventory held by the wholesaler as deferred cost of goods sold within other current assets. Additionally, for royalties paid to technology partners based on product shipments to wholesalers, the Company records the cost of such royalties as deferred royalty expense as an offset to deferred revenue. Royalties paid to technology partners are deferred as the Company has the right to offset royalties paid for product that are later returned against subsequent royalty obligations. Royalties for which the Company does not have the ability to offset (for example, at the end of the contracted royalty period) are expensed in the period the royalty obligation becomes due. The Company recognizes revenue when inventory is sold through (as discussed below), on a first-in first-out (FIFO) basis. Sell-through for AVINZA is considered to be at the prescription level or at the time of end user consumption for non-retail prescriptions. Thus, changes in wholesaler or retail pharmacy inventories of AVINZA do not affect the Company s product revenues, but will be reflected on the balance sheet as a change to deferred product revenue. Sell-through for ONTAK, Targretin capsules, and Targretin gel is considered to be at the time the product moves from the wholesaler to the wholesaler s customer. Changes in wholesaler inventories for all the Company s products, including product that the wholesaler returns to the Company for credit, do not affect product revenues but will be reflected as a change in deferred product revenue.

The Company s revenue recognition is subject to the inherent limitations of estimates that rely on third-party data, as certain-third party information is itself in the form of estimates. Accordingly, the Company s sales and revenue recognition under the sell-through method reflect the Company s estimates of actual product sold through the distribution channel. The estimates by third parties include inventory levels and customer sell-through information the

Company obtains from wholesalers which currently account for a large percentage of the market demand for its products. The Company also uses third-party market research data to make estimates where time lags prevent the use of actual data. Certain third-party data and estimates are validated against the Company s internal product movement information. To assess the reasonableness of third-party demand (i.e. sell-through) information, the Company prepares separate demand reconciliations based on inventory in the distribution channel. Differences identified through these demand reconciliations outside an acceptable range will be recognized as an adjustment to the third-party reported demand in the period those differences are identified. This adjustment mechanism is designed to identify and correct for any material variances between reported and actual demand over time and other potential anomalies such as inventory shrinkage at wholesalers or retail pharmacies.

Table of Contents

As a result of the Company s adoption of the sell-through method, it recorded reductions to net product sales in the amounts of $12.8 million, $8.1 million and $9.2 million for the quarters ended September 30, 2004, June 30, 2004 and March 31, 2004, respectively, and $25.5 million, $13.4 million, $12.8 million, and $7.5 million for the quarters ended December 31, 2003, September 30, 2003, June 30, 2003, and March 31, 2003, respectively. Additionally, for the years ended December 31, 2003 and 2002, the Company recorded a reduction to net product revenue in the amounts of $59.2 million and $24.2 million, respectively. These amounts do not include other adjustments also affected by the change to the sell-through method such as cost of products sold and royalties. Revenue which has been deferred will be recognized as the product sells through in future periods as discussed above.

Sale of Royalty Rights. In March 2002, the Company entered into an agreement with Royalty Pharma AG (Royalty Pharma) to sell a portion of its rights to future royalties from the net sales of three selective estrogen receptor modulator (SERM) products now in late stage development with two of the Company s collaborative partners, Pfizer Inc. and American Home Products Corporation, now known as Wyeth, in addition to the right, but not the obligation, to acquire additional percentages of the SERM products net sales on future dates by giving the Company notice. When the Company entered into the agreement with Royalty Pharma and upon each subsequent exercise of its options to acquire additional percentages of royalty payments to the Company, the Company recognized the consideration paid to it by Royalty Pharma as revenue. Cumulative payments totaling $63.3 million were received from Royalty Pharma from 2002 through 2004 for the sale of royalty rights from the net sales of the SERM products.

The Company determined that, while the current accounting classification is appropriate, a portion of the revenue recognized under the Royalty Pharma agreement should have been deferred since Pfizer and Wyeth each had the right to offset a portion of future royalty payments for, and to the extent of, amounts previously paid to the Company for certain developmental milestones. Approximately $0.6 million of revenue was deferred in each of 2003 and 2002 related to the offset rights by the Company s collaborative partners, Pfizer and Wyeth. The amounts associated with the offset rights against future royalty payments will be recognized as revenue upon receipt of future royalties from the respective partners or upon determination that no such future royalties will be forthcoming. Additionally, the Company determined to defer a portion of such revenue as it relates to the value of the option rights sold to Royalty Pharma until Royalty Pharma exercised such options or upon the expiration of the options. The value of Royalty Pharma options outstanding at the end of 2002 which was recognized in 2003 was $0.1 million. The value of options outstanding at the end of 2003 which was recognized in 2004 was $0.2 million. As of December 31, 2004, all of the option revenue deferred during fiscal 2002 and 2003 has been recognized. Accordingly, for the years ended December 31, 2003 and 2002, the Company has restated revenue from the sale of royalty rights under the Royalty Pharma agreement, which reduced royalty revenue by approximately $0.7 million for each of the years ended December 31, 2003 and 2002.

Buy-Out of Salk Royalty Obligation. In March 2004, the Company paid The Salk Institute $1.12 million in connection with the Company s exercise of an option to buy out milestone payments, other payment-sharing obligations and royalty payments due on future sales of lasofoxifene, a product under development by Pfizer for which a NDA was expected to be filed in 2004. At the time of the Company s exercise of its buyout right, the payment was accounted for as a prepaid royalty asset to be amortized on a straight-line basis over the period for which the Company had a contractual right to the lasofoxifene royalties. This payment was included in Other assets on the Company s consolidated balance sheet at September 30, 2004, June 30, 2004, and March 31, 2004. Pfizer filed the NDA for lasofoxifene with the United States Food and Drug Administration in the third quarter of 2004. Because the NDA had not been filed at the time the Company exercised its buyout right, the Company determined in the course of the restatement that the payment should have been expensed. Accordingly, the Company corrected such error and recognized the Salk payment as development expense for the quarter ended March 31, 2004 and the year ended December 31, 2004.

X-Ceptor Therapeutics, Inc. In June 1999, the Company invested $6.0 million in X-Ceptor Therapeutics, Inc. (X-Ceptor) through the acquisition of convertible preferred stock. Additionally, in October 1999, the Company issued warrants to X-Ceptor investors, founders and certain employees to purchase 950,000 shares of Ligand common stock with an exercise price of $10.00 per share and expiration date of October 6, 2006. At the time of issuance, the warrants were recorded at their fair value of $4.20 per warrant or $4.0 million as deferred warrant expense within

stockholders deficit and were amortized to operating expense through June 2002. The Company determined during the course of the restatement that the warrant issuance should have been capitalized as an asset rather than treated as a deferred expense within equity since the warrant issuance was deemed to be consideration for the right granted to the Company by X-Ceptor to acquire all of the outstanding stock of X-Ceptor (the Purchase Right). Accordingly, the Company recorded the Purchase Right as an other asset in the amount of $4.0 million. The effect of this change resulted in a decrease in expense for the year ended December 31, 2002 of $0.7 million. The asset was subsequently written off to other, net expense in the quarter ended March 31, 2003, the period the Company determined that the Purchase Right would not be exercised.

Table of Contents

Pfizer Settlement Agreement and Elan Shares. In April 1996, the Company and Pfizer entered into a settlement agreement with respect to a lawsuit filed in December 1994 by the Company against Pfizer. In connection with a collaborative research agreement the Company entered into with Pfizer in 1991, Pfizer purchased shares of the Company s common stock. Under the terms of the settlement agreement, at the option of either the Company or Pfizer, milestone and royalty payments owed to the Company can be satisfied by Pfizer by transferring to the Company shares of the Company s common stock at an exchange ratio of $12.375 per share. At the time of the settlement, the Company accounted for the prior issuance of common stock to Pfizer as equity on its balance sheet.

Additionally, in 1998, Elan International (Elan) agreed to exclusively license to the Company in the United States and Canada its proprietary product AVINZA. In connection with the November 2002 restructuring of the AVINZA license agreement with Elan, the Company agreed to repurchase approximately 2.2 million shares of the Company s common stock held by an affiliate of Elan for $9.00 a share (the Elan Shares). At the time of the November 2002 agreement, the shares were classified as equity on the Company s balance sheet. The Elan Shares were repurchased and retired in February 2003.

In conjunction with the restatement, the remaining common stock issued and outstanding to Pfizer following the settlement and the Elan shares were reclassified as common stock subject to conditional redemption/repurchase (between liabilities and equity) in accordance with Emerging Issue Task Force Topic D-98, Classification and Measurement of Redeemable Securities (EITF D-98), which was issued in July 2001.

EITF D-98 requires the security to be classified outside of permanent equity if there is a possibility of redemption of securities that is not solely within the control of the issuer. Since Pfizer has the option to settle with Company s shares milestone and royalties payments owed to the Company, and as of December 31, 2002, the Company was required to repurchase the Elan shares, the Company determined that such factors indicated that the redemptions were not within the Company s control, and accordingly, EITF D-98 was applicable to the treatment of the common stock issued to Pfizer and the Elan Shares. These adjustments totaling $34.6 million only had an effect on the balance sheet classification, not on the consolidated statements of operations. Of the total adjustments, $14.6 million related to the Pfizer shares and $20.0 million related to the Elan Shares.

Seragen Litigation. On December 11, 2001, a lawsuit was filed in the United States District Court for the District of Massachusetts against the Company by the Trustees of Boston University and other former stakeholders of Seragen. The suit was subsequently transferred to federal district court in Delaware. The complaint alleges breach of contract, breach of the implied covenants of good faith and fair dealing and unfair and deceptive trade practices based on, among other things, allegations that the Company wrongfully withheld approximately $2.1 million in consideration due the plaintiffs under the Seragen acquisition agreement. This amount had been previously accrued for in the Company s consolidated financial statements in 1998. The complaint seeks payment of the withheld consideration and treble damages. The Company filed a motion to dismiss the unfair and deceptive trade practices claim. The Court subsequently granted the Company s motion to dismiss the unfair and deceptive trade practices claim (i.e. the treble damages claim), in April 2003. In November 2003, the Court granted Boston University s motion for summary judgment, and entered judgment for Boston University. In January 2004, the district court issued an amended judgment awarding interest of approximately $0.7 million to the plaintiffs in addition to the approximately $2.1 million withheld. The Court award of interest was not previously accrued. Though the Company has appealed the judgment in this case as well as the award of interest and the calculation of damages, in view of the judgment, the Company revised its consolidated financial statements in the fourth quarter of 2003 to record a charge of $0.7 million.

Other. In conjunction with the restatement, the Company also made other adjustments and reclassifications to its accounting for various other errors, in various years, including, but not limited to: (1) a correction to the Company s estimate of the accrual necessary for clinical trials; (2) corrections to estimates of other accrued liabilities; (3) royalty payments made to technology partners; (4) straight-line recognition of rent expense for contractual annual rent increases; and (5) corrections to estimates of future obligations and bonuses to employees.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
(in thousands, except share and per share data)

The following tables reconcile the Company s financial position and results of operations from the previously reported consolidated financial statements to the restated consolidated financial statements. Additionally, set forth below for each of the tables is an explanation of the restatement adjustments. Please refer to the discussion herein regarding further explanation of the restatement adjustments.

	For the Year Ended December 31,	
	2003	**2002**
Net loss, as previously reported:	$ (37,462)	$ (32,596)
Adjustments to net loss (increase) decrease:		
Product sales:		
Net product sales (a)	(59,187)	(24,160)
Other (b)	(121)	(36)
Sale of royalty rights, net (c)	(714)	(675)
Cost of products sold:		
Product cost (d)	151	2,549
Royalties (d)	4,910	3,019
Research and development:		
Reclassification (e)	55	
Clinical trial (f)	918	(1,107)
X-Ceptor warrant amortization (g)		692
Patent expense accrual (h)		345
Other (b)	28	(183)
Selling, general and administrative:		
Reclassification (e)	(55)	
Rent (i)	(111)	(158)
Seragen litigation (j)	(739)	
Other (b)	26	11
Interest (b)	(172)	
Other, net:		
X-Ceptor purchase right (k)	(3,990)	
Income tax expense (l)	56	44
Other (b)	(8)	42
Income tax expense (l)	(56)	(44)
Net loss, as restated	$ (96,471)	$ (52,257)
Per Share Data		
As previously reported:		
Basic and diluted net loss per share	$ (0.53)	$ (0.47)
Weighted average number of common shares	70,685,234	69,118,976
As restated:		
Basic and diluted net loss per share	$ (1.36)	$ (0.76)

Weighted average number of common shares	70,685,234	69,118,976

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following:

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(b) To reflect other adjustments and reclassifications.

(c) To reflect the deferral of a portion of the sale of royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties.

(e) To reclassify expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(f) To correct clinical trial expense.

(g) To reverse X-Ceptor warrant amortization.

(h) To correct patent expense.

(i) To adjust rent expense for contractual annual rent increase which is recognized over the lease term on a straight-line basis.

(j) To reflect accrued interest for the Seragen acquisition litigation.

(k) To reflect the write-off of the X-Ceptor purchase right in March 2003.

(l) To reclassify income taxes related to international operations.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
(in thousands, except share and per share data)
(unaudited)

	2004 Quarterly Periods		
	March 31,	June 30,	September 30,
Net loss, as previously reported:	$ (13,139)	$ (14,216)	$ (6,789)
Adjustments to net loss (increase) decrease:			
Product sales:			
Net product sales (a)	(9,245)	(8,097)	(12,842)
Other (b)	48	(89)	50
Sale of royalty rights, net (c)			67
Cost of products sold:			
Product cost (d)	886	214	163
Royalties (d)	392	(6)	1,029
Research and development:			
Reclassification (e)	742	1,454	1,221
Salk-buyout (f)	(1,120)		
Patent expense (g)	(238)		
Other (b)	(49)	154	12
Selling, general and administrative:			
Reclassification (e)	(742)	(1,454)	(1,221)
Legal expense (h)	373		
Other (b)	136	(37)	(200)
Interest:			
Factoring arrangement (i)			(238)
Other (b)	44	12	12
Other, net:			
Factoring arrangement (i)			238
Income taxes (j)	16	18	3
Income tax expense (j)	(16)	(18)	(3)
Net loss, as restated	$ (21,912)	$ (22,065)	$ (18,498)
Per Share Data			
As previously reported:			
Basic and diluted net loss per share	$ (0.18)	$ (0.19)	$ (0.09)
Weighted average number of common shares	73,299,281	73,754,146	73,845,613
As restated:			
Basic and diluted net loss per share	$ (0.30)	$ (0.30)	$ (0.25)
Weighted average number of common shares	73,299,281	73,754,146	73,845,613

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following:

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(b) To reflect other adjustments and reclassifications.

(c) To reflect the recognition of revenue previously deferred in regard to the sale of royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties.

(e) To reclassify expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(f) To expense the payment to The Salk Institute to buy-out the Company s royalty obligation on lasofoxifene in March 2004.

(g) To correct patent expense.

(h) To correct legal expense.

(i) To reclassify interest and factoring expenses incurred under a factoring arrangement.

(j) To reclassify income taxes related to international operations.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
(in thousands, except share and per share data)
(unaudited)

	2003 Quarterly Periods			
	March 31,	June 30,	September 30,	December 31,
Net (loss) income, as previously reported:	$ (20,320)	$ (11,997)	$ (11,087)	$ 5,942
Adjustments to net (loss) (increase) decrease/ income increase (decrease):				
Product sales:				
Net product sales (a)	(7,468)	(12,835)	(13,376)	(25,508)
Other (b)	13	(181)	13	34
Sale of royalty rights, net (c)			35	(749)
Cost of products sold:				
Product cost (d)	3	(437)	(23)	608
Royalties (d)	415	1,358	1,547	1,590
Research and development:				
Reclassification (e)		9	20	26
Clinical trial expense (f)		331	281	233
Other (b)	91	(125)	(40)	175
Selling, general and administrative:				
Reclassification (e)		(9)	(20)	(26)
Seragen litigation (g)				(739)
Other (b)	74	11	(6)	(164)
Interest (b)	(26)	(81)	(170)	105
Other, net:				
X-Ceptor purchase right (h)	(3,990)			
Income tax expense (i)	15	16	9	16
Other (b)	80		113	(201)
Income tax expense (i)	(15)	(16)	(9)	(16)
Net loss, as restated	$ (31,128)	$ (23,956)	$ (22,713)	$ (18,674)
Per Share Data				
As previously reported:				
Basic and diluted net (loss) income per share	$ (0.29)	$ (0.17)	$ (0.16)	$ 0.08
Weighted average number of common shares used in basic per share calculation	70,238,438	69,275,323	70,100,280	73,098,427
Weighted average number of common shares used in fully diluted per share calculation				99,684,427
As restated:				

Basic and diluted net loss per share	$ (0.44)	$ (0.35)	$ (0.32)	$ (0.26)
Weighted average number of common shares	70,238,438	69,275,323	70,100,280	73,098,427

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following:

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(b) To reflect other adjustments and reclassifications.

(c) To reflect the recognition/(deferral) regarding the sale of royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties.

(e) To reclassify expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(f) To correct clinical trial expense.

(g) To reflect accrued interest for the Seragen acquisition litigation.

(h) To reflect the write-off of the X-Ceptor purchase right in March 2003, which was previously deferred and recognized over the period from 1999 through June 2002.

(i) To reclassify income taxes related to international operations.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(in thousands)

	December 31, 2003			
	As Previously Reported	Cumulative Effect of Prior Year Adjustments	Current Year Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 59,030			$ 59,030
Short-term investments	40,004			40,004
Accounts receivable, net	19,051	$ 247(a)	$ (397)(a)(c)	18,901
Current portion of inventories, net	8,262	150(a)	(2,778)(a)(o)	5,634
Other current assets	3,810	7,665(a)(b)	4,886(a)(b)	16,361
Total current assets	130,157	8,062	1,711	139,930
Restricted investments	1,656			1,656
Long-term portion of inventories, net			2,846(o)	2,846
Property and equipment, net	23,501			23,501
Acquired technology and product rights, net	137,857	260(a)(d)		138,117
Other assets	8,084	3,958(a)(e)	(4,046)(a)(e)	7,996
	$ 301,255	$ 12,280	$ 511	$ 314,046
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 18,691	$ 913(a)(f)	$ (763)(a)(f)	$ 18,841
Accrued liabilities	30,315	(2,182)(a)(g)	4,534(a)(h)	32,667
Current portion of deferred revenue, net	2,564	43,926(i)	59,229(i)	105,719
Current portion of equipment financing obligations	2,184	253(j)	(253)(j)	2,184
Current portion of long-term debt	295			295
Total current liabilities	54,049	42,910	62,747	159,706
Long-term debt	167,408			167,408
Long-term portion of deferred revenue, net	2,275	581(k)	592(k)	3,448
Long-term portion of equipment financing obligations	2,644	(253)(j)	253(j)	2,644
Other long-term liabilities	4,151	(463)(l)	111(l)	3,799
Total liabilities	230,527	42,775	63,703	337,005

Common stock subject to conditional redemption/repurchase		34,595(m)	(20,000)(n)	14,595
Stockholders equity (deficit):				
Common stock	73	(3)(m)	2(n)	72
Additional paid-in capital	727,410	(30,355)(a)(m)	15,815(a)(n)	712,870
Accumulated other comprehensive loss	(66)			(66)
Accumulated deficit	(655,778)	(34,732)	(59,009)	(749,519)
	71,639	(65,090)	(43,192)	(36,643)
Treasury stock	(911)			(911)
Total stockholders equity (deficit)	70,728	(65,090)	(43,192)	(37,554)
	$ 301,255	$ 12,280	$ 511	$ 314,046

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) Cumulative effect of prior year adjustments includes $7,603 related to the change to the sell-through revenue recognition method (deferred royalties $4,215; deferred cost of products sold $3,388). Current year adjustments include $5,668 related to the change to the sell-through revenue recognition method (deferred royalties $5,465; deferred cost of products sold $203); correct prepaid clinical trial expense $(254); reclassify Organon cost-sharing receivable balance to co-promotion liability $(461).

(c) To correct bad debt expense $(205).

(d) To correct accumulated amortization related to ONTAK acquired technology $357.

(e) To record the capitalization of the X-Ceptor Purchase Right in October 1999 $3,990; to write-off the X-Ceptor Purchase Right in March 2003, which was previously recognized over the period from 1999 to June 2002 $(3,990).

(f) To correct clinical trial expense. Cumulative effect of prior year adjustments $918; current year adjustments $(918).

(g) Includes $(1,089) related to the change to the sell-through revenue recognition method (product cost $(1,491); royalties $402); to correct accruals for bonus expense $694; and property tax expense $(316); reclassification of Seragen acquisition liability from other long-term liabilities $2,700; reclassification of the Elan shares from accrued liabilities to additional paid-in capital $(4,133).

(h) Includes $446 adjustment related to the change to the sell-through revenue recognition method (product cost $(108); royalties $554); to correct accruals for bonus expense - $(424) and legal, trademark and patent expense $230; to reclassify Organon cost-sharing receivable balance to co-promotion liability $(461); to reflect accrued interest for the Seragen acquisition liability $739; reclassification of the Elan shares from accrued liabilities to additional paid-in capital $4,133.

(i) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(j) To reclassify equipment lease obligation from long-term to current obligation.

(k) To reflect the deferral of a portion of the sale of the royalty rights to Royalty Pharma.

(l) The cumulative effect of prior year adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,237; to reclassify the Seragen acquisition litigation to accrued liabilities $(2,700). Current year adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $111.

(m) In accordance with EITF D-98, to reclassify from equity the Company s issuance of common stock to Pfizer -common stock $(1); additional paid in capital $(14,594); Elan shares common stock $(2); additional paid in capital $(19,998); reclassification of the Elan shares from accrued liabilities to additional paid-in capital $4,133.

(n)

To reflect the repurchase and retirement of the Elan shares in February 2003 $20,000 common stock $2; additional paid-in capital $19,998; reclassification of the Elan shares from accrued liabilities to additional paid-in capital $(4,133).

(o) To reclassify portion of inventory not expected to be used within one year to long-term.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(in thousands, except share and per share data)

	Year Ended December 31, 2003		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 114,632	$ (59,308) (a)(b)	$ 55,324
Sale of royalty rights, net	12,500	(714) (c)	11,786
Collaborative research and development and other revenues	14,008		14,008
Total revenues	141,140	(60,022)	81,118
Operating costs and expenses:			
Cost of products sold	31,618	(5,061) (d)	26,557
Research and development	67,679	(1,001) (b)(e)(f)	66,678
Selling, general and administrative	51,661	879(b)(f)(g)	52,540
Co-promotion	9,360		9,360
Total operating costs and expenses	160,318	(5,183)	155,135
Loss from operations	(19,178)	(54,839)	(74,017)
Other income (expense):			
Interest income	783		783
Interest expense	(10,970)	(172) (b)	(11,142)
Other, net	(6,092)	(3,942) (b)(h)(i)	(10,034)
Total other expense, net	(16,279)	(4,114)	(20,393)
Loss before income taxes and cumulative effect of a change in accounting principle	(35,457)	(58,953)	(94,410)
Income tax expense		(56) (i)	(56)
Loss before cumulative effect of a change in accounting principle	(35,457)	(59,009)	(94,466)
Cumulative effect of changing method of accounting for variable interest entity	(2,005)		(2,005)

Net loss	$ (37,462)	$ (59,009)	$ (96,471)
Basic and diluted per share amounts:			
Loss before cumulative effect of a change in accounting principle	$ (0.50)		$ (1.33)
Cumulative effect of changing method of accounting for variable interest entity	(0.03)		(0.03)
Net loss	$ (0.53)		$ (1.36)
Weighted average number of common shares	70,685,234		70,685,234
Pro forma amounts assuming the changed method of accounting for variable interest entity is applied retroactively:			
Net loss	$ (35,557)		$ (94,352)
Basic and diluted net loss per share	$ (0.50)		$ (1.34)

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(59,187).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the deferral of a portion of the sale of the royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $(151); royalties $(4,910).

(e) To correct clinical trial expense $(918).

(f) To reclassify $55 of expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(g) To reflect interest expense for the Seragen acquisition liability $739.

(h) To reflect the write-off of the X-Ceptor Purchase Right in March 2003 $3,990.

(i) To reclassify income taxes related to international operations $56.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	December 31, 2002			
	As Previously Reported	Cumulative Effect of Prior Year Adjustments	Current Year Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 42,423	$	$ (1,600)(a)	$ 40,823
Short-term investments	21,825		1,600(a)	23,425
Accounts receivable, net	12,176	196(b)	51(b)	12,423
Inventories, net	4,841	596(c)	(446) (c)	4,991
Other current assets	7,308	1,456(b)(d)	6,209(b)(d)	14,973
Total current assets	88,573	2,248	5,814	96,635
Restricted investments	10,646			10,646
Property and equipment, net	9,672	248(e)	(248) (e)	9,672
Acquired technology and product rights, net	148,546	357(f)	(97) (b)	148,806
Other assets	17,992	3,868(b)(g)	90(b)	21,950
	$ 275,429	$ 6,721	$ 5,559	$ 287,709
Current liabilities:				
Accounts payable	$ 11,979	$ 79(b)	$ 834(b)(h)	$ 12,892
Accrued liabilities	16,606	3,219(b)(i)	(5,401) (b)(i)	14,424
Current portion of deferred revenue, net	4,683	18,423(j)	25,503(j)	48,609
Current portion of equipment financing obligations	2,087		253(k)	2,340
Current portion of long-term debt				
Total current liabilities	35,355	21,721	21,189	78,265
Long-term debt	155,250			155,250
Long-term portion of deferred revenue, net	3,014		581(l)	3,595
Long-term portion of equipment financing obligations	4,095		(253) (k)	3,842
Other long-term liabilities	3,700	(621) (m)	158(m)	3,237
Total liabilities	201,414	21,100	21,675	244,189

Common stock subject to conditional redemption/repurchase		14,595(n)	20,000(o)	34,595
Stockholders equity:				
Common stock	72	(1) (n)	(2) (o)	69
Additional paid-in capital	693,213	(14,594) (n)	(15,761) (b)(o)	662,858
Deferred warrant expense		692(p)	(692) (p)	
Accumulated other comprehensive loss	(43)			(43)
Accumulated deficit	(618,316)	(15,071) (q)	(19,661)	(653,048)
	74,926	(28,974)	(36,116)	9,836
Treasury stock	(911)			(911)
Total stockholders equity	74,015	(28,974)	(36,116)	8,925
	$ 275,429	$ 6,721	$ 5,559	$ 287,709

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reclassify cash to short-term investments.

(b) To reflect other adjustments and reclassifications.

(c) To reverse replacement reserve due.

(d) Cumulative effect of prior year adjustments includes $1,576 related to the change to the sell-through revenue recognition method (deferred royalties $1,055; deferred cost of products sold $521). Current year adjustments include $6,027 related to the change to the sell-through revenue recognition method (deferred royalties $3,160; deferred cost of products sold $2,867).

(e) To accrue for fixed asset additions at December 31, 2001 $248.

(f) To correct accumulated amortization expense related to ONTAK acquired technology.

(g) To record the capitalization of the X-Ceptor Purchase Right in October 1999 $3,990.

(h) To correct clinical trial expense $1,168 and fixed asset additions $(248).

(i) Cumulative effect of prior year adjustments includes $90 related to the change to the sell-through revenue recognition method (product cost $(268); royalties $358); to correct accruals for vendor expenses $321, bonus expense $236, property tax expense - $(364); reclassification of Seragen acquisition liability from other long-term liabilities $2,700. Current year adjustments include $(1,179) related to the change to the sell-through revenue recognition method (product cost $(1,223); royalties $44); correct accruals for vendor expenses- $(321), bonus expense $458, legal, trademark and patent expense $(263); reclassification of the Elan shares from accrued liabilities to additional paid-in capital $(4,133).

(j) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(k) To reclassify equipment lease obligation from long term to current obligation.

(l) To reflect the deferral of a portion of the sale of the royalty rights to Royalty Pharma.

(m) The cumulative effect of prior year adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,079, to reclassify the Seragen acquisition liability to accrued liabilities $(2,700). Current year adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $158.

(n) To reclassify from equity the Company s issuance of common stock to Pfizer in accordance with EITF D-98 $(14,595) common stock $(1); additional paid in capital - $(14,594).

(o) To reclassify from equity the Elan shares in accordance with EITF D-98 $(20,000) - common stock $(2); additional paid-in capital $(19,998); reclassification of the Elan shares from accrued liabilities to additional paid-in capital $4,133.

(p) To write off deferred warrant amortization in connection with the capitalization of the X-Ceptor Purchase Right.

(q) To reflect the cumulative effect, as of January 1, 2002, of the restatement for years prior to 2000 $(2,033) product sales $(1,015), rent expense $(1,614), royalties - $59, reversal of X-Ceptor warrant amortization $530, other $7; 2000 $(2,728) - product sales $(4,092), rent expense $(255), royalties $(235); reversal of X-Ceptor warrant amortization $1,384, amortization of acquired technology $357, other $113; 2001 $(10,310) product sales $(13,585), rent expense $(209), royalties $1,368, reversal of X-Ceptor warrant amortization $1,384, other $732.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(in thousands, except share and per share data)

	Year Ended December 31, 2002		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 54,522	$ (24,196) (a)(b)	$ 30,326
Sale of royalty rights, net	18,275	(675) (c)	17,600
Collaborative research and development and other revenues	23,843		23,843
Total revenues	96,640	(24,871)	71,769
Operating costs and expenses:			
Cost of products sold	20,306	(5,568) (b)(d)	14,738
Research and development	58,807	253(b)(e)	59,060
Selling, general and administrative	41,678	147(b)	41,825
Total operating costs and expenses	120,791	(5,168)	115,623
Loss from operations	(24,151)	(19,703)	(43,854)
Other income (expense):			
Interest income	1,086		1,086
Interest expense	(6,295)		(6,295)
Debt conversion expense	(2,015)		(2,015)
Other, net	(1,221)	86(b)(f)	(1,135)
Total other expense, net	(8,445)	86	(8,359)
Loss before income taxes	(32,596)	(19,617)	(52,213)
Income tax expense		(44) (f)	(44)
Net loss	$ (32,596)	$ (19,661)	$ (52,257)
Basic and diluted per share amounts:			
Net loss	$ (0.47)		$ (0.76)

Weighted average number of common shares	69,118,976	69,118,976
Pro forma amounts assuming the changed method of accounting for variable interest entity is applied retroactively:		
Net loss	$ (32,795)	$ (52,456)
Basic and diluted net loss per share	$ (0.47)	$ (0.76)

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(24,160).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the deferral of a portion of the sale of the royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $(2,549); royalties $(3,116).

(e) To correct clinical trial expense $1,107; to reverse X-Ceptor warrant amortization $(692); to correct patent expense $(345).

(f) To reclassify income taxes related to international operations $44.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	March 31, 2004			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 65,558			$ 65,558
Short-term investments	31,625			31,625
Accounts receivable, net	14,185	$ (150) (a)	$ 37(a)	14,072
Current portion of inventories, net	9,770	(2,628) (a)(j)	(1,358) (a)(j)	5,784
Other current assets	3,764	12,551(a)(b)	1,273(a)(b)	17,588
Total current assets	124,902	9,773	(48)	134,627
Restricted investments	1,656			1,656
Long-term portion of inventories, net		2,846(j)	1,237(j)	4,083
Property and equipment, net	23,620			23,620
Acquired technology and product rights, net	135,189	260(a)(c)		135,449
Other assets	8,822	(88) (a)	(1,120) (d)	7,614
	$ 294,189	$ 12,791	$ 69	$ 307,049
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 16,866	$ 150(a)	$ (149)(a)	$ 16,867
Accrued liabilities	35,304	2,352(a)(e)	(2,286) (a)(e)	35,370
Current portion of deferred revenue, net	2,346	103,155(f)	10,657(f)	116,158
Current portion of equipment financing obligations	2,439			2,439
Current portion of long-term debt	303			303
Total current liabilities	57,258	105,657	8,222	171,137
Long-term debt	167,328			167,328
Long-term portion of deferred revenue, net	2,198	1,173(g)		3,371
Long-term portion of equipment financing obligations	3,518			3,518
Other long-term liabilities	3,516	(352) (h)	620(h)	3,784

Total liabilities	233,818	106,478	8,842	349,138
Common stock subject to conditional redemption		14,595(i)		14,595
Stockholders equity (deficit):				
Common stock	74	(1) (i)		73
Additional paid-in capital	730,178	(14,540) (a)(i)		715,638
Accumulated other comprehensive loss	(53)			(53)
Accumulated deficit	(668,917)	(93,741)	(8,773)	(771,431)
	61,282	(108,282)	(8,773)	(55,773)
Treasury stock	(911)			(911)
Total stockholders equity (deficit)	60,371	(108,282)	(8,773)	(56,684)
	$ 294,189	$ 12,791	$ 69	$ 307,049

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) Cumulative effect of prior period adjustments includes $13,271 related to the change to the sell-through revenue recognition method (deferred royalties $9,680; deferred cost of products sold $3,591); to reclassify Organon cost sharing receivable balance to co-promotion liability $(461). Current quarter adjustments include $786 related to the change to the sell-through revenue recognition method (deferred royalties $(100); deferred cost of products sold $886); to reclassify Organon cost-sharing receivable balance to co-promotion liability $461; to correct prepaid clinical trial expense $(192);.

(c) To correct accumulated amortization expense related to ONTAK acquired technology $357.

(d) To expense the payment to The Salk Institute to buy-out the Company s royalty obligation on lasofoxifene in March 2004.

(e) Cumulative effect of prior period adjustments includes $(643) related to the change to the sell-through revenue recognition method (product cost $(1,599); royalties $956); to reclassify Organon cost-sharing receivable balance to co-promotion liability $(461); to correct accruals for bonus expense $270 and property tax expense $(277); to reclassify Seragen acquisition liability from other long-term liabilities $2,700; to accrue interest for the Seragen acquisition liability $739. Current quarter adjustments include $(2,055) related to the change to the sell-through revenue recognition method (product cost - $(1,563); royalties $(492)); to reclassify Organon cost-sharing receivable balance to co-promotion liability $461; to reclassify from other long term liabilities the payment of a portion of the Seragen acquisition liability $(600).

(f) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(g) To reflect the deferral of a portion of the sales of royalty rights to Royalty Pharma.

(h) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,348; to reclassify the Seragen acquisition liability to accrued liabilities $(2,700). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $20; to reclassify to accrued liabilities the payment of a portion of the Seragen acquisition liability $600.

(i) To reclassify from equity the Company s issuance of common stock subject to conditional redemption to Pfizer, in connection with the Pfizer settlement agreement in accordance with EITF D-98 $(14,595) common stock $(1), additional paid in capital $(14,594).

(j) To reclassify portions of inventory not expected to be used within one year to long-term.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended March 31, 2004		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 34,136	$ (9,197)(a)(b)	$ 24,939
Collaborative research and development and other revenues	2,476		2,476
Total revenues	36,612	(9,197)	27,415
Operating costs and expenses:			
Cost of products sold	8,823	(1,278) (c)	7,545
Research and development	16,852	665(b)(d)(e)	17,517
Selling, general and administrative	14,472	233(b)(d)(f)	14,705
Co-promotion	6,731		6,731
Total operating costs and expenses	46,878	(380)	46,498
Loss from operations	(10,266)	(8,817)	(19,083)
Other income (expense):			
Interest income	231		231
Interest expense	(3,091)	44(b)	(3,047)
Other, net	(13)	16(g)	3
Total other expense, net	(2,873)	60	(2,813)
Loss before income taxes	(13,139)	(8,757)	(21,896)
Income tax expense		(16) (g)	(16)
Net loss	$ (13,139)	$ (8,773)	$ (21,912)
Basic and diluted per share amounts:			
Net loss	$ (0.18)		$ (0.30)

Weighted average number of common shares	73,299,281	73,299,281

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(9,245).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $(886); royalties $(392).

(d) To reclassify $742 of expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(e) To expense $1,120 payment to The Salk Institute to buy-out the Company s royalty obligation on lasofoxifene in March 2004; to reflect patent expense in the proper accounting period $238.

(f) To reflect legal expense in the proper accounting period $(373).

(g) To reclassify income taxes related to international operations $16.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	June 30, 2004			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 41,920			$ 41,920
Short-term investments	43,958			43,958
Accounts receivable, net	17,936	$ (113) (a)	$ (49) (a)	17,774
Current portion of inventories, net	11,752	(3,986) (a)(j)	(49) (a)(j)	7,717
Other current assets	3,245	13,824(a)(b)	(601) (a)(b)	16,468
Total current assets	118,811	9,725	(699)	127,837
Restricted investments	1,656			1,656
Long-term portion of inventories, net		4,083(j)	167(j)	4,250
Property and equipment, net	23,910			23,910
Acquired technology and product rights, net	132,520	260(a)(c)		132,780
Other assets	8,420	(1,208) (a)(d)		7,212
	$ 285,317	$ 12,860	$ (532)	$ 297,645
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 20,225	$ 1(a)	$	$ 20,226
Accrued liabilities	36,108	66(a)(e)	(364) (a)(e)	35,810
Current portion of deferred revenue, net	2,381	113,812(f)	7,661(f)	123,854
Current portion of equipment financing obligations	2,453			2,453
Current portion of long-term debt	303			303
Total current liabilities	61,470	113,879	7,297	182,646
Long-term debt	167,256			167,256
Long-term portion of deferred revenue, net	2,120	1,173(g)		3,293
Long-term portion of equipment financing obligations	3,547			3,547
Other long-term liabilities	2,925	268(h)	20(h)	3,213

Total liabilities	237,318	115,320	7,317	359,955
Common stock subject to conditional redemption		14,595(i)		14,595
Stockholders equity (deficit):				
Common stock	74	(1)(i)		73
Additional paid-in capital	732,096	(14,540) (a)(i)		717,556
Accumulated other comprehensive loss	(127)			(127)
Accumulated deficit	(683,133)	(102,514)	(7,849)	(793,496)
	48,910	(117,055)	(7,849)	(75,994)
Treasury stock	(911)			(911)
Total stockholders equity (deficit):	47,999	(117,055)	(7,849)	(76,905)
	$ 285,317	$ 12,860	$ (532)	$ 297,645

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) Cumulative effect of prior period adjustments includes $14,057 related to the change to the sell-through revenue recognition method (deferred royalties $9,580; deferred cost of products sold $4,477). Current quarter adjustments include $(781) related to the change to the sell-through revenue recognition method (deferred royalties $(876); deferred cost of products sold $95).

(c) To correct accumulated amortization expense related to ONTAK acquired technology $357.

(d) To expense the effect of The Salk Institute payment to buy-out the Company s royalty obligation on lasofoxifene $(1,120).

(e) Cumulative effect of prior period adjustments includes $(2,698) related to the change to the sell-through revenue recognition method (product cost $(3,162); royalties $464); to correct property tax expense $(260); to reclassify Seragen acquisition liability from other long-term liabilities $2,100; accrual of interest on the Seragen acquisition liability $739. Current quarter adjustments include $(358) related to the change to the sell-through revenue recognition method (product cost $510; royalties $(868)).

(f) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(g) To reflect the deferral of a portion of the sales of royalty rights to Royalty Pharma.

(h) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,368; to reclassify the Seragen acquisition liability to accrued liabilities $(2,100). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $20.

(i) To reclassify from equity the Company s issuance of common stock subject to conditional redemption to Pfizer, in connection with the Pfizer settlement agreement in accordance with EITF D-98 $(14,595) common stock $(1), additional paid-in capital $(14,594).

(j) To reclassify portion of inventory not expected to be used within one year to long-term.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended June 30, 2004		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 37,485	$ (8,186) (a)(b)	$ 29,299
Collaborative research and development and other revenues	2,975		2,975
Total revenues	40,460	(8,186)	32,274
Operating costs and expenses:			
Cost of products sold	9,926	(208) (c)	9,718
Research and development	18,174	(1,608) (b)(d)	16,566
Selling, general and administrative	16,625	1,491(b)(d)	18,116
Co-promotion	7,000		7,000
Total operating costs and expenses	51,725	(325)	51,400
Loss from operations	(11,265)	(7,861)	(19,126)
Other income (expense):			
Interest income	208		208
Interest expense	(3,140)	12(b)	(3,128)
Other, net	(19)	18(e)	(1)
Total other expense, net	(2,951)	30	(2,921)
Loss before income taxes	(14,216)	(7,831)	(22,047)
Income tax expense		(18) (e)	(18)
Net loss	$ (14,216)	$ (7,849)	$ (22,065)
Basic and diluted per share amounts:			
Net loss	$ (0.19)		$ (0.30)

Weighted average number of common shares	73,754,146	73,754,146

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(8,097).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product sales $(214); royalties $6.

(d) To reclassify $1,454 of expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(e) To reclassify income taxes related to international operations $18.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	September 30, 2004			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 46,020			$ 46,020
Short-term investments	34,387			34,387
Accounts receivable, net	30,583	$ (162) (a)	$ 36(a)	30,457
Current portion of inventories, net	11,355	(4,035)(b)(l)	66(a)(l)	7,386
Other current assets	2,985	13,223(a)(c)	2,729(a)(c)	18,937
Total current assets	125,330	9,026	2,831	137,187
Restricted investments	1,656			1,656
Long-term portion of inventories, net		4,250(l)	(45)(l)	4,205
Property and equipment, net	23,844			23,844
Acquired technology and product rights, net	129,852	260(a)(d)		130,112
Other assets	7,977	(1,208)(a)(e)		6,769
	$ 288,659	$ 12,328	$ 2,786	$ 303,773
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 16,719	$ 1(a)	$ 68(a)	$ 16,788
Accrued liabilities	49,527	(298)(a)(f)	(3,308) (a)(f)	45,921
Current portion of deferred revenue, net	2,352	121,473(g)	17,720(g)	141,545
Current portion of equipment financing obligations	2,617			2,617
Current portion of long-term debt	314			314
Total current liabilities	71,529	121,176	14,480	207,185
Long-term debt	167,171			167,171
Long-term portion of deferred revenue, net	2,043	1,173(h)		3,216
Long-term portion of equipment financing obligations	4,087			4,087
Other long-term liabilities	2,870	288(i)	15(i)	3,173

Total liabilities	247,700	122,637	14,495	384,832
Common stock subject to conditional redemption		14,595(j)	(2,250) (k)	12,345
Stockholders equity (deficit):				
Common stock	74	(1)(j)		73
Additional paid-in capital	731,841	(14,540)(a)(j)	2,250(k)	719,551
Accumulated other comprehensive loss	(123)			(123)
Accumulated deficit	(689,922)	(110,363)	(11,709)	(811,994)
	41,870	(124,904)	(9,459)	(92,493)
Treasury stock	(911)			(911)
Total stockholders equity (deficit)	40,959	(124,904)	(9,459)	(93,404)
	$ 288,659	$ 12,328	$ 2,786	$ 303,773

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) To reverse replacement reserve.

(c) Cumulative effect of prior period adjustments includes $13,276 related to the change to the sell-through revenue recognition method (deferred royalties $8,704; deferred cost of products sold $4,572). Current quarter adjustments include $2,654 related to the change to the sell-through revenue recognition method (deferred royalties $2,486; deferred cost of products sold $168).

(d) To correct accumulated amortization expense related to ONTAK acquired technology - $357.

(e) To expense the payment to The Salk Institute to buy-out the Company s royalty obligation on lasofoxifene $(1,120).

(f) Cumulative effect of prior period adjustments includes $(3,056) related to the change to the sell-through revenue recognition method (product cost $(2,652); royalties - $(404)); to correct bonus expense $(201); to reclassify Seragen acquisition liability from other long-term liabilities $2,100; to accrue interest on Seragen acquisition liability $739. Current quarter adjustments include $(3,349) related to the change to the sell-through revenue recognition method (product cost $(4,806); royalties $1,457).

(g) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(h) To reflect the deferral of a portion of the sale of royalty rights to Royalty Pharma.

(i) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,388; to reclassify the Seragen acquisition liability to accrued liabilities $(2,100). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis- $15.

(j) To reclassify from equity the Company s issuance of common stock subject to conditional redemption to Pfizer, in connection with the Pfizer settlement agreement in accordance with EITF D-98 $(14,595) common stock $(1), additional paid-in capital $(14,594).

(k) To reflect Pfizer s redemption of shares in connection with the achievement of a milestone in accordance with the Pfizer settlement agreement.

(l) To reclassify portion of inventory not expected to be used with one year to long-term.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended September 30, 2004		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 44,726	$ (12,792)(a)(b)	$ 31,934
Sale of royalty rights, net		67(c)	67
Collaborative research and development and other revenues	4,771		4,771
Total revenues	49,497	(12,725)	36,772
Operating costs and expenses:			
Cost of products sold	11,011	(1,192)(d)	9,819
Research and development	17,980	(1,233)(b)(e)	16,747
Selling, general and administrative	15,890	1,421(b)(e)	17,311
Co-promotion	8,501		8,501
Total operating costs and expenses	53,382	(1,004)	52,378
Loss from operations	(3,885)	(11,721)	(15,606)
Other income (expense):			
Interest income	255		255
Interest expense	(2,919)	(226)(b)(f)	(3,145)
Other, net	(240)	241(b)(f)(g)	1
Total other expense, net	(2,904)	15	(2,889)
Loss before income taxes	(6,789)	(11,706)	(18,495)
Income tax expense		(3)(g)	(3)
Net loss	$ (6,789)	$ (11,709)	$ (18,498)
Basic and diluted per share amounts:			
Net loss	$ (0.09)		$ (0.25)

Weighted average number of common shares	73,845,613	73,845,613

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(12,842).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the recognition of revenue previously deferred in regard to the sale of royalty rights to Royalty Pharma.

(d) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $(163), royalties $(1,029).

(e) To reclassify $1,221 of expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(f) To reclassify $238 of interest and factoring expenses incurred under a factoring arrangement from other, net to interest expense.

(g) To reclassify income taxes related to international operations $3.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	March 31, 2003			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 12,979			$ 12,979
Short-term investments	21,004			21,004
Accounts receivable, net	17,086	$ 247(a)	$ 13(a)	17,346
Inventories, net	5,395	150(a)	(18)(a)	5,527
Other current assets	6,547	7,665(a)(b)	(280)(a)(b)	13,932
Total current assets	63,011	8,062	(285)	70,788
Restricted investments	10,741			10,741
Property and equipment, net	9,229			9,229
Acquired technology and product rights, net	145,862	260(a)(c)		146,122
Other assets	12,333	3,958(a)(d)	(3,958)(a)(d)	12,333
	$ 241,176	$ 12,280	$ (4,243)	$ 249,213
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 13,441	$ 913(a)(e)	$ (314)(a)(e)	$ 14,040
Accrued liabilities	17,640	(2,182)(a)(f)	3,386(a)(f)	18,844
Current portion of deferred revenue, net	4,637	43,926(g)	7,594(g)	56,157
Current portion of equipment financing obligations	2,105	253(h)	15(h)	2,373
Total current liabilities	37,823	42,910	10,681	91,414
Long-term debt	155,250			155,250
Long-term portion of deferred revenue, net	2,709	581(i)		3,290
Long-term portion of equipment financing obligations	3,707	(253)(h)	(15)(h)	3,439
Other long-term liabilities	3,664	(463)(j)	32(j)	3,233

Total liabilities	203,153	42,775	10,698	256,626
Common stock subject to conditional redemption/repurchase		34,595(k)	(20,000)(l)	14,595
Stockholders equity (deficit):				
Common stock	70	(3)(k)	2(l)	69
Additional paid-in capital	677,561	(30,355)(a)(k)	15,865(l)	663,071
Accumulated other comprehensive loss	(61)			(61)
Accumulated deficit	(638,636)	(34,732)	(10,808)	(684,176)
	38,934	(65,090)	5,059	(21,097)
Treasury stock	(911)			(911)
Total stockholders equity (deficit)	38,023	(65,090)	5,059	(22,008)
	$ 241,176	$ 12,280	$ (4,243)	$ 249,213

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) Cumulative effect of prior period adjustments includes $7,603 related to the change to the sell-through revenue recognition method (deferred royalties $4,215; deferred cost of products sold $3,388). Current quarter adjustments include $118 related to the change to the sell-through revenue recognition method (deferred royalties $98; deferred cost of products sold $20); to correct prepaid clinical trial expense $(352).

(c) To correct accumulated amortization expense related to ONTAK acquired technology $357.

(d) To record the capitalization of the X-Ceptor Purchase Right in October 1999 $3,990; to write-off the X-Ceptor Purchase Right in March 2003, which was previously recognized for the period from 1999 to June 2002 $(3,990).

(e) To correct clinical trial expense cumulative effect of prior period adjustments $918; current quarter adjustments $(367).

(f) Cumulative effect of prior period adjustments include $(1,089) related to the change to the sell-through revenue recognition method (product cost $(1,491); royalties $402); to correct accruals for bonus expense $694, and property tax expense $(316); to reclassify Seragen acquisition liability from other long-term liabilities $2,700; reclassification of the Elan shares from accrued liabilities to additional paid-in capital $(4,133). Current quarter adjustments include $(444) related to the change to the sell-through revenue recognition method (product cost $(126); royalties $(318)) ; reclassification of the Elan shares from accrued liabilities to additional paid-in capital $4,133.

(g) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(h) To reclassify equipment lease obligations from long-term to current obligations.

(i) To reflect the deferral of a portion of the sales of royalty rights to Royalty Pharma.

(j) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for annual rent increases amortized over the lease term on a straight line basis $2,237; to reclassify the Seragen acquisition liability to accrued liabilities - $(2,700). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $32.

(k) In accordance with EITF D-98, to reclassify from equity the Company s issuance of common stock to Pfizer common stock $(1); additional paid in capital $(14,594); Elan shares common stock $(2); additional paid in capital $(19,998); reclassification of the Elan shares from accrued liabilities to additional paid-in capital $4,133.

(l) To reflect the repurchase and retirement of the Elan shares in February 2003 $20,000 common stock $2; additional paid-in capital $19,998; reclassification of the Elan shares from accrued liabilities to additional paid-in capital $(4,133).

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended March 31, 2003		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 18,928	$ (7,455)(a)(b)	$ 11,473
Collaborative research and development and other revenues	4,195		4,195
Total revenues	23,123	(7,455)	15,668
Operating costs and expenses:			
Cost of products sold	6,620	(418)(c)	6,202
Research and development	16,640	(91)(b)	16,549
Selling, general and administrative	12,426	(74)(b)	12,352
Total operating costs and expenses	35,686	(583)	35,103
Loss from operations	(12,563)	(6,872)	(19,435)
Other income (expense):			
Interest income	243		243
Interest expense	(2,682)	(26)(b)	(2,708)
Other, net	(5,318)	(3,895)(b)(d)(e)	(9,213)
Total other expense, net	(7,757)	(3,921)	(11,678)
Loss before income taxes	(20,320)	(10,793)	(31,113)
Income tax expense		(15)(e)	(15)
Net loss	$ (20,320)	$ (10,808)	$ (31,128)
Basic and diluted per share amounts:			
Net loss	$ (0.29)		$ (0.44)
Weighted average number of common shares	70,238,438		70,238,438

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(7,468).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $(3); royalties $(415).

(d) To reflect the write off of the X-Ceptor Purchase Right in March 2003 $3,990.

(e) To reclassify income taxes related to international operations $15.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	June 30, 2003			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 24,248			$ 24,248
Short-term investments	17,595			17,595
Accounts receivable, net	7,689	$ 260(a)	$ (221) (a)	7,728
Inventories, net	4,806	132(a)	93(a)	5,031
Other current assets	2,635	7,385(a)(b)	1,390(a)(b)	11,410
Total current assets	56,973	7,777	1,262	66,012
Restricted investments	6,204			6,204
Property and equipment, net	8,843			8,843
Acquired technology and product rights, net	143,194	260(a)(c)		143,454
Other assets	11,718			11,718
	$ 226,932	$ 8,037	$ 1,262	$ 236,231
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)				
Current liabilities:				
Accounts payable	$ 10,819	$ 599(a)(d)	$ (185)(a)	$ 11,233
Accrued liabilities	18,319	1,204(a)(e)	(26)(a)(e)	19,497
Current portion of deferred revenue, net	4,126	51,520(f)	13,400(f)	69,046
Current portion of equipment financing obligations	1,890	268(g)	224(g)	2,382
Total current liabilities	35,154	53,591	13,413	102,158
Long-term debt	155,250			155,250
Long-term portion of deferred revenue, net	2,430	581(h)		3,011
Long-term portion of equipment financing obligations	3,403	(268)(g)	(224)(g)	2,911
Other long-term liabilities	3,638	(431)(i)	32(i)	3,239

Total liabilities	199,875	53,473	13,221	266,569
Common stock subject to conditional redemption		14,595(j)		14,595
Stockholders equity (deficit):				
Common stock	70	(1)(j)		69
Additional paid-in capital	678,577	(14,490)(a)(j)		664,087
Accumulated other comprehensive loss	(46)			(46)
Accumulated deficit	(650,633)	(45,540)	(11,959)	(708,132)
	27,968	(60,031)	(11,959)	(44,022)
Treasury stock	(911)			(911)
Total stockholders equity (deficit)	27,057	(60,031)	(11,959)	(44,933)
	$ 226,932	$ 8,037	$ 1,262	$ 236,231

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect other adjustments and reclassifications.

(b) Cumulative effect of prior period adjustments includes $7,721 related to the change to the sell-through revenue recognition method (deferred royalties $4,313; deferred cost of products sold $3,408); to correct prepaid clinical trial expense $(290). Current quarter adjustments include $1,416 related to the change to the sell-through revenue recognition method (deferred royalties $1,818; deferred cost of products sold $(402)).

(c) To correct accumulated amortization expense related to ONTAK acquired technology $357.

(d) To correct clinical trial expense $551.

(e) Cumulative effect of prior period adjustments includes $(1,533) related to the change to the sell-through revenue recognition method (product cost $(1,617); royalties $84); to correct accruals for bonus expense $588, property tax expense $(361), and legal, trademark and patent expense -$(240); to reclassify Seragen acquisition liability from long-term to current $2,700. Current quarter adjustments includes $(105) related to the change to the sell-through revenue recognition method (product cost $(565); royalties $460).

(f) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method.

(g) To reclassify equipment financing obligations from long-term to current obligations.

(h) To reflect the deferral of a portion of the sales of royalty rights to Royalty Pharma.

(i) The cumulative effect of prior period adjustments reflects the effect of the adjustment to rent expense for contractual annual rent increases recognized over the lease term on a straight line basis $2,269; to reclassify the Seragen acquisition liability to accrued liabilities $(2,700). Current quarter adjustment reflects the adjustment to rent expense for contractual annual rent increase recognized over the lease term on a straight line basis $32.

(j) To reclassify from equity the Company s issuance of common stock subject to conditional redemption to Pfizer, in connection with the Pfizer settlement agreement in accordance with EITF D-98 $(14,595) common stock $(1); additional paid in capital $(14,594).

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED STATEMENT OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended June 30, 2003		
	As Previously Reported	Adjustments	As Restated
Product sales	$ 25,187	$ (13,016)(a)(b)	$ 12,171
Collaborative research and development and other revenues	3,939		3,939
Total revenues	29,126	(13,016)	16,110
Operating costs and expenses:			
Cost of products sold	7,766	(921)(c)	6,845
Research and development	16,859	(215)(b)(d)(e)	16,644
Selling, general and administrative	13,571	(2)(b)(d)	13,569
Total operating costs and expenses	38,196	(1,138)	37,058
Loss from operations	(9,070)	(11,878)	(20,948)
Other income (expense):			
Interest income	140		140
Interest expense	(2,688)	(81)(b)	(2,769)
Other, net	(379)	16(f)	(363)
Total other expense, net	(2,927)	(65)	(2,992)
Loss before income taxes	(11,997)	(11,943)	(23,940)
Income tax expense		(16)(f)	(16)
Net loss	$ (11,997)	$ (11,959)	$ (23,956)
Basic and diluted per share amounts:			
Net loss	$ (0.17)		$ (0.35)
Weighted average number of common shares	69,275,323		69,275,323

Refer to the explanation of adjustments on the next page.

Table of Contents

EFFECTS OF THE RESTATEMENT

The adjustments relate to the following (in thousands):

(a) To reflect the change in the revenue recognition method from the sell-in method to the sell-through method net product sales $(12,835).

(b) To reflect other adjustments and reclassifications.

(c) To reflect the effect of the sell-through revenue recognition method on cost of products sold and royalties product cost $437; royalties $(1,358).

(d) To reclassify $9 of expenses incurred for the technology transfer and validation effort related to the second source of supply for AVINZA from research and development expense to selling, general and administrative expense.

(e) To correct clinical trial expense $(331).

(f) To reclassify income taxes related to international operations $16.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
EFFECTS OF THE RESTATEMENT
CONSOLIDATED BALANCE SHEET
(unaudited) (in thousands)

	September 30, 2003			
	As Previously Reported	Cumulative Effect of Prior Period Adjustments	Current Quarter Adjustments	As Restated
ASSETS				
Current assets:				
Cash and cash equivalents	$ 73,002			$ 73,002
Short-term investments	13,744			13,744
Accounts receivable, net	9,923	$ 39(a)	$ (42)(a)	9,920
Current portion of inventories, net	6,005	225(a)	(798)(a)(k)	5,432
Other current assets	3,188	8,775(a)(b)	1,684(a)(b)	13,647
Total current assets	105,862	9,039	844	115,745
Restricted investments	6,203			6,203
Long-term portion of inventories, net			679(k)	679
Property and equipment, net	9,072			9,072
Acquired technology and product rights, net	140,526	260(a)(c)		140,786
Other assets	11,134			11,134
	$272,797	$9,299	$1,523	$283,619