

LIGAND PHARMACEUTICALS INC

Form 10-Q

August 08, 2012

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Mark One

Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2012 or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Transition Period From to . Commission File Number: 001-33093

LIGAND PHARMACEUTICALS INCORPORATED

(Exact name of registrant as specified in its charter)

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Delaware **77-0160744**
(State or other jurisdiction of **(I.R.S. Employer**

incorporation or organization) **Identification No.)**

11119 North Torrey Pines Road

La Jolla, CA **92037**
(Address of principal executive offices) **(Zip Code)**
Registrant's Telephone Number, Including Area Code: (858) 550-7500

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

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

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

Large Accelerated Filer Accelerated Filer

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

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

As of August 8, 2012, the registrant had 19,936,740 shares of common stock outstanding.

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LIGAND PHARMACEUTICALS INCORPORATED

QUARTERLY REPORT

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* No information provided due to inapplicability of item.

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(in thousands, except share data)

| | June 30, 2012 (Unaudited) | December 31, 2011 |
|---|---------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 8,885 | \$ 7,041 |
| Short-term investments | 1,500 | 10,000 |
| Accounts receivable | 817 | 6,110 |
| Inventory | 2,698 | 1,301 |
| Deferred income taxes | 237 | 237 |
| Other current assets | 2,025 | 1,344 |
| Current portion of co-promote termination payments receivable | 4,934 | 6,197 |
| | | |
| Total current assets | 21,096 | 32,230 |
| Restricted cash and investments | 1,341 | 1,341 |
| Property and equipment, net | 644 | 455 |
| Intangible assets, net | 56,273 | 57,437 |
| Goodwill | 14,894 | 14,894 |
| Long-term portion of co-promote termination payments receivable | 9,822 | 15,255 |
| Other assets | 524 | 738 |
| | | |
| Total assets | \$ 104,594 | \$ 122,350 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 6,746 | \$ 11,065 |
| Accrued liabilities | 4,228 | 5,054 |
| Current portion of liability for contingent value rights | 3,739 | 6,879 |
| Bank line of credit | 1,500 | 10,000 |
| Current portion of note payable | 5,806 | |
| Current portion of co-promote termination liability | 4,934 | 6,197 |
| Current portion of lease exit obligations | 3,054 | 3,208 |
| Current portion of deferred revenue | 412 | 1,240 |
| | | |
| Total current liabilities | 30,419 | 43,643 |
| Long-term portion of note payable | 22,211 | 20,286 |
| Long-term portion of co-promote termination liability | 9,822 | 15,255 |
| Long-term portion of deferred revenue, net | 2,722 | 3,466 |
| Long-term portion of lease exit obligations | 7,355 | 8,367 |
| Deferred income taxes | 2,812 | 2,522 |
| Long-term portion of liability for contingent value rights | 10,413 | 11,433 |
| Other long-term liabilities | 388 | 388 |
| | | |
| Total liabilities | 86,142 | 105,360 |

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Commitments and contingencies

Common stock subject to conditional redemption; 0 and 112,371 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively 8,344

Stockholders' equity

| | | |
|---|-----------|-----------|
| Common stock, \$0.001 par value; 33,333,333 shares authorized; 20,904,962 and 20,682,506 shares issued at June 30, 2012 and December 31, 2011, respectively | 21 | 21 |
| Additional paid-in capital | 743,365 | 732,676 |
| Accumulated other comprehensive income | | |
| Accumulated deficit | (682,654) | (681,771) |
| Treasury stock, at cost; 1,118,222 shares at June 30, 2012 and December 31, 2011 | (42,280) | (42,280) |

| | | |
|----------------------------|--------|-------|
| Total stockholders' equity | 18,452 | 8,646 |
|----------------------------|--------|-------|

| | | |
|--|------------|------------|
| Total liabilities and stockholders' equity | \$ 104,594 | \$ 122,350 |
|--|------------|------------|

See accompanying notes.

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LIGAND PHARMACEUTICALS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands, except share data)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-----------------|------------------------------|-----------------|
| | 2012 | 2011 | 2012 | 2011 |
| Revenues: | | | | |
| Royalties | \$ 2,983 | \$ 2,172 | \$ 6,043 | \$ 4,165 |
| Material sales | 1,665 | 2,984 | 2,332 | 4,034 |
| Collaborative research and development and other revenues | 1,094 | 2,307 | 3,003 | 3,160 |
| Total revenues | 5,742 | 7,463 | 11,378 | 11,359 |
| Operating costs and expenses: | | | | |
| Cost of sales | 435 | 1,623 | 590 | 2,148 |
| Research and development | 2,850 | 3,237 | 5,668 | 5,223 |
| General and administrative | 3,940 | 3,855 | 7,442 | 7,299 |
| Lease exit and termination costs | 247 | (16) | 173 | (168) |
| Total operating costs and expenses | 7,472 | 8,699 | 13,873 | 14,502 |
| Accretion of deferred gain on sale leaseback | | 426 | | 851 |
| Loss from operations | (1,730) | (810) | (2,495) | (2,292) |
| Other income (expense): | | | | |
| Interest expense, net | (847) | (674) | (1,622) | (1,063) |
| Decrease (increase) in liability for contingent value rights | (1,153) | 679 | (389) | (1,057) |
| Other, net | 2 | 32 | 256 | 82 |
| Total other income (expense), net | (1,998) | 37 | (1,755) | (2,038) |
| Loss before income taxes | (3,728) | (773) | (4,250) | (4,330) |
| Income tax benefit (expense) | (338) | (141) | (303) | 13,444 |
| Income (loss) from continuing operations | (4,066) | (914) | (4,553) | 9,114 |
| Discontinued operations: | | | | |
| Gain on sale of AVINZA Product Line before income taxes | 1,608 | | 3,656 | |
| Gain on sale of Oncology Product Line before income taxes | | | | 4 |
| Income tax benefit on discontinued operations | 191 | | 14 | |
| Discontinued operations | 1,799 | | 3,670 | 4 |
| Net income (loss): | \$ (2,267) | \$ (914) | \$ (883) | \$ 9,118 |

Basic and diluted per share amounts:

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| | | | | |
|---|-------------------|-------------------|-------------------|-------------------|
| Income (Loss) from continuing operations | \$ (0.20) | \$ (0.05) | \$ (0.23) | \$ 0.46 |
| Discontinued operations | 0.09 | 0 | 0.19 | 0 |
| Net income (loss) | \$ (0.11) | \$ (0.05) | \$ 0.04 | \$ 0.46 |
| Weighted average number of common shares-basic | 19,749,266 | 19,650,260 | 19,728,852 | 19,623,249 |
| Weighted average number of common shares-diluted | 19,749,266 | 19,650,260 | 19,728,852 | 19,637,983 |

See accompanying notes.

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LIGAND PHARMACEUTICALS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(in thousands)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|----------|------------------|----------|
| | June 30, | | June 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| Net income (loss) | \$ (2,267) | \$ (914) | \$ (883) | \$ 9,118 |
| Unrealized net loss on available-for-sale securities | | (5) | | (31) |
| Comprehensive income (loss) | \$ (2,267) | \$ (919) | \$ (883) | \$ 9,087 |

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

| | Six Months Ended June 30, | |
|--|--------------------------------------|-------------|
| | 2012 | 2011 |
| Operating activities | | |
| Net income (loss) | \$ (883) | \$ 9,118 |
| Less: gain from discontinued operations | 3,670 | 4 |
| Income (loss) from continuing operations | (4,553) | 9,114 |
| Adjustments to reconcile net income (loss) to net cash used in operating activities, including effects of business acquired: | | |
| Non-cash change in estimated fair value of contingent value rights | 389 | 1,057 |
| Accretion of deferred gain on sale leaseback | | (851) |
| Depreciation and amortization | 1,340 | 1,349 |
| Non-cash lease costs | | (135) |
| Share-based compensation | 2,103 | 1,696 |
| Deferred income taxes | 303 | (13,590) |
| Other | 221 | 109 |
| Changes in operating assets and liabilities, net of acquisition: | | |
| Accounts receivable | 5,293 | 1,157 |
| Inventory | (305) | (179) |
| Other current assets | (683) | 4,340 |
| Other long term assets | 214 | 570 |
| Accounts payable and accrued liabilities | (3,651) | (8,918) |
| Other liabilities | | (1,636) |
| Deferred revenue | (1,572) | (1,217) |
| Net cash used in operating activities of continuing operations | (901) | (7,134) |
| Net cash used in operating activities of discontinued operations | (200) | |
| Net cash used in operating activities | (1,101) | (7,134) |
| Investing activities | | |
| Acquisition of CyDex, net of cash acquired | | (32,024) |
| Payments to CVR holders | (4,549) | |
| Purchases of property, equipment and building | (261) | (5) |
| Proceeds from sale of property, and equipment and building | 13 | |
| Purchases of short-term investments | | (10,000) |
| Proceeds from sale of short-term investments | 8,500 | 19,346 |
| Other, net | | (33) |
| Net cash provided by (used in) investing activities | 3,703 | (22,716) |
| Financing activities | | |
| Proceeds from issuance of debt | 7,500 | 30,000 |
| Repayment of debt | (8,500) | |
| Proceeds from issuance of common stock, net | 242 | |

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| | | |
|---|----------|----------|
| Share repurchases | | (55) |
| Net cash provided by (used in) financing activities | (758) | 29,945 |
| Net increase in cash and cash equivalents | 1,844 | 95 |
| Cash and cash equivalents at beginning of period | 7,041 | 3,346 |
| Cash and cash equivalents at end of period | \$ 8,885 | \$ 3,441 |
| Supplemental Disclosure of cash flow information | | |
| Interest paid | 1,302 | 1,093 |
| Taxes paid | 15 | 27 |
| <i>See accompanying notes.</i> | | |

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LIGAND PHARMACEUTICALS INCORPORATED

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

Ligand Pharmaceuticals Incorporated, a Delaware corporation (the "Company" or "Ligand"), is a biotechnology company that focuses on drug discovery and early-stage development and partnering of pharmaceuticals that address critical unmet medical needs or that are more effective and/or safer than existing therapies, more convenient to administer and are cost effective. The Company sold its Oncology Product Line (Oncology) and Avinza Product Line (Avinza) on October 25, 2006 and February 26, 2007, respectively. The operating results for Oncology and Avinza have been presented in the accompanying consolidated financial statements as Discontinued Operations .

The Company has incurred significant losses since its inception. At June 30, 2012, the Company's accumulated deficit was \$682.7 million and the Company had negative working capital of \$9.3 million. Based on recent product approvals and regulatory developments, as well as management's plans including expense reductions, if necessary, the Company believes its currently available cash, cash equivalents, and short-term investments as well as its current and future royalty, license and milestone revenues will be sufficient to satisfy its anticipated operating and capital requirements through at least the next twelve months. The Company's future operating and capital requirements will depend on many factors, including, but not limited to: the pace of scientific progress in its research and development programs; the potential success of these programs; the scope and results of preclinical testing and clinical trials; the time and costs involved in obtaining regulatory approvals; the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims; competing technological and market developments; the amount of royalties on sales of the commercial products of its partners; the efforts of its collaborative partners; obligations under its operating lease agreements; and the capital requirements of any companies the Company previously acquired, including Pharmacoepia, Inc. (Pharmacoepia), Neurogen Corporation (Neurogen), Metabasis Therapeutics, Inc. (Metabasis) and CyDex Pharmaceuticals, Inc. (CyDex). Management's plans and efforts may not fully address any significant adverse impact from any or all of these factors and the Company may be required to obtain additional financing, which may not be available at acceptable terms, or at all.

Principles of Consolidation

The condensed consolidated financial statements include the Company's wholly owned subsidiaries, Seragen, Inc. (Seragen), Nexus Equity VI LLC (Nexus), Pharmacoepia, Neurogen, Metabasis and CyDex. All significant intercompany accounts and transactions have been eliminated in consolidation.

Basis of Presentation

The Company's accompanying unaudited consolidated condensed financial statements as of June 30, 2012 and for the three and six months ended June 30, 2012 and 2011 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for annual financial statements. The Company's consolidated condensed balance sheet at December 31, 2011 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the financial position and results of operations of the Company, and its subsidiaries have been included. Operating results for the three and six months ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. These financial statements should be read in conjunction with the consolidated financial statements and notes therein included in the Company's annual report on Form 10-K for the year ended December 31, 2011.

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

Income (Loss) Per Share

Basic earnings per share is calculated by dividing net income or loss by the weighted average number of common shares and vested restricted stock units outstanding. Diluted earnings per share is computed by dividing net income or loss by the weighted average number of common shares and vested restricted stock units outstanding and the weighted average number of dilutive common stock equivalents, including stock options and non-vested restricted stock units. Common stock equivalents are only included in the diluted earnings per share calculation when their effect is dilutive. For the three and six months ended June 30, 2012 and for the three months ended June 30, 2011, no potential common shares are included in the computation of any diluted per share amounts, including income (loss) per share from discontinued operations and net loss per share, as the Company reported a loss from continuing operations. For the six months ended June 30, 2011, 14,734 common shares are included in the computation of diluted income per share. Potential common shares, the shares that would be issued upon the exercise of outstanding stock options and warrants and the vesting of restricted shares that would be excluded from the computation of diluted loss per share, were 2.0 million and 1.6 million at June 30, 2012 and 2011, respectively.

The following table sets forth the computation of basic and diluted net income (loss) per share for the periods indicated (in thousands, except per share amounts):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|------------|------------------------------|------------|
| | 2012 | 2011 | 2012 | 2011 |
| Net income (loss) from continuing operations | \$ (4,066) | \$ (914) | \$ (4,553) | \$ 9,114 |
| Net income from discontinued operations | 1,799 | | 3,670 | 4 |
| Net income (loss) | (2,267) | (914) | (883) | 9,118 |
| Shares used to compute basic and diluted income per share | 19,749,266 | 19,650,260 | 19,728,852 | 19,623,249 |
| Dilutive potential common shares: | | | | |
| Restricted stock | | | | 14,734 |
| Shares used to compute diluted income (loss) per share | 19,749,266 | 19,650,260 | 19,728,852 | 19,637,983 |
| Basic and diluted per share amounts: | | | | |
| Income (loss) from continuing operations | \$ (0.20) | \$ (0.05) | \$ (0.23) | \$ 0.46 |
| Income from discontinued operations | 0.09 | | 0.19 | |
| Net income (loss) | \$ (0.11) | \$ (0.05) | \$ (0.04) | \$ 0.46 |

Revenue Recognition

Royalties on sales of products commercialized by the Company's partners are recognized in the quarter reported by the respective partner.

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Material sales revenue is recognized upon transfer of title, which normally passes to the buyer upon shipment to the customer. The Company's credit and exchange policy includes provisions for the return of product between 30 to 90 days, depending on the specific terms of the individual agreement, when that product (1) does not meet specifications, (2) is damaged in shipment (in limited circumstances where title does not transfer until delivery), or (3) is exchanged for an alternative grade of Captisol.

Revenue from research funding under the Company's collaboration agreements is earned and recognized on a percentage-of-completion basis as research hours are incurred in accordance with the provisions of each agreement.

Nonrefundable, up-front license fees and milestone payments with standalone value that are not dependent on any future performance by the Company under the Company's collaboration agreements are recognized as revenue upon the earlier of when payments are received or collection is assured, but are deferred if the Company has continuing performance obligations. If the Company is unable to determine the stand alone value under multiple-element arrangements, revenue is recognized over the period of services or performance. Amounts received under multiple-element arrangements requiring ongoing services or performance by the Company are recognized over the period of such services or performance.

Revenue from milestones are recognized when earned, as evidenced by written acknowledgement from the collaborator, provided that (i) the milestone event is substantive, its achievability was not reasonably assured at the inception of the agreement, and the Company has no further performance obligations relating to that event, and (ii) collectability is reasonably assured. If these criteria are not met, the milestone payment is recognized over the remaining period of the Company's performance obligations under the arrangement.

Income Taxes

The Company recognizes liabilities or assets for the deferred tax consequences of temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets or liabilities are recovered or settled. A valuation allowance is established when management determines that it is more likely than not that all or a portion of a deferred tax asset will not be realized. Management evaluates the realizability of its net deferred tax assets on a quarterly basis and valuation allowances are provided, as necessary. During this evaluation, management reviews its forecasts of income in conjunction with other positive and negative evidence surrounding the realizability of its deferred tax assets to determine if a valuation allowance is required. Adjustments to the valuation allowance will increase or decrease the Company's income tax provision or benefit. Management also applies the relevant guidance to determine the amount of income tax expense or benefit to be allocated among continuing operations, discontinued operations, and items charged or credited directly to stockholders' equity.

A tax position must meet a minimum probability threshold before a financial statement benefit is recognized. The minimum threshold is a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

Table of Contents*Accounting for Share-Based Compensation*

Share-based compensation expense for awards to employees and non-employee directors is recognized on a straight-line basis over the vesting period until the last tranche vests. Compensation cost for consultant awards is recognized over each separate tranche's vesting period. The following table summarizes share-based compensation expense recorded as components of research and development expenses and general and administrative expenses for the periods indicated (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|----------|---------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Share-based compensation expense as a component of: | | | | |
| Research and Development expenses | \$ 523 | \$ 405 | \$ 948 | \$ 512 |
| General and administrative expenses | 871 | 816 | 1,155 | 1,178 |
| | \$ 1,394 | \$ 1,221 | \$ 2,103 | \$ 1,690 |

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------------|--------------------------------|-----------|------------------------------|------------|
| | 2012 | 2011 | 2012 | 2011 |
| Risk-free interest rate | 0.9% | 2.4% | 1.0% | 2.5% |
| Dividend yield | | | | |
| Expected volatility | 69% | 68% | 69% | 69% |
| Expected term | 6.3 years | 6.1 years | 6.3 years | 6.1 years |
| Forfeiture rate | 8.0% | 9.4% | 8.0%-11.2% | 9.4%-14.1% |

The expected term of the employee and non-employee director options is the estimated weighted-average period until exercise or cancellation of vested options (forfeited unvested options are not considered) based on historical experience. The expected term for consultant awards is the remaining period to contractual expiration.

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

Cash, Cash Equivalents and Short-term Investments

Cash and cash equivalents consist of cash and highly liquid securities with maturities at the date of acquisition of three months or less. Non-restricted equity and debt securities with a maturity of more than three months are considered short term investments. Restricted cash and investments consist of certificates of deposit held with financial institutions as collateral under a facility lease and third-party service provider arrangement. The following table summarizes the various investment categories at June 30, 2012 and December 31, 2011 (in thousands):

| | Cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
|--------------------------------------|----------|---------------------------|----------------------------|-------------------------|
| June 30, 2012 | | | | |
| Certificates of deposit | \$ 1,500 | \$ | \$ | \$ 1,500 |
| Certificates of deposit - restricted | 1,341 | | | 1,341 |
| | \$ 2,841 | \$ | \$ | \$ 2,841 |

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| December 31, 2011 | | | | |
|--------------------------------------|-----------|----|----|-----------|
| Certificates of deposit | 10,000 | | | 10,000 |
| Certificates of deposit - restricted | 1,341 | | | 1,341 |
| | \$ 11,341 | \$ | \$ | \$ 11,341 |

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Table of Contents*Concentrations of Credit Risk*

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash equivalents and investments and accounts receivable.

The Company invests its excess cash principally in United States government debt securities, investment grade corporate debt securities and certificates of deposit. The Company has established guidelines relative to diversification and maturities that maintain safety and liquidity. These guidelines are periodically reviewed and modified to take advantage of trends in yields and interest rates. Except as described above, the Company has not experienced any significant losses on its cash equivalents, short-term investments or restricted investments.

As of June 30, 2012 and December 31, 2011, cash deposits held at financial institutions in excess of FDIC insured amounts of \$250,000 were approximately \$9.9 million and \$13.1 million, respectively.

Accounts receivable from one customer was 37% and 67% of total accounts receivable at June 30, 2012 and December 31, 2011, respectively.

The Company obtains Captisol from a sole-source supplier. If this supplier was not able to supply the requested amounts of Captisol, the Company would be unable to continue to derive revenues from the sale of Captisol until it obtained an alternative source, which might take a considerable length of time.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts based on the best estimate of the amount of probable losses in the Company's existing accounts receivable. Accounts receivable that are outstanding longer than their contractual payment terms, ranging from 30 to 90 days, are considered past due. When determining the allowance for doubtful accounts, several factors are taken into consideration, including historical write-off experience and review of specific customer accounts for collectability. Account balances are charged off against the allowance after collection efforts have been exhausted and the potential for recovery is considered remote. There was no allowance for doubtful accounts included in the balance sheets at June 30, 2012 and December 31, 2011.

Inventory

Inventory is stated at the lower of cost or market. The Company determines cost using the first-in, first-out method. The Company analyzes its inventory levels periodically and writes down inventory to its net realizable value if it has become obsolete, has a cost basis in excess of its expected net realizable value or is in excess of expected requirements.

Other Current Assets

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

| | June 30, 2012 | December 31, 2011 |
|---------------------------------|--------------------------|------------------------------|
| Prepaid expenses | \$ 848 | \$ 905 |
| Advanced manufacturing payments | 56 | 312 |
| Other receivables | 1,121 | 127 |
| | \$ 2,025 | \$ 1,344 |

Table of Contents*Property and Equipment*

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

| | June 30, 2012 | December 31, 2011 |
|--|--------------------------|------------------------------|
| Lab and office equipment | \$ 4,392 | \$ 4,110 |
| Leasehold improvements | | 62 |
| Computer equipment and software | 1,134 | 1,054 |
| | 5,526 | 5,226 |
| Less accumulated depreciation and amortization | (4,882) | (4,771) |
| | \$ 644 | \$ 455 |

Depreciation of equipment is computed using the straight-line method over the estimated useful lives of the assets, which range from three to ten years. Leasehold improvements are amortized using the straight-line method over their estimated useful lives or their related lease term, whichever is shorter.

Goodwill and Other Identifiable Intangible Assets

Goodwill and other identifiable intangible assets consist of the following (in thousands):

| | June 30, 2012 | December 31, 2011 |
|--|--------------------------|------------------------------|
| Acquired in-process research and development | \$ 13,036 | \$ 13,036 |
| Complete technology | 14,643 | 14,643 |
| Trade name | 2,537 | 2,537 |
| Customer relationships | 29,400 | 29,400 |
| Goodwill | 14,894 | 14,894 |
| | 74,510 | 74,510 |
| Accumulated amortization | (3,343) | (2,179) |
| | \$ 71,167 | \$ 72,331 |

Intangible assets related to IPR&D are considered to be indefinite-lived until the completion or abandonment of the associated research and development efforts. During the period the assets are considered to be indefinite-lived, they will not be amortized but will be tested for impairment on an annual basis and between annual tests if the Company becomes aware of any events occurring or changes in circumstances that would indicate a reduction in the fair value of the IPR&D projects below their respective carrying amounts. If and when development is complete, which generally occurs if and when regulatory approval to market a product is obtained, the associated assets would be deemed finite-lived and would then be amortized based on their respective estimated useful lives at that point in time. Amortization expense of \$1.2 million and \$1.3 million was recognized for the six months ended June 30, 2012 and 2011, respectively. Estimated amortization expense for the years ending December 31, 2012 through 2016 is \$2.3 million per year.

Table of Contents*Impairment of Long-Lived Assets*

Management reviews long-lived assets for impairment annually or whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair value for the Company's long-lived assets is determined using the expected cash flows discounted at a rate commensurate with the risk involved. As of June 30, 2012, management does not believe there have been any events or circumstances indicating that the carrying amount of its long-lived assets may not be recoverable.

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

| | June 30, 2012 | December 31, 2011 |
|-------------------|------------------|----------------------|
| Compensation | \$ 682 | \$ 1,806 |
| Professional fees | 576 | 355 |
| Other | 2,970 | 2,893 |
| | \$ 4,228 | \$ 5,054 |

Other Long-Term Liabilities

Other long-term liabilities consist of the following (in thousands):

| | June 30, 2012 | December 31, 2011 |
|----------|------------------|----------------------|
| Deposits | 388 | 388 |
| | \$ 388 | \$ 388 |

Sale of Royalty Rights

The Company previously sold to third parties the rights to future royalties of certain of its products. As part of the underlying royalty agreements, the partners have the right to offset a portion of any future royalty payments owed to the Company to the extent of previous milestone payments. Accordingly, the Company deferred a portion of the revenue associated with each tranche of royalty right sold, 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. As of June 30, 2012 and December 31, 2011, the Company had deferred \$1.0 million and \$1.2 million, respectively, of revenue related to the sale of royalty rights. As of June 30, 2012, \$0.4 million is included in current portion of deferred revenue and \$0.6 million is included in long-term portion of deferred revenue.

Recently Adopted Accounting Pronouncements

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220) - Presentation of Comprehensive Income*. This ASU amends Topic 220, *Comprehensive Income*, to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' investment. The amendments to the Codification in the ASU do not change the items that must be reported in other comprehensive

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income or when an item of other comprehensive income must be reclassified to net income. The ASU was effective for fiscal years beginning after December 15, 2011 for the Company. In 2012, the Company has elected to present comprehensive income in a separate statement.

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In September 2011, the FASB issued ASU 2011-08, *Intangibles – Goodwill and other: testing for goodwill impairment*, which, among other things, amends *Accounting Standards Topic 350 Intangibles – Goodwill and Other*, to allow entities to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. Our adoption of this standard had no impact on our consolidated financial position, results of operations or cash flows.

In December 2011, the FASB issued ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income* in ASU 2011-12. The amendments in ASU 2011-12 defer the changes in ASU 2011-05 that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. The amendments in this ASU are effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011. See above for the provisions of ASU 2011-05.

2. Business Combinations

On January 24, 2011, the Company acquired CyDex Pharmaceuticals, Inc., a specialty pharmaceutical company developing products and licensing its Captisol® technology. Captisol is currently incorporated in six FDA-approved medications and marketed by three of CyDex's licensees: Pfizer, Bristol-Myers Squibb, Onyx Pharmaceuticals, Inc., and Baxter International. In addition, CyDex is supporting drug development efforts with more than 40 companies worldwide.

Under the terms of the agreement, the Company paid \$32.0 million to the CyDex shareholders and issued a series of Contingent Value Rights recorded at an initial fair value of \$19.2 million. The initial fair value of the liability was determined using a discounted cash flow analysis incorporating the estimated future cash flows from potential milestones and revenue sharing. These cash flows were then discounted to present value using a discount rate of 21.6%. The liability will be periodically assessed based on events and circumstances related to the underlying milestones, and the change in fair value will be recorded in the Company's consolidated statements of operations. The carrying amount of the liability may fluctuate significantly and actual amounts paid under the CVR agreements may be materially different than the carrying amount of the liability. The fair value of the liability at June 30, 2012 was \$13.7 million.

The Company paid the CyDex shareholders \$4.3 million in January 2012, \$3.5 million in July 2012 and may be required to pay up to an additional \$6.0 million upon achievement of certain milestones. In addition, the Company will pay CyDex shareholders, for each respective year from 2011 through 2016, 20% of all CyDex-related revenue, but only to the extent that and beginning only when CyDex-related revenue for such year exceeds \$15.0 million; plus an additional 10% of all CyDex-related revenue recognized during such year, but only to the extent that and beginning only when aggregate CyDex-related revenue for such year exceeds \$35.0 million. The Company paid \$0.3 million to the CyDex shareholders in March 2012 for 20% of all 2011 CyDex-related revenue in excess of \$15 million.

Ligand is required by the CyDex Contingent Value Rights Agreement (CVR) to dedicate at least five experienced full-time employee equivalents per year to the acquired business and to invest at least \$1.5 million per year, inclusive of such employee expenses, in the acquired business, through 2015. As of June 30, 2012, the Company estimates it has exceeded this amount.

Had the merger with CyDex been completed as of the beginning of 2011, the Company's pro forma results for the six months ended June 30, 2011 would have been as follows:

| (in thousands, except per share data) | 2011 |
|---|-----------|
| Revenue | \$ 11,548 |
| Operating loss | (2,300) |
| Net income | 8,974 |
| Basic and diluted earnings per share: | |
| Continuing operations | \$ 0.46 |
| Discontinued operations | \$ 0.00 |
| Net income | \$ 0.46 |
| Basic and diluted weighted average shares | 19,623 |

The primary adjustments relate to interest expense on long-term debt, the loss of interest income due to the timing of transaction related payments and amortization of intangible assets. The above pro forma information was determined based on historical results adjusted for the purchase price allocation and estimated related changes in income associated with the merger of CyDex.

Table of Contents**3. Financial Instruments**

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including available-for-sale fixed income and equity securities and other equity securities. The following table provides a summary of the assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2012 (in thousands):

Fair Value Measurements at Reporting Date Using

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|--|------------------|---|---|--|
| Assets: | | | | |
| Short-term investments | \$ 1,500 | \$ 1,500 | \$ | \$ |
| Liabilities: | | | | |
| Current portion of liability for contingent value rights - CyDex | \$ 3,739 | \$ | \$ | \$ 3,739 |
| Liability for contingent value rights - Metabasis | | | | |
| Liability for contingent value rights - Neurogen | 500 | | | 500 |
| Liability for contingent value rights - CyDex | 9,913 | | | 9,913 |
| Total liabilities | \$ 14,152 | \$ | \$ | \$ 14,152 |

The following table provides a summary of the assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2011 (in thousands):

Fair Value Measurements at Reporting Date Using

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|--|------------------|---|---|--|
| Assets: | | | | |
| Short-term investments | \$ 10,000 | \$ 10,000 | \$ | \$ |
| Liabilities: | | | | |
| Current portion of liability for contingent value rights - CyDex | \$ 6,879 | \$ | \$ | \$ 6,879 |
| Liability for contingent value rights - Metabasis | 1,068 | 1,068 | | |
| Liability for contingent value rights - Neurogen | 700 | | | 700 |
| Liability for contingent value rights - CyDex | 9,665 | | | 9,665 |
| Total liabilities | \$ 18,312 | \$ 1,068 | \$ | \$ 17,244 |

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The Company's short-term investments are fixed income available-for-sale securities and include Corporate Notes, Corporate Discount Commercial Paper and certificates of deposit. The fair value of the Company's short-term investments and liability for contingent value rights-Metabasis are determined using quoted market prices in active markets.

4. 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. Subsequently in January 2006, Ligand signed an agreement with Organon that terminated the Avinza co-promotion agreement between the two companies and returned Avinza co-promotion rights to Ligand. In consideration of the early termination, Ligand agreed to 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.

In February 2007, Ligand and King Pharmaceuticals, Inc., (King), executed an agreement pursuant to which King acquired all of the Company's rights in and to Avinza. King also assumed the Company's co-promote termination obligation to make royalty payments to Organon based on net sales of Avinza.

In connection with King's assumption of this obligation, Organon did not consent to the legal assignment of the co-promote termination obligation to King. Accordingly, Ligand remains liable to Organon in the event of King's default of the obligation. Therefore, Ligand recorded an asset as of February 26, 2007 to recognize King's assumption of the obligation, while continuing to carry the co-promote termination liability in the Company's consolidated financial statements to recognize Ligand's legal obligation as primary obligor to Organon. This asset represents a non-interest bearing receivable for future payments to be made by King and is recorded at its fair value. The receivable and liability will remain equal and adjusted each quarter for changes in the fair value of the obligation including for any changes in the estimate of future net Avinza product sales. This receivable will be assessed on a quarterly basis for impairment (e.g. in the event King defaults on the assumed obligation to pay Organon).

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

A summary of the co-promote termination liability as of June 30, 2012 is as follows (in thousands):

| | |
|--|-----------|
| Net present value of payments based on estimated future net AVINZA product sales as of December 31, 2011 | \$ 21,452 |
| Assumed payments made by King or assignee | (1,702) |
| Fair value adjustments | (4,994) |
| Total co-promote termination liability as of June 30, 2012 | 14,756 |
| Less: current portion of co-promote termination liability as of June 30, 2012 | 4,934 |
| Long-term portion of co-promote termination liability as of June 30, 2012 | \$ 9,822 |

Table of Contents**5. Lease obligations**

The Company leases office and laboratory facilities in California, Kansas, and New Jersey. These leases expire between 2014 and 2019 and are subject to annual increases which range from 3.0% and 3.5%. The Company currently subleases office and laboratory space in California and New Jersey. The following table provides a summary of operating lease obligations and payments expected to be received from sublease agreements as of June 30, 2012 (in thousands):

| | Square Footage | Lease Termination Date | Less than | | | More than 5 years | Total |
|--|----------------|------------------------|-----------------|------------------|-----------------|-------------------|------------------|
| | | | 1 year | 1-3 years | 3-5 years | | |
| Operating lease obligations: | | | | | | | |
| Corporate headquarters-San Deigo, CA | 16,500 | July 2019 | \$ 550 | \$ 1,151 | \$ 1,220 | \$ 962 | \$ 3,883 |
| Bioscience and Technology Business Center-Lawrence, KS | 1,500 | December 2014 | 57 | 85 | | | 142 |
| Vacated office and research facility-San Diego, CA | 52,800 | July 2015 | 2,143 | 4,481 | 191 | | 6,815 |
| Vacated office and research facility-Cranbury, NJ | 99,000 | August 2016 | 2,715 | 5,432 | 3,169 | | 11,316 |
| Total operating lease obligations | | | \$ 5,465 | \$ 11,149 | \$ 4,580 | \$ 962 | \$ 22,156 |
| Sublease payments expected to be received: | | | | | | | |
| Office and research facility-San Diego, CA | 52,800 | July 2015 | \$ 892 | \$ 1,866 | | | \$ 2,758 |
| Office and research facility-Cranbury, NJ | 5,100 | August 2016 | 252 | 746 | 373 | | 1,371 |
| Net operating lease obligations | | | \$ 4,321 | \$ 8,537 | \$ 4,207 | \$ 962 | \$ 18,027 |

Table of Contents**6. Segment Reporting**

Under Accounting Standards Codification No. 280, Segment Reporting, or ASC 280, operating segments are defined as components of an enterprise about which separate financial information is available that is regularly evaluated by the entity's chief operating decision maker, in deciding how to allocate resources and in assessing performance. The Company has evaluated this Codification and has identified two reportable segments: the development and commercialization of drugs using Captisol technology by CyDex Pharmaceuticals, Inc. and the traditional biotech operations including drug discovery and development of Ligand Pharmaceuticals, Inc. We evaluate performance based on the operating profit (loss) of the respective business segments. The segment results may not represent actual results that would be expected if they were independent, stand-alone businesses. Segment information was as follows:

Balance Sheet Data:

| | As of June 30, 2012 | | |
|--------------|---------------------|-----------|------------|
| | Ligand | CyDex | Total |
| Total Assets | \$ 71,580 | \$ 33,223 | \$ 104,594 |

| | As of December 31, 2012 | | |
|--------------|-------------------------|-----------|------------|
| | Ligand | CyDex | Total |
| Total Assets | \$ 81,277 | \$ 41,073 | \$ 122,350 |

Operating Data:

| | For the three months Ended June 30, 2012 | | |
|--|--|----------|----------|
| | Ligand | CyDex | Total |
| Net revenues from external customers | \$ 3,929 | \$ 1,813 | \$ 5,742 |
| Operating loss | (1,514) | (245) | (1,730) |
| Depreciation and amortization expense | 73 | 605 | 678 |
| Income tax expense from continuing operations | 338 | | 338 |
| Income tax benefit from discontinuing operations | 191 | | 191 |
| Interest expense, net | 847 | | 847 |

| | For the six months Ended June 30, 2012 | | |
|---|--|----------|-----------|
| | Ligand | CyDex | Total |
| Net revenues from external customers | \$ 8,030 | \$ 3,348 | \$ 11,378 |
| Operating profit (loss) | (1,799) | (696) | (2,495) |
| Depreciation and amortization expense | 128 | 1,212 | 1,340 |
| Income tax expense (benefit) from continuing operations | 303 | | 303 |
| Income tax expense from discontinuing operations | 14 | | 14 |
| Interest expense | 1,622 | | 1,622 |

Table of Contents**7. Financing Arrangements**

The Company has a secured term loan credit facility (secured debt). Under the terms of the secured debt, the Company will make interest only payments through March 2013. Subsequent to the interest only payments, the note will amortize with principal and interest payments through the remaining term of the loan. Additionally, the Company must also make an additional final payment equal to 6% of the total amount borrowed which is due at maturity and is being accreted over the life of the loan. The Company also has a cash-collateralized revolving credit facility under which the Company may elect to borrow up to \$10 million. All outstanding amounts under the credit facility may become due and payable if the Company fails to maintain a cash balance equal to the amount outstanding under the credit facility. The carrying values and the fixed contractual coupon rates of our financing arrangements are as follows (dollars in millions):

| | June 30, 2012 | December 31, 2011 |
|--|------------------|-------------------|
| Bank line of credit, Prime + 2.0%, due March 29, 2013 | \$ 1,500 | \$ 10,000 |
| Current portion notes payable, 8.64%, due August 1, 2014 | 4,224 | |
| Current portion notes payable, 8.9012%, due August 1, 2014 | 1,582 | |
| Total current portion of notes payable | \$ 5,806 | \$ |
| Long-term portion notes payable, 8.64%, due August 1, 2014 | 16,233 | 20,286 |
| Long-term portion notes payable, 8.9012%, due August 1, 2014 | 5,978 | |
| Total long-term portion of notes payable | \$ 22,211 | \$ 20,286 |

8. Stockholders Equity

On May 31, 2012, the Company's stockholders approved the amendment and restatement of the Company's 2002 Stock Incentive Plan to increase the number of shares available for issuance by 1.8 million shares.

Stock Option Activity

The following is a summary of the Company's stock option plan activity and related information:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term in Years | Aggregate Intrinsic Value (In thousands) |
|---|-----------|---------------------------------|--|--|
| Balance at December 31, 2011 | 1,146,046 | \$ 14.61 | 7.96 | \$ 1,489 |
| Granted | 642,845 | 14.28 | | |
| Exercised | (17,003) | 10.25 | | |
| Forfeited | (65,927) | 10.01 | | |
| Cancelled | (12,823) | 40.50 | | |
| Balance at June 30, 2012 | 1,693,138 | 14.51 | | |
| Exercisable at June 30, 2012 | 689,860 | 16.87 | 7.15 | 2,634 |
| Options vested and expected to vest as of June 30, 2012 | 1,693,138 | 14.51 | 8.35 | 6,702 |

The weighted-average grant date fair value of all stock options granted during the six months ended June 30, 2012 was \$8.90 per share. The total intrinsic value of all options exercised during the six months ended June 30, 2012 and 2011 was approximately \$0.3 million and \$2,500, respectively. As of June 30, 2012, there was \$6.6 million of total unrecognized compensation cost related to nonvested stock options. That cost

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is expected to be recognized over a weighted-average period of 3.1 years.

As of June 30, 2012, 1.9 million shares were available for future option grants or direct issuance under the Company's 2002 Stock Incentive Plan, as amended.

Table of Contents**Restricted Stock Activity**

Restricted stock activity for the three months ended June 30, 2012 is as follows:

| | Shares | Weighted-Average Grant Date Fair Value |
|--------------------------------|----------|--|
| Nonvested at December 31, 2011 | 115,506 | \$ 10.63 |
| Granted | 108,661 | 13.75 |
| Vested | (71,406) | 11.48 |
| Forfeited | (2,917) | 9.86 |
| Nonvested at June 30, 2012 | 149,844 | 12.50 |

The weighted-average grant-date fair value of restricted stock granted during the six months ended June 30, 2012 was \$13.75 per share. As of June 30, 2012, there was \$1.4 million of total unrecognized compensation cost related to nonvested restricted stock. That cost is expected to be recognized over a weighted-average period of 2.0 years.

Employee Stock Purchase Plan

The Company's Employee Stock Purchase Plan, as amended and restated (the "Amended ESPP") allows participants to purchase up to 1,250 shares of Ligand common stock during each offering period, but in no event may a participant purchase more than 1,250 shares of common stock during any calendar year. The length of each offering period is six months, and employees are eligible to participate in the first offering period beginning after their hire date.

The Amended ESPP allows employees to purchase Ligand common stock at the end of each six month period at a price equal to 85% of the lesser of fair market value on either the start date of the period or the last trading day of the period (the "Lookback Provision"). The 15% discount and the Lookback Provision make the Amended ESPP compensatory. There were 7,374 and 2,404 shares of common stock issued and \$75,000 and \$18,000 of proceeds received under the Amended ESPP during the six months ended June 30, 2012 and 2011, respectively. The Company recorded compensation expense related to the ESPP of \$22,000 and \$700 for the six months ended June 30, 2012 and 2011, respectively. As of June 30, 2012, 89,917 shares were available for future purchases under the Amended ESPP.

Warrants

As of June 30, 2012, 163,568 warrants with an exercise price of \$179.40 per warrant and an expiration date of April 2013 were outstanding to purchase an aggregate of 129,360 shares of the Company's common stock. If exercised, these warrants are also entitled to receive \$0.1 million in cash and 981,411 of each of the Company's four contingent value rights issued to Neurogen shareholders in December 2009. The series of warrants was assumed in the acquisition of Neurogen Corporation.

Share Repurchases

On June 15, 2010, the Company announced that its Board of Directors had authorized the Company to repurchase up to \$10.0 million of its common stock from time to time in privately negotiated and open market transactions for a period of up to two years, subject to the Company's evaluation of market conditions, applicable legal requirements and other factors. The authority to repurchase shares of the Company's common stock expired on June 8, 2012, at which time the Company had repurchased 16,905 shares of its common stock totaling \$0.1 million.

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9. Litigation

From time to time the Company is subject to various lawsuits and claims with respect to matters arising out of the normal course of its business. If, based on the Company's assessment, it is probable that a liability has been incurred and can be reasonably estimated, then such loss is accrued and charged to operations. Management believes all costs that can be reasonably estimated will not exceed the related existing accruals.

10. Common Stock Subject to Conditional Redemption - 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 \$74.25 per share, for revenue related to lasofoxifene and drolofoxifene. 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) since Pfizer has the option to settle milestone and royalties payments owed to the Company with the Company's shares, and such option is not within the Company's control. The remaining shares of the Company's common stock that could be redeemed totaled 112,371 and are reflected at the exchange ratio price of \$74.25. Pfizer has notified Ligand that the development of the two compounds covered under the 1996 settlement agreement have been terminated and thus the Company reclassified the shares and the current carrying amount of \$8.3 million to permanent equity in the first quarter of 2012.

12. Subsequent Events

Through August 8, 2012, the Company issued, pursuant to an at-the-market registered public offering, 150,000 common shares at a weighted average price of \$18.19 per share. Total net proceeds to the Company after underwriting discounts and expenses were approximately \$2.6 million.

Table of Contents**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

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

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

References to Ligand Pharmaceuticals Incorporated (Ligand, the Company, we or our) include our wholly owned subsidiaries - Seragen, Inc. (Seragen); Nexus Equity VI LLC (Nexus); Pharmacoepia, LLC; Neurogen Corporation; Metabasis Therapeutics, Inc.; and CyDex Pharmaceuticals, Inc.

Overview

We are a biotechnology company that operates with a simple business model focused on developing or acquiring revenue generating assets and coupling them to a lean corporate cost structure. Our goal is to create a sustainably profitable business and generate meaningful value for our stockholders. Since a portion of our business model is based on the goal of partnering with other pharmaceutical companies to commercialize and market our assets, a significant amount of our revenue is based largely on payments made to us by partners for royalties, milestones and license fees. We recognized the important role of the drug reformulation segment in the pharmaceutical industry and in 2011 added Captisol® to our technology portfolio. Captisol is a formulation technology that has enabled six FDA approved products, including Pfizer's Vfend® IV, Baxter International's Nexterone®, and Onyx's KyprolisSM and is currently being used in a number of clinical-stage partner programs. In comparison to our peers, we believe we have assembled one of the largest and most diversified asset portfolios in the industry with the potential to generate significant revenue in the future. In addition, therapies in development address the unmet medical needs of patients for a broad spectrum of diseases including hepatitis, muscle wasting, Alzheimer's disease, dyslipidemia, diabetes, anemia, asthma, rheumatoid arthritis and osteoporosis. We have established multiple alliances with the world's leading pharmaceutical companies including GlaxoSmithKline, Merck, Pfizer, Baxter International, Bristol-Myers Squibb, Celgene, Onyx Pharmaceuticals, Lundbeck Inc., Eli Lilly & Company, Rib-X Pharmaceuticals, Inc., and The Medicines Company.

In February 2012, we announced that we had licensed the full world-wide rights to DARA (a Dual Acting Receptor Antagonist of Angiotension and Endothelin receptors) to Retrophin, LLC (Retrophin). Retrophin intends to develop DARA for orphan indications of severe kidney diseases including Focal Segmental Glomerulosclerosis (FSGS) as well as conduct proof-of-concept studies in resistant hypertension and diabetic nephropathy. Certain patient groups with severely compromised renal function exhibit extreme proteinuria resulting in progression to dialysis and a high mortality rate. DARA, with its unique dual blockade of angiotensin and endothelin receptors, is expected to provide meaningful clinical benefits in mitigating proteinuria in indications where there are no approved therapies. We received a net up-front payment of approximately \$1 million, and may receive, net of amounts owed to third parties, over \$75 million in milestones as well as 9% in royalties on potential future worldwide sales by Retrophin.

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GSK has recently completed two large Phase III studies (ENABLE 1 and 2) designed to demonstrate Promacta's value in treatment of thrombocytopenia in patients with Hepatitis C. In May 2012, GSK submitted U.S. and European regulatory applications for use of Promacta to increase platelet counts in patients with hepatitis C. In July 2012, GSK announced they had been granted priority review for this application in the U.S.

In July 2012, our licensee, Onyx Pharmaceuticals, Inc. (Onyx), received accelerated approval from the U.S. Food and Drug Administration, or FDA, for Kyprolis (Carfilzomib) for injection. Kyprolis is formulated with Ligand's Captisol® and is used for the treatment of patients with multiple myeloma who have received at least two prior therapies, including bortezomib and an immunomodulatory agent, and have demonstrated disease progression on or within 60 days of completion of the last therapy. The indication for Kyprolis is based on response rate. Currently, no data are available for Kyprolis that demonstrate an improvement in progression-free survival or overall survival. Under our agreement with Onyx, we are entitled to receive milestones, tiered royalties ranging between 1.5% and 3% as shown in the table below, and revenue from clinical and commercial Captisol material sales.

| AGGREGATE NET SALES IN EACH CALENDAR YEAR | ROYALTY RATE |
|---|--------------|
| Up to, and including, \$250 million | 1.5% |
| \$251 million to \$500 million | 2.0% |
| \$501 million to \$750 million | 2.5% |
| Above \$750 million | 3.0% |

The royalty rates set forth above will be applied to the total Net Sales of Product falling within the applicable range of aggregate annual Net Sales during the quarter.

Metabasis Contingent Value Rights

In January 2010, we completed our acquisition of Metabasis. In addition to cash consideration, we issued four tradable Contingent Value Rights (CVRs), one CVR from each of four respective series of CVRs, for each Metabasis share. The CVRs will entitle the holder to cash payments as frequently as every six months as cash is received by us from the sale or partnering of any of the Metabasis drug development programs, among other triggering events. We have also committed to spend at least \$7 million within 30 months and \$8 million within 42 months, in new research and development funding on the Metabasis programs. Through June 30, 2012, we estimate that we have spent approximately \$6.7 million of the committed amount.

In January 2011, we entered into a strategic relationship with Chiva Pharmaceuticals, Inc. to develop multiple assets and technology in China and potentially worldwide. Chiva was granted licenses to begin immediate development in China of two clinical-stage HepDirect programs, Pradefovir for hepatitis B and MB01733 for hepatocellular carcinoma. Additionally, we granted Chiva a non-exclusive HepDirect technology license for the discovery, development and worldwide commercialization of new compounds in hepatitis B (HepB), hepatitis C (HepC) and hepatocellular carcinoma (HCC). Under the terms of the agreement, we are entitled to milestones and royalties on potential sales. In addition, we are entitled to receive a portion of any sublicensing revenue generated from sublicensing of collaboration compounds to third parties in a major world market. We received a \$0.5 million license payment in March 2011, of which \$0.1 million was remitted to CVR holders.

In August 2011, we entered into an amendment to the license agreement which required that a second \$0.5 million licensing fee be paid in September 2011. In addition, the amendment increased royalty rates which we may receive under the license agreement to 6% of net sales of products (other than Pradefovir) and 9% of net sales for Pradefovir. In addition, the amendment removed from the license agreement a provision that afforded us the potential to earn a 10% equity position in Chiva as a milestone payment. In September 2011, Chiva paid us the \$0.5 million licensing fee called for by the amendment, of which \$0.1 million was remitted to CVR holders.

Results of Operations*Three and Six Months Ended June 30, 2012 and 2011*

Total revenues for the three and six months ended June 30, 2012 were \$5.7 million and \$11.4 million compared to \$7.5 million and \$11.4 million for the same periods in 2011. We reported a loss from continuing operations of \$4.1 million and \$4.6 million for the three and six months ending June 30, 2012, compared to a loss from continuing operations of \$0.9 million and income from continuing operations of \$9.1 million for the three and six months ended June 30, 2011.

Royalty Revenue

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Royalty revenues were \$3.0 million and \$6.0 million for the three and six months ended June 30, 2012, compared to \$2.2 million and \$4.2 million for the same periods in 2011. The increase in royalty revenue is primarily due to an increase in Promacta royalties and royalties on CyDex licensed products offset by a decrease in Avinza royalties.

Table of Contents*Material Sales*

We recorded material sales of \$1.7 million and \$2.3 million for the three and six months ended June 30, 2012, compared to \$3.0 million and \$4.0 million for the same periods in 2011. The decrease in material sales is due to timing of customer purchases of Captisol.

Collaborative Research and Development and Other Revenues

We recorded collaborative research and development and other revenues of \$1.1 million and \$3.0 million for the three and six months ended June 30, 2012, compared to \$2.3 million and \$3.2 million for the same periods in 2011. The decrease of \$1.2 million for the three months ended June 30, 2012, compared to the same period in 2011, is primarily due to the recognition of \$1.3 million of deferred revenue related to the previous sale of royalty rights for the three month period ending June 30, 2011. Additionally, license fees and milestones increased \$0.1 million for the three month period ending June 30, 2012 compared to the same period in 2011. The decrease of \$0.2 million for the six months ended June 30, 2012, compared to the same period in 2011 is due to the recognition of \$1.3 million of deferred revenue related to the previous sale of royalty rights for the six months ending June 30, 2011, partially offset by an increase in license fees and milestones of \$1.1 million for the six months ending June 30, 2012 compared to the same period in 2011.

Research and Development Expenses

Research and development expenses were \$2.9 million and \$5.7 million for the three and six months ended June 30, 2012, respectively, compared to \$3.2 million and \$5.2 million for the same periods in 2011. The decrease of \$0.3 million for the three months ended June 30, 2012, compared to the same period in 2011, is primarily due to timing of costs associated with internal programs. The increase of \$0.5 million for the six months ended June 30, 2012, compared to the same period in 2011, is primarily due to an increase in costs associated with internal programs.

As summarized in the table below, we are developing several proprietary products for a variety of indications. Our programs are not limited to the following, but are representative of a range of future licensing opportunities to expand our partnered asset portfolio.

| Program | Disease/Indication | Development Phase |
|---|----------------------------|-------------------|
| Selective Androgen Receptor Modulators (SARMs) (agonists) | Muscle wasting and frailty | Phase I |
| Captisol-Enabled Melphalan IV | Oncology | Pivotal |
| Captisol-Enabled Topiramate IV | Epilepsy/Seizures | Preclinical |
| Glucagon receptor antagonist | Diabetes | Preclinical |

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

Table of Contents*General and Administrative Expenses*

General and administrative expenses were \$3.9 million and \$7.4 million for the three and six months ended June 30, 2012, respectively, compared to \$3.9 million and \$7.3 million for the same periods in 2011.

Lease Exit and Termination Costs

In September 2010, we ceased use of our facility located in Cranbury, New Jersey. As a result, during the quarter ended September 30, 2010, we recorded lease exit costs of \$9.7 million for costs related to the difference between the remaining lease obligations of the abandoned operating leases, which run through August 2016, and management's estimate of potential future sublease income, discounted to present value. Actual future sublease income may differ materially from our estimate, which would result in us recording additional expense or reductions in expense. In addition, we wrote-off approximately \$5.4 million of property and equipment related to the facility closure and recorded approximately \$1.8 million of severance related costs. We recorded \$0.2 million as a reduction of lease exit and termination costs for the three and six months ending June 30, 2012. During the three and six months ended June 30, 2011, we sold certain property and equipment for \$16,000 and \$0.2 million, respectively, from our former facility, which was recorded as a reduction of lease termination and exit costs.

Accretion of Deferred Gain on Sale Leaseback

On November 9, 2006, we sold real property located in San Diego, California for a sale price of \$47.6 million. This property included our corporate headquarter building totaling approximately 82,500 square feet, the land on which the building was situated, and two adjacent vacant lots. As part of the sale transaction, we agreed to leaseback the building for a period of 15 years. We recognized an immediate pre-tax gain on the sale transaction of \$3.1 million and deferred a gain of \$29.5 million on the sale of the building. The deferred gain was being recognized on a straight-line basis over the 15 year term of the lease at a rate of approximately \$2.0 million per year. In August 2009, we entered into a lease termination agreement for this building. As a result, we recognized \$20.4 million of accretion of deferred gain during the quarter ended September 30, 2009, and recognized the remaining balance of the deferred gain through the term of our new building lease, which expired in December 2011. The amount of the deferred gain recognized for the three and six months ended June 30, 2011 was \$0.4 million and \$0.9 million, and was fully amortized as of December 31, 2011.

Interest Expense

Interest expense was \$0.8 million and \$1.6 million, for the three and six months ended June 30, 2012, respectively, compared to \$0.7 million and \$1.1 million for the same period in 2011. The increases in interest expense of \$0.1 million for the three month period and \$0.5 million for the six month period ending June 30, 2012 were due to the increase in the outstanding balance of notes payable at June 30, 2012 compared to June 30, 2011. Additionally, the \$20 million loan obtained to acquire CyDex in January 2011 was outstanding for a partial period for the six months ending June 30, 2011.

Change in liability for Contingent Value Rights

We recorded an increase in the liability for CVRs of \$1.2 million and \$0.4 million for the three and six months ended June 30, 2012, compared to a decrease in liability for CVRs of \$0.7 million and an increase in the liability for CVRs of \$1.1 million for the three and six months ended June 30, 2011. The increase for the three months ended June 30, 2012 relates to an increase in the liability for amounts potentially due to holders of CVRs associated with our CyDex acquisition, primarily due to the increased likelihood of approval of Kyprolis following an FDA advisory meeting, for which we owe CyDex CVR holders \$3.5 million upon approval. Partially offsetting this increase, we recorded a decrease in our liability for amounts potentially due to shareholders associated with our Neurogen acquisition of \$0.2 million. The increase of \$0.4 million in our liability for CVRs for the six months ended June 30, 2012 is due to an increase in the liability for amounts potentially due to holders of CVRs associated with our CyDex acquisition of \$1.7 million, primarily due to the increased likelihood of approval of Kyprolis. Partially offsetting this increase, for the six months ended June 30, 2012, our liability for CVRs associated with our Metabasis acquisition decreased \$1.1 million and our liability for CVRs associated with our Neurogen acquisition decreased \$0.2 million.

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The decrease in the liability for CVRs of \$0.7 million for the three months ended June 30, 2011 is due to a decrease in the liability for amounts potentially due to holders of CVRs associated with our Metabasis acquisition of \$0.1 million and a decrease in the liability for amounts potentially due to holders of CVRs associated with our CyDex acquisition of \$0.6 million. The increase in the liability for CVRs of \$1.1 million for the six months ended June 30, 2011 is due to an increase in the liability for amounts potentially due to holders of CVRs associated with our Metabasis acquisition of \$1.6 million, partially offset by a decrease for amounts potentially due to holders of CVRs associated with our CyDex acquisition of \$0.5 million.

Other, net

We recorded other income of \$1,000 and \$0.3 million for the three and six months ended June 30, 2012 compared to \$32,000 and \$82,000 for the three and six months ending June 30, 2011. Other income for 2012 primarily relates to income related to the release of obligations previously recorded associated with the acquisition of CyDex.

Income Taxes

We recorded income tax expense from continuing operations of \$0.3 million for the three and six months ended June 30, 2012. We recorded income tax expense of \$0.1 million for the three months ended June 30, 2011 and an income tax benefit of \$13.4 million for the six months ended June 30, 2011. The income tax benefit for the six months ended June 30, 2011 relates to the release of a portion of our valuation allowance against deferred tax assets which can be used to offset deferred tax liabilities recorded in connection with our acquisition of CyDex in January 2011.

Discontinued Operations

Oncology Product Line

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

During the three and six months ended June 30, 2011, we recognized \$0 and \$4,000, respectively, of pre-tax gains due to subsequent changes in certain estimates and liabilities recorded as of the sale date.

Avinza Product Line

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

Pursuant to the terms of the Avinza Purchase Agreement, we retained the liability for returns of product from wholesalers that had been sold by us prior to the close of the Transaction. Accordingly, as part of the accounting for the gain on the sale of Avinza, we recorded a reserve for Avinza product returns.

During the three and six months ended June 30, 2012, we recognized pre-tax gains of \$1.6 million and \$3.7 million, respectively, due to subsequent changes in certain estimates and liabilities recorded as of the sale date.

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Income Taxes

We recorded an income tax benefit of \$0.2 million and \$14,000 for income taxes related to discontinued operations for the three and six month periods ended June 30, 2012. We did not record any provision for income taxes for the three and six month periods ending June 30, 2011 as we did not realize any taxable income from discontinued operations.

Liquidity and Capital Resources

We have financed our operations through offerings of our equity securities, borrowings from long-term debt, issuance of convertible notes, product sales and the subsequent sales of our commercial assets, royalties, collaborative research and development and other revenues, capital and operating lease transactions.

We have incurred significant losses since inception. At June 30, 2012, our accumulated deficit was \$682.7 million and we had negative working capital of \$9.3 million. We believe that cash flows from operations will improve due to consistent Captisol® sales, an increase in royalty revenues driven primarily from continued increases in Promacta sales, recent product approvals and regulatory developments as well as anticipated new license and milestone revenues. In the event revenues and operating cash flows do not meet expectations, management plans to reduce discretionary expenses. However, it is possible that we may be required to seek additional financing. There can be no assurance that additional financing will be available on terms acceptable to management, or at all. We believe our available cash, cash equivalents, and short-term investments as well as our current and future royalty, license and milestone revenues will be sufficient to satisfy our anticipated operating and capital requirements, through at least the next twelve months. Our future operating and capital requirements will depend on many factors, including, but not limited to: the pace of scientific progress in our research and development programs; the potential success of these programs; the scope and results of preclinical testing and clinical trials; the time and costs involved in obtaining regulatory approvals; the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims; competing technological and market developments; the amount of royalties on sales of the commercial products of our partners; the efforts of our collaborative partners; obligations under our operating lease agreements; and the capital requirements of any companies we acquire, including Pharmacopeia, Inc. (Pharmacopeia), Neurogen Corporation (Neurogen), Metabasis Therapeutics, Inc. (Metabasis) and CyDex Pharmaceuticals, Inc. (CyDex). Our ability to achieve our operational targets is dependent upon our ability to further implement our business plan and generate sufficient operating cash flow.

In January 2011, we entered into a \$20 million secured term loan credit facility (secured debt) with Oxford Financial Group (Oxford). The loan was amended in January 2012 to increase the secured credit facility to \$27.5 million. The original \$20 million borrowed under the facility bears interest at a fixed rate of 8.6%. The additional \$7.5 million bears interest at a fixed rate of 8.9%. Under the terms of the secured debt, we will make interest only payments through March 2013. Subsequent to the interest only payments, the note will amortize with principal and interest payments through the remaining term of the loan. Additionally, we must also make an additional final payment equal to 6% of the total amount borrowed which is due at maturity and is being accreted over the life of the loan. The maturity date of the term loan is August 1, 2014.

We also have a cash-collateralized revolving credit facility under which we may elect to borrow up to \$10 million. Amounts borrowed under the revolving credit facility bear interest at a floating rate equal to 200 basis points above the prime rate. All outstanding amounts under the credit facility may become due and payable if we fails to maintain a cash balance equal to the amount outstanding under the credit facility. The maturity date of the revolving credit facility is March 29, 2013.

In October 2011, we filed a Registration Statement on Form S-3 with the Securities and Exchange Commission (SEC) for the issuance and sale of up to \$30 million of equity or other securities, proceeds from which will be used for general corporate purposes. The Form S-3 provides additional financial flexibility for us to sell shares or other securities as needed at any time. As of August 8, 2012, 150,000 shares have been issued under this registration statement for total net proceeds of approximately \$2.6 million.

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In connection with the acquisition of CyDex Pharmaceuticals, Inc. on January 24, 2011, we issued a series of Contingent Value Rights (CVR). We paid the CVR holders \$4.3 million in January 2012 and may be required to pay up to an additional \$6.0 million upon achievement of certain milestones. In 2011, \$0.9 million was paid to the CyDex Shareholders upon completion of a licensing agreement with The Medicines Company for the Captisol enabled Intravenous formulation of Clopidogrel. An additional \$2 million was paid to the CyDex Shareholders upon acceptance by the FDA of the New Drug Application submitted by Onyx and an additional \$3.5 million was paid upon approval by the FDA of Kyprolis for the potential treatment of patients with relapsed and refractory multiple myeloma. In addition, we will pay CyDex shareholders, for each respective year from 2011 through 2016, 20% of all CyDex-related revenue, but only to the extent that and beginning only when CyDex-related revenue for such year exceeds \$15.0 million; plus an additional 10% of all CyDex-related revenue recognized during such year, but only to the extent that and beginning only when aggregate CyDex-related revenue for such year exceeds \$35.0 million. We paid \$0.3 million to the CyDex shareholders in March 2012 for 20% of all 2011 CyDex-related revenue in excess of \$15 million. Pursuant to the CVR Agreement, the shareholders' representative on behalf of the former CyDex shareholders has recently filed a notice of objection with us regarding the calculation of payments due to the CyDex former shareholders for the first and second quarters of 2011. In addition, the shareholders' representative has claimed that we exceeded the \$35 million financial indebtedness limitation contained in the CVR Agreement. We disagree with these claims and intend to work with the shareholders' representative to resolve the claims. If we and the shareholders' representative fail to agree, the claims may be resolved through arbitration.

We are also required by the CyDex CVR Agreement to dedicate at least five experienced full-time employee equivalents per year to the acquired business and to invest at least \$1.5 million per year, inclusive of such employee expenses, in the acquired business, through 2015. As of June 30, 2012, we estimate we have exceeded our commitment for the year ending December 31, 2012.

Based on management's plans, including projected increases in Captisol sales and royalty revenues, as well as anticipated new license revenue and expense reductions, if necessary, we believe our currently available cash, cash equivalents, and short-term investments as well as our current and future royalty, license and milestone revenues will be sufficient to satisfy our anticipated operating and capital requirements, through at least the next twelve months. Our future operating and capital requirements will depend on many factors, including, but not limited to: the pace of scientific progress in our research and development programs; the magnitude of these programs; the scope and results of preclinical testing and clinical trials; the time and costs involved in obtaining regulatory approvals; the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims; competing technological and market developments; the amount of royalties on sales of our partners' commercial products; the efforts of our collaborative partners; obligations under our operating lease agreements and lease termination agreement; and the capital requirements of any companies we may acquire, including Neurogen, Metabasis and CyDex. We believe that the actions presently being taken to generate sufficient operating cash flow provide the opportunity for us to continue as a going concern. While we believe in the viability of our strategy to generate sufficient operating cash flow and in our ability to raise additional funds, there can be no assurances to that effect. Our ability to achieve our operational targets is dependent upon our ability to further implement our business plan and generate sufficient operating cash flow.

Operating Activities

Operating activities used cash of \$1.1 million for the six months ended June 30, 2012, compared to \$7.1 million of cash used in operating activities for the same period in 2011.

The cash used for the six months ended June 30, 2012 reflects a net loss of \$0.9 million, adjusted by \$3.7 million of gain from discontinued operations and \$4.4 million of non-cash items to reconcile the net loss to net cash used in operations. These reconciling items primarily reflect the non-cash change in the estimated fair value of CVRs of \$0.4 million, depreciation and amortization of \$1.3 million, share-based compensation of \$2.1 million, and the change in deferred income taxes of \$0.3 million. The cash used during the six months ended June 30, 2012 is further impacted by changes in operating assets and liabilities due primarily to an increase in inventory of \$0.3 million, a decrease in deferred revenue of \$1.6 million, a decrease in accounts payable and accrued liabilities of \$3.7 million, and an increase in other current assets of \$0.7 million. Partially offset by decreases in accounts receivable of \$5.3 million and other long term assets of \$0.2 million. Cash used in operating activities of discontinued operations was \$0.2 million for the six months ended June 30, 2012.

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The cash used for the six months ended June 30, 2011 reflects net income of \$9.1 million, adjusted by \$4,000 of gain from discontinued operations and \$10.4 million of non-cash items to reconcile the net income to net cash used in operations. These reconciling items primarily reflect the change in deferred income taxes of \$13.6 million, accretion of deferred gain on the sale leaseback of the building of \$0.9 million and non-cash lease costs of \$0.1 million partially offset by the change in estimated fair value of contingent value rights of \$1.1 million, depreciation and amortization of \$1.3 million and share-based compensation of \$1.7 million. The cash generated during the six months ended June 30, 2011 is further impacted by changes in operating assets and liabilities due primarily to a decrease in other liabilities of \$1.6 million, an increase in inventory of \$0.2 million, a decrease in deferred revenue of \$1.2 million and a decrease in accounts payable and accrued liabilities of \$8.9 million, partially offset by increases in other current assets of \$4.3 million, accounts receivable of \$1.2 million and other long term assets of \$0.6 million. None of the cash used in operating activities for the six months ended June 30, 2011 related to discontinued operations.

Investing Activities

Investing activities provided cash of \$3.7 million for the six months ended June 30, 2012, compared to \$22.7 million of cash used by investing activities for the same 2011 period.

Cash provided by investing activities during the six months ended June 30, 2012 primarily reflects \$8.5 million of proceeds from the sale of short-term investments, partially offset by payment to CVR holders of \$4.5 million and purchases of property, equipment and building of \$0.3 million. None of the cash provided by investing activities for the six months ended June 30, 2011 related to discontinued operations.

Cash used by investing activities during the six months ended June 30, 2011 primarily reflects \$32.0 million of cash paid for the acquisition of CyDex and \$10.0 million for purchases of short-term investments, partially offset by \$19.3 million of proceeds from the sale of short-term investments. None of the cash provided by investing activities for the six months ended June 30, 2011 related to discontinued operations.

Financing Activities

Financing activities used cash of \$0.8 million for the six months ended June 30, 2012, compared to cash provided by financing activities of \$30 million for the same 2011 period.

Cash used by financing activities for the six months ended June 30, 2012 primarily reflects \$8.5 million of repayment of debt, partially offset by proceeds from the issuance of debt of \$7.5 million and proceeds from the issuance of common stock of \$0.2 million.

Cash provided by financing activities for the six months ended June 30, 2011 primarily reflects \$30.0 million of proceeds from the issuance of debt, partially offset by share repurchases of \$0.1 million.

None of the cash used in financing activities for the six months ended June 30, 2012 and 2011 relates to discontinued operations.

Other

In connection with the acquisition of Neurogen Corporation on December 23, 2009, Neurogen security holders received CVRs under four CVR agreements. The CVRs entitle Neurogen shareholders to cash payments upon the sale or licensing of certain assets and upon the achievement of a specified clinical milestone. At June 30, 2012 and December 31, 2011, the aggregate fair values of the Aplindore, VR1 and H3 CVR's were \$0.5 million and \$0.7 million, respectively, and included in long-term portion of liability for contingent value rights in the accompanying balance sheets as management is unable to estimate the timing of potential future payments.

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In connection with the acquisition of Metabasis Therapeutics on January 27, 2010, Metabasis security holders received CVRs under four CVR agreements. The CVRs entitle the holders to cash payments upon the sale or licensing of certain assets and upon the achievement of specified milestones. The fair value of the liability at June 30, 2012 and December 31, 2011 was \$0 and \$1.1 million, respectively.

In connection with the acquisition of CyDex Pharmaceuticals, Inc. on January 24, 2011, we issued a series of Contingent Value Rights. In 2011, \$0.9 million was paid to the CyDex Shareholders upon completion of a licensing agreement with The Medicines Company for the Captisol enabled Intravenous formulation of Clopidogrel. An additional \$2.0 million was paid to the CyDex Shareholders upon acceptance by the FDA of Onyx's NDA Onyx and an additional \$3.5 million was paid upon approval by the FDA of Kyprolis for the potential treatment of patients with relapsed and refractory multiple myeloma. We may be required to pay an additional \$6.0 million upon achievement of certain milestones. In addition, we will pay CyDex shareholders, for each respective year from 2011 through 2016, 20% of all CyDex-related revenue, but only to the extent that and beginning only when CyDex-related revenue for such year exceed \$15.0 million; plus an additional 10% of all CyDex-related revenue recognized during such year, but only to the extent that and beginning only when aggregate CyDex-related revenue for such year exceeds \$35.0 million. We paid \$0.3 million to the CyDex shareholders in March 2012 related to 2011 CyDex-related revenue. The estimated fair value of the liability at June 30, 2012 was \$13.7 million.

Leases and off-balance sheet arrangements

We lease our office and research facilities under operating lease arrangements with varying terms through November 2021. The agreements provide for increases in annual rents based on changes in the Consumer Price Index or fixed percentage increases ranging from 3% to 3.5%. Commencing in January 2008, we also sublease a portion of our facilities through July 2015. The sublease agreement provides for a 3% increase in annual rents. We had no off-balance sheet arrangements at June 30, 2012 and December 31, 2011.

Contractual Obligations

As of June 30, 2012, future minimum payments due under our contractual obligations are as follows (in thousands):

| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
|---------------------------------|--------------|-----------------------------|------------------|------------------|------------------------------|
| Operating lease obligations (1) | \$ 22,156 | \$ 5,465 | \$ 11,149 | \$ 4,580 | \$ 962 |

(1) We currently sublease two of our facilities through their respective lease terms of July 2015 and August 2016. As of June 30, 2012, we expect to receive aggregate future minimum lease payments totaling \$4.1 million (nondiscounted) over the duration of the sublease agreements as follows: less than one year, \$1.1 million; one to three years, \$2.6 million; and three to five years, \$0.4 million.

We outsource the production of Captisol to Hovione, LLC. Under the terms of the supply agreement with Hovione, the Company has ongoing minimum annual purchase commitments and is required to purchase a total of \$15 million of Captisol over the term of the supply agreement which expires in December 2019. Through June 30, 2012 we have spent approximately \$14.8 million towards that commitment. Either party may terminate the Agreement for the uncured material breach or bankruptcy of the other party or an extended force majeure event. The Company may also terminate the supply agreement for extended supply interruption, regulatory action related to Captisol or other specified events.

Under the terms of our merger with Metabasis, we are committed to spend at least \$7 million within 30 months following the close of the transaction and \$8.0 million within 42 months in new research and development funding on the Metabasis programs. Through June 30, 2012, we estimate that we have spent approximately \$6.7 million of the committed amount.

We are also required under our CyDex CVR Agreement to invest at least \$1.5 million per year, inclusive of employee expenses, in the acquired business, through 2015. As of June 30, 2012, we estimate we have exceeded that amount.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At June 30, 2012, our investment portfolio included fixed-income securities of \$1.5 million. These securities are subject to interest rate risk and will decline in value if interest rates increase. However, due to the short duration of our investment portfolio, an immediate 10% change in interest rates would have no material impact on our financial condition, results of operations or cash flows. Declines in interest rates over time will, however, reduce our interest income.

We do not have a significant level of transactions denominated in currencies other than U.S. dollars and as a result we have very limited foreign currency exchange rate risk. We purchase Captisol from Hovione, located in Lisbon, Portugal. Payments to Hovione are denominated and paid in US dollars, however the unit price of Captisol contains an adjustment factor which is based on the sharing of foreign currency risk between the two parties. 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.

We are exposed to market risk involving rising interest rates. To the extent interest rates rise, our interest costs could increase. An increase in interest costs of 10% would have no material impact on our financial condition, results of operations, or cash flows.

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ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, as of the end of the period covered by this report, which we refer to as the Evaluation Date.

As a result of a material weakness in our internal control over financial reporting, our management concluded our disclosure controls and procedures were not effective as of December 31, 2011. Additionally, the material weakness could not be remediated until the applicable remedial procedures could be tested and management could conclude on the effectiveness of the procedures and controls.

Remediation of a Material Weakness in Internal Controls Over Financial Reporting

Since the transaction date which resulted in this material weakness, the applicable remedial procedures were tested and management has concluded that the procedures and controls are operating effectively for the period ending June 30, 2012. Management will continue to review and make necessary changes to the overall design of its internal control environment, as well as to policies and procedures to improve the overall effectiveness of internal control over financial reporting.

Changes in Internal Controls

Except as described above, there have been no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

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ITEM 1A. RISK FACTORS

The following is a summary description of some of the many risks we face in our business. You should carefully review these risks in evaluating our business, including the businesses of our subsidiaries. You should also consider the other information described in this report.

Risks Related To Us and Our Business.

Our business has recently undergone a significant change, and we may not be successful in integrating the Captisol technology and CyDex's other development product candidates into our existing operations or in realizing the planned results from our recently expanded product portfolio and pipeline.

In January 2011, we completed our merger with CyDex, in which we obtained the Captisol technology, in addition to other product candidates. We will need to overcome significant challenges in order to realize the benefits from this acquisition. These challenges will include the timely, efficient and successful execution of a number of tasks, including the following:

integrating CyDex into our existing operations;

integrating CyDex's developmental product candidates and successfully managing the development and regulatory processes; and

coordinating with CyDex's and our collaborative partners concerning the development, manufacturing, regulatory and intellectual property protection strategies for Captisol and new development product candidates.

In addition, we rely on our collaborative partners for many aspects of our developmental and commercialization activities, and we are subject to risks related to their financial stability and solvency. We may not succeed in addressing these risks or any other problems encountered in connection with the acquisition of CyDex.

Furthermore, all of CyDex's products and product candidates, as well as the technology that it outlicenses, are based on Captisol. In addition, CyDex or its partners are attempting to develop some product candidates that may contain significantly higher levels of Captisol than in any currently-approved product and has directed developers to demonstrate an adequate safety margin and specifically acceptable renal safety. If products or product candidates incorporating Captisol technology were to cause any unexpected adverse events, whether in preclinical studies, clinical trials or as commercialized products, whether as a result of Captisol or otherwise, the perception of Captisol safety could be seriously harmed. If this were to occur, we may not be able to market these products unless and until we are able to demonstrate that the adverse event was unrelated to Captisol, which we may not be able to do. Further, whether or not the adverse event was a result of Captisol, we could be required by the FDA to submit to additional regulatory reviews or approvals, including extensive safety testing or clinical testing of products using Captisol, which would be expensive and, even if we were to demonstrate that the adverse event was unrelated to Captisol, would delay our marketing of Captisol-enabled products and receipt of revenue related to those products.

Revenues based on sales of Promacta represent a substantial portion of our overall current and/or expected future revenues.

GSK is obligated to pay us royalties based on its sales of Promacta. These payments are expected to be a substantial portion of our ongoing revenues for some time. As a result, any setback that may occur with respect to Promacta could significantly impair our operating results and/or reduce the market price of our stock. Setbacks for Promacta could include problems with shipping, distribution, manufacturing, product safety, marketing, government regulation, safety issues, licenses and approvals, intellectual property rights, competition with existing or new products and physician or patient acceptance of the products, as well as higher than expected total rebates, returns or discounts.

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Revenues based on sales of Kyprolis represent a substantial portion of our overall expected future revenues.

Revenues from Onyx based on sales of Kyprolis are expected to be a substantial portion of our revenue in the future and any setbacks that occur with respect to Kyprolis could significantly impair our future operating results and/or reduce the market price of our stock. Setbacks for Kyprolis could include problems with shipping, distribution, manufacturing, product safety, marketing, government regulations, safety issues, licenses and approvals, intellectual property rights, competition with existing or new products and physician or patient acceptance of the products, as well as higher than expected total rebates, returns or discounts.

Our product candidates face significant development and regulatory hurdles prior to marketing which could delay or prevent sales and/or milestone revenue.

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

The rates at which we complete our clinical trials depends on many factors, including, but are not limited to, our ability to obtain adequate supplies of the products to be tested and patient enrollment. Patient enrollment is a function of many factors, including the size of the patient population, the proximity of patients to clinical sites and the eligibility criteria for the trial. Delays in patient enrollment for our trials may result in increased costs and longer development times. For example, the trial entitled "Eltrombopag To Reduce The Need For Platelet Transfusion In Subjects With Chronic Liver Disease And Thrombocytopenia Undergoing Elective Invasive Procedures (ELEVATE)" was suspended in October 2009 in accordance with an IDMC Recommendation. GSK terminated the ELEVATE study. In addition, our collaborative partners have rights to control product development and clinical programs for products developed under the collaborations. As a result, these collaborative partners may conduct these programs more slowly or in a different manner than expected. Moreover, even if clinical trials are completed, we or our collaborative partners still may not apply for FDA approval in a timely manner or the FDA still may not grant approval.

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

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

In addition, our collaborators may develop drugs, either alone or with others that compete with the types of drugs they are developing with us. This would result in increased competition for our programs. If products are approved for marketing under our collaborative programs, revenues we receive will depend on the manufacturing, marketing and sales efforts of our collaborative partners, who generally retain commercialization rights under the collaborative agreements. Generally, our current collaborative partners also have the right to terminate their collaborations under specified circumstances. If any of our collaborative partners breach or terminate their agreements with us or otherwise fail to conduct their collaborative activities successfully, for example, by not making required payments when due, or at all our product development under these agreements will be delayed or terminated. Disputes or litigation may also arise with our collaborators, including disputes or litigation over ownership rights to intellectual property, know-how or technologies developed with our collaborators. Such disputes or litigation could adversely affect our rights to one or more of our product candidates. Any such dispute or litigation could delay, interrupt or terminate the collaborative research, development and commercialization of certain potential products, create uncertainty as to ownership rights of intellectual property, or could result in litigation or arbitration. The occurrence of any of these problems could be time-consuming and expensive and could adversely affect our business.

We obtain Captisol from a sole source supplier, and if this supplier were to cease to be able to supply Captisol to us, or decline to supply Captisol to us, we would be unable to continue to derive revenue or continue to develop our product candidates until we obtained an alternative source, which could take a considerable length of time.

We currently have one supplier of Captisol, Hovione FarmaCiencia SA, or Hovione, through its agent Hovione LLC. Hovione is a major supplier of APIs and API intermediates located in Lisbon, Portugal. Hovione has other production sites in Cork, Ireland, Macau, China, and Zhejiang, China, but those sites are not yet fully qualified to make Captisol. If a major disaster were to happen at Hovione or Hovione were to suffer major production problems or were to fail to deliver Captisol to us for any other reason, there could be a significant interruption of our Captisol supply. While we carry a significant inventory of Captisol for this type of occurrence, which should permit us to satisfy our existing supply obligations through 2012 under current and anticipated demand conditions, a series of unusually large orders could rapidly deplete that inventory and cause significant problems with our licensees and disrupt our business. In addition, if we fail to supply Captisol under our supply agreements, our customers could obtain the right to have Captisol manufactured by other suppliers, which would significantly harm our business.

We rely on contract manufacturers for the manufacture of Captisol and product candidates, and if these contract manufacturers fail to perform as we expect, we will incur delays in our ability to generate revenue and substantial additional expenses in obtaining new contract manufacturers.

We do not manufacture products or product candidates, but rather contract with contract manufacturers for the manufacture of products and product candidates. With respect to any specific product or product candidate, we only contract with one contract manufacturer due to the high cost of compliance with good manufacturing practices prior to the contract manufacturer being permitted to manufacture the product or product candidate for use in humans. If a

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contract manufacturer is unable or unwilling to continue to manufacture for us in the future, we would be required to contract with a new contract manufacturer for the specific product or product candidate. In the case of products, this would cause us to lose revenue during the qualification process, and in the case of product candidates, this could cause a delay in the commercialization of the product candidate. In addition, in either case we would incur substantial additional expenses as a result of the new contract manufacturer becoming qualified. Further, if a contract manufacturer were to experience a delay in producing products or product candidates due to a failure to meet strict FDA manufacturing requirements or otherwise, we would also experience a delay in development and commercialization of the product candidate or, in the case of products, sales of the product. This risk is exacerbated in the case of manufacture of injectables, which require heightened sterility and other conditions as well as specialized facilities for preparation.

If we consume cash more quickly than expected, and if we are unable to raise additional capital, we may be forced to curtail operations.

Our operations have consumed substantial amounts of cash since inception. As of June 30, 2012, we had a negative working capital of \$9.3 million. Clinical and preclinical development of drug candidates is a long, expensive and uncertain process. Also, we may acquire companies, businesses or products and the consummation of such acquisitions may consume additional cash. For example, as part of the consideration for our recent acquisition of CyDex, we distributed approximately \$12.0 million of our cash to CyDex stockholders. In connection with the acquisition, we entered into a \$20 million Loan and Security Agreement, or the Loan Agreement, with a lender. Under the terms of the Loan Agreement, we will make interest only payments for one year at a fixed rate of 8.64%, with an option to extend the interest only payments for an additional year, which we intend to exercise. Subsequent to the interest only payments, the note will amortize with principal and interest payments due through the remaining term of the loan. The loan term, including interest only payments, is 42 months.

In March 2011, we borrowed \$5.0 million from Square 1 Bank and April 2011 we borrowed an additional \$5.0 million from Square 1. All outstanding amounts under the loan bear interest at a floating rate equal to 200 basis points above the prime rate and may become immediately due and payable if we fail to maintain a cash balance at Square 1 equal to the amount outstanding under the credit facility. We paid \$4.5 million on our revolving credit facility in January 2012, \$4.0 million in March 2012, and the remaining \$1.5 million in July 2012. On March 29, 2012, we entered into a Second Amendment to Loan and Security Agreement (the "Square 1 Second Amendment to Loan and Security Agreement"). The Square 1 Second Amendment to Loan and Security Agreement changed the maturity date of the revolving line of credit facility to March 28, 2013. The Square 1 Second Amendment to Loan and Security Agreement did not change the interest rate and interest payment schedule established in the Loan and Security Agreement.

In October 2011, we filed a Registration Statement on Form S-3 with the Securities and Exchange Commission (SEC) for the issuance and sale of up to \$30 million of equity or other securities, proceeds from which will be used for general corporate purposes. The Form S-3 provides additional financial flexibility for us to sell shares or other securities as needed at any time. As of August 8, 2012, 150,000 common shares have been issued under this registration statement for total net proceeds of \$2.6 million. In March 2012, we entered into a Controlled Equity Offering Sales Agreement with Cantor Fitzgerald & Co. (Cantor), as sales agent, to create an at-the-market equity program under which we may, from time to time, sell shares of common stock, par value \$0.001 per share, up to an aggregate offering price of \$30 million.

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We believe that our capital resources, including our currently available cash, cash equivalents, and short-term investments as well as our current and future royalty revenues, will be adequate to fund our operations at their current levels at least for the next twelve months. However, changes may occur that would cause us to consume available capital resources before that time. Examples of relevant potential changes that could impact our capital resources include:

the costs associated with our drug research and development activities, and additional costs we may incur if our development programs are delayed or are more expensive to implement than we currently anticipate;

changes in collaborative relationships, including the funding we receive in connection with those relationships;

the progress of our milestone and royalty producing activities;

acquisitions of other businesses or technologies;

the termination of our lease agreements;

the costs of the closure of our operations at our Cranbury, New Jersey facility;

the purchase of additional capital equipment;

cash payments, including CVR payments, or refunds we may be required to make pursuant to certain agreements with third parties;

competing technological and market developments; and

the cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights, and the outcome of related litigation.

Additional capital may not be available on favorable terms, or at all. If additional capital is not available, we may be required to curtail operations significantly, including but not limited to reducing our current headcount, or to obtain funds by entering into arrangements with partners or other third parties that may require us to relinquish rights to certain of our technologies, products or potential markets that we would not otherwise relinquish.

Our collaborative partners may change their strategy or the focus of their development and commercialization efforts with respect to our alliance products, the success of our alliance products could be adversely affected.

If our collaborative partners terminate their collaborations with us or do not commit sufficient resources to the development, manufacture, marketing or distribution of our alliance products, we could be required to devote additional resources to our alliance products, seek new collaborative partners or abandon such alliance products, all of which could have an adverse effect on our business.

In September 2010, we received notice from GSK that it was exercising its right to terminate the Product Development and Commercialization Agreement, dated as of March 24, 2006 and as amended, among SmithKlineBeecham Corporation, doing business as GlaxoSmithKline, Glaxo Group Limited and Pharmacoepia, LLC, as successor to Pharmacoepia Drug Discovery, Inc. The termination became effective on October 7, 2010. Absent the termination by GSK, the research term under this agreement would have terminated on March 24, 2011. Following

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termination, we retained rights to the current programs under this agreement and may continue to develop the programs and commercialize any products resulting from the programs, or we may elect to cease progressing the programs and/or seek other partners for further development and commercialization.

In September 2011, we received a notice from MedImmune (a subsidiary of AstraZeneca) that it was exercising its right to terminate the Collaboration and License Agreement, dated April 19, 2001. Upon termination, all materials and know-how related to the IL-9 antibody program by MedImmune was returned to us. MedImmune is required to discuss the granting of a royalty-bearing license to intellectual property with respect to the product licensed under the agreement. However, MedImmune has no obligation to grant such a license or retain the ability to grant such a license. The termination became effective on November 30, 2011.

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In October 2011, we received notice from Merck that it was exercising its right to terminate the Collaboration and License Agreement, dated November 24, 2003. The collaboration and licensing program was related to the physiology, pharmacology, chemistry, and potential therapeutic applications and potential clinical utilities related to Vanilloid Receptors, subtype 1, also known as TRPV1. Upon termination, Merck is required to transfer and/or disclose specified materials and know-how to us (which is under an obligation to transfer certain specified materials to Merck). In addition, we will receive an exclusive, perpetual, irrevocable, royalty-free (but subject to any third party royalty obligations), fully-paid, worldwide license, with right to sub-license, under specified patents and technology for the research, development or commercialization of specified compounds and products in a limited field of use. We will also receive a non-exclusive license to all other know-how Merck deems necessary to sell the specified compounds or products. The termination became effective on April 18, 2012.

We are currently dependent upon outlicensing business and we may not be successful in entering into additional out-license agreements on favorable terms, which may adversely affect our liquidity or require us to alter development plans on our products.

We have entered into several out-licensing agreements for the development and commercialization of our products. We currently depend on our arrangements with our outlicensees to sell products using our Captisol technology. These agreements generally provide that outlicensees may terminate the agreements at will. If our outlicensees discontinue sales of products using our Captisol technology, fail to obtain regulatory approval for their products using our Captisol technology, fail to satisfy their obligations under their agreements with us, or otherwise choose to utilize a generic form of Captisol should it become available, or if we are unable to establish new licensing and marketing relationships, our financial results and growth prospects would be materially affected. Further, under most of our Captisol outlicenses, the amount of royalties we receive will be reduced or will cease when the relevant patent expires. While we have other more recent patents relating to Captisol with later expiration dates (for example, our high purity patent, U.S. Patent No. 7,635,773 is not expected to expire until 2029 and our morphology patent, U.S. Patent No. 7,629,331 is not expected to expire until 2025), the initially filed patents relating to Captisol expired in 2010 and 2011 in the U.S. and are expected to expire between 2012 and 2016 in most countries outside the U.S. If our other intellectual property rights are not sufficient to prevent a generic form of Captisol from coming to market and if in such case our outlicensees choose to terminate their agreements with us, the source of the vast majority of our Captisol revenue may cease to exist.

Although we expend considerable resources on internal research and development for our proprietary programs, we may not be successful in entering into additional out-licensing agreements under favorable terms due to several factors including:

the difficulty in creating valuable product candidates that target large market opportunities;

research and spending priorities of potential licensing partners;

willingness of and the resources available to pharmaceutical and biotechnology companies to in-license product candidates for their clinical pipelines; or

differences of opinion with potential partners on the valuation of products we are seeking to out-license.

The inability to enter into out-licensing agreements under favorable terms and to earn milestone payments, license fees and/or upfront fees may adversely affect our liquidity and may force us to curtail or delay development of some or all of our proprietary programs, which in turn may harm our business and the value of our stock.

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

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

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

Disagreements or litigation with our collaborative partners could delay our ability and the ability of our collaborative partners to achieve milestones or our receipt of other payments. In addition, other possible disagreements or litigation could delay, interrupt or terminate the research, development and commercialization of certain potential products being developed by either our collaborative partners or by us. The occurrence of any of the foregoing problems could be time-consuming and expensive and could adversely affect our business.

Third parties have not directly threatened an action or claim against us, although we do periodically receive other communications or have other conversations with the owners of other patents or other intellectual property. If others obtain patents with conflicting claims, we may be required to obtain licenses to those patents or to develop or obtain alternative technology. We may not be able to obtain any such licenses on acceptable terms, or at all. Any failure to obtain such licenses could delay or prevent us from pursuing the development or commercialization of our potential products.

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

Expirations of, challenges to or failure to secure patents and other proprietary rights may significantly hurt our business.

The initially filed patents relating to Captisol expired in 2010 and 2011 in the U.S. and are expected to expire between 2012 and 2016 in most countries outside the U.S. We have also obtained patent protection in the U.S. through 2025 on one or more Agglomerated forms of Captisol and through 2029 on one or more High Purity form of Captisol. We have obtained patent protection on a number of combinations of APIs and Captisol through three combination patents in the U.S., and we have applied for six additional combination patents in the U.S. relating to the combination of Captisol with specific APIs. Our U.S. combination patent relating to Fosphenytoin expires June 12, 2018 and our U.S. combination patent relating to Amiodarone expires May 4, 2022. Our U.S. combination patent relating to one of our early-stage product candidates expires March 19, 2022. There is no guarantee that these patents will be sufficient to prevent competitors from creating a generic form of Captisol after 2010 and competing against us, or from developing combination patents for products that will prevent us from developing products using those APIs. In addition, most of the agreements in our Captisol outlicensing business, including our agreements with Pfizer relating to Geodon IM, Vfend IV and Cerenia, provide that once the relevant patent expires, the amount of royalties we receive will be reduced or eliminated.

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

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

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

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

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

We were founded in 1987. We have incurred significant losses since our inception. As of June 30, 2012, our accumulated deficit was \$682.7 million.

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

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

Any future material weaknesses or deficiencies in our internal control over financial reporting could harm stockholder and business confidence on our financial reporting, our ability to obtain financing and other aspects of our business.

As described in Item 4, we identified a material weakness in our internal controls for the year ended December 31, 2011. Since the transaction date which resulted in this material weakness, the applicable remedial procedures were tested and management has concluded that the procedures and controls are operating effectively for the period ending June 30, 2012. While no material weaknesses were identified as of June 30, 2012, we cannot assure you that material weaknesses will not be identified in future periods. The existence of one or more material weakness or significant deficiency could result in errors in our consolidated financial statements. Substantial costs and resources may be required to rectify any internal control deficiencies. If we fail to achieve and maintain the adequacy of our internal controls in accordance with applicable standards, we may be unable to conclude on an ongoing basis that we have effective internal controls over financial reporting. If we cannot produce reliable financial reports, our business and financial condition could be harmed, investors could lose confidence in our reported financial information, or the market price of our stock could decline significantly. In addition, our ability to obtain additional financing to operate and expand our business, or obtain additional financing on favorable terms, could be materially and adversely affected, which, in turn, could materially and adversely affect our business, our financial condition and the market value of our securities. Moreover, our reputation with customers, lenders, investors, securities analysts and others may be adversely affected.

We may undertake strategic acquisitions in the future and any difficulties from integrating such acquisitions could adversely affect our stock price, operating results and results of operations.

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We may acquire companies, businesses and products that complement or augment our existing business. We may not be able to integrate any acquired business successfully or operate any acquired business profitably. Integrating any newly acquired business could be expensive and time-consuming. Integration efforts often take a significant amount of time, place a significant strain on managerial, operational and financial resources and could prove to be more difficult or expensive than we predict. The diversion of our management's attention and any delay or difficulties encountered in connection with any future acquisitions we may consummate could result in the disruption of our on-going business or inconsistencies in standards and controls that could negatively affect our ability to maintain third-party relationships. Moreover, we may need to raise additional funds through public or private debt or equity financing, or issue additional shares, to acquire any businesses or products, which may result in dilution for stockholders or the incurrence of indebtedness.

As part of our efforts to acquire companies, business or product candidates or to enter into other significant transactions, we conduct business, legal and financial due diligence with the goal of identifying and evaluating material risks involved in the transaction. Despite our efforts, we ultimately may be unsuccessful in ascertaining or evaluating all such risks and, as a result, might not realize the intended advantages of the transaction. If we fail to realize the expected benefits from acquisitions we may consummate in the future, whether as a result of unidentified risks, integration difficulties, regulatory setbacks and other events, our business, results of operations and financial condition could be adversely affected. If we acquire product candidates, we will also need to make certain assumptions about, among other things, development costs, the likelihood of receiving regulatory approval and the market for such product candidates. Our assumptions may prove to be incorrect, which could cause us to fail to realize the anticipated benefits of these transactions.

In addition, we will likely experience significant charges to earnings in connection with our efforts, if any, to consummate acquisitions. For transactions that are ultimately not consummated, these charges may include fees and expenses for investment bankers, attorneys, accountants and other advisors in connection with our efforts. Even if our efforts are successful, we may incur, as part of a transaction, substantial charges for closure costs associated with elimination of duplicate operations and facilities and acquired IPR&D charges. In either case, the incurrence of these charges could adversely affect our results of operations for particular quarterly or annual periods.

Revenues based on sales of Avinza represent a substantial portion of our overall current and/or expected future revenues.

Pfizer, as successor to King, is obligated to pay us royalties based on the sales of Avinza. These payments are expected to be a substantial portion of our ongoing revenues for some time. As a result, any setback that may occur with respect to Avinza could significantly impair our operating results and/or reduce the market price of our stock. Setbacks for Avinza could include problems with shipping, distribution, manufacturing, product safety, marketing, government regulation, licenses and approvals, intellectual property rights, competition with existing or new products and physician or patient acceptance of the products, as well as higher than expected total rebates, returns or discounts.

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

In September 2007, King reported that Actavis, a manufacturer of generic pharmaceutical products headquartered in Iceland, had filed with the FDA an Abbreviated New Drug Application, or ANDA, with a Paragraph IV Certification pertaining to Avinza, the rights to which were acquired by King from us in February 2007. According to the report, Actavis's Paragraph IV Certification sets forth allegations that U.S. Patent No. 6,066,339, or the 339 patent, which pertains to Avinza, and which is listed in the FDA's Approved Drug Products With Therapeutic Equivalence Evaluations, will not be infringed by Actavis's manufacture, use, or sale of the product for which the ANDA was submitted. The expiration date for this patent is November 2017. King, King Pharmaceuticals Research and Development, Inc., Elan Corporation, plc, or Elan, and Elan Pharma International Ltd. jointly filed suit in federal district court in New Jersey on October 18, 2007 against Actavis, Inc. and Actavis Elizabeth LLC for patent infringement under the 339 patent. The lawsuit was settled and dismissed without prejudice in July 2011.

On July 21, 2009, King, King Pharmaceuticals Research and Development, Inc., Elan and Elan Pharma International Ltd. jointly filed suit in federal district court in New Jersey against Sandoz Inc., or Sandoz, for patent infringement under the 339 patent. According to the complaint, Sandoz filed an ANDA for morphine sulfate extended release capsules and, in connection with the ANDA filing, Sandoz provided written certification to the FDA alleging that the claims of the 339 patent are invalid, unenforceable and/or will not be infringed by the manufacture, use or sale of Sandoz's proposed morphine product. The case was dismissed on consent of the parties in July 2012.

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

If we are unable to hire and/or retain key employees, we may not have sufficient resources to successfully manage our assets or our business, and we may not be able to perform our obligations under various contracts and commitments. Furthermore, there can be no assurance that we will be able to retain all of our key management and scientific personnel. If we fail to retain such key employees, we may not realize the anticipated benefits of our mergers. Either of these could have substantial negative impacts on our business and our stock price.

If plaintiffs bring product liability lawsuits against us or our partners, we or our partners may incur substantial liabilities and may be required to limit commercialization of our approved products and product candidates, and we may be subject to other liabilities related to the sale of our prior commercial product lines.

We and our partners face an inherent risk of product liability as a result of the clinical testing of our product candidates in clinical trials and face an even greater risk for commercialized products. Although we are not currently a party to product liability litigation, if we are sued, we may be held liable if any product or product candidate we

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develop causes injury or is found otherwise unsuitable during product testing, manufacturing, marketing or sale. Regardless of merit or eventual outcome, liability claims may result in decreased demand for any product candidates or products that we may develop, injury to our reputation, discontinuation of clinical trials, costs to defend litigation, substantial monetary awards to clinical trial participants or patients, loss of revenue and the inability to commercialize any products that we develop. We have product liability insurance that covers our clinical trials up to a \$5.0 million annual limit. We intend to expand product liability insurance coverage to include the sale of commercial products if we obtain marketing approval for any products that we may develop. However, this insurance may be prohibitively expensive, or may not fully cover our potential liabilities. Inability to obtain sufficient insurance coverage at an acceptable cost or otherwise to protect against potential product liability claims could prevent or delay the commercialization of our product candidates. If we are sued for any injury caused by our product candidates or any future products, our liability could exceed our total assets.

In addition, we agreed to indemnify Eisai and King under certain circumstances pursuant to the asset purchase agreements we entered into with Eisai and King in connection with the sale of our prior commercial product lines. Some of our indemnification obligations still remain and our potential liability in certain circumstances is not limited to specific dollar amounts. We cannot predict the liabilities that may arise as a result of these matters. Any claims related to our indemnification obligations to King or Eisai could materially and adversely affect our financial condition.

In addition, King assumed our obligation to make payments to Organon based on net sales of Avinza (the fair value of which was \$14.8 million as of June 30, 2012). We remain liable to Organon in the event King defaults on this obligation. Any requirement to pay a material amount to Organon, could adversely affect our business and the price of our securities.

The sale of our prior commercial product lines does not relieve us of exposure to product liability risks on products we sold prior to divesting these product lines. A successful product liability claim or series of claims brought against us may not be insured and could result in payment of significant amounts of money and divert management's attention from running our business.

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

We face intense competition in our development activities. Our competitors might succeed in obtaining regulatory approval for competitive products more rapidly than our partners can for our products. In addition, competitors might develop technologies and products that are less expensive and perceived to be safer or more effective than those being developed by us or our partners, which could impair our product development and render our technology obsolete.

We use hazardous materials, which may expose us to significant liability.

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. We believe that we carry reasonably adequate insurance for toxic tort claims. However, we cannot eliminate the risk or predict the exposure of accidental contamination or injury from the handling and disposing of hazardous materials, whether by us or our third-party contractors. Any accident in the handling and disposing of hazardous materials may expose us to significant liability.

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

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

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

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

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

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

In October 2011, we filed a Registration Statement on Form S-3 with the Securities and Exchange Commission (SEC) for the issuance and sale of up to \$30 million of equity or other securities, proceeds from which will be used for general corporate purposes. The Form S-3 provides additional financial flexibility for us to sell shares as needed at any time. As of August 8, 2012, 150,000 securities have been issued under this registration statement for total net proceeds of \$2.6 million.

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

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

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

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

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

While we expect to fund our research and development activities from cash generated from royalties and milestones from our partners in various past and future collaborations 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

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financing. These financings could depress our stock price. If additional funds are required to support our operations and we are unable to obtain them on terms favorable to us, we may be required to cease or reduce further development or commercialization of our products, to sell some or all of our technology or assets or to merge with another entity.

Our results of operations and liquidity needs could be materially negatively affected by market fluctuations and economic downturn.

Our results of operations could be materially negatively affected by economic conditions generally, both in the U.S. and elsewhere around the world. Continuing concerns over inflation, energy costs, geopolitical issues, the availability and cost of credit, the U.S. mortgage market and a declining residential real estate market in the U.S. have contributed to increased volatility and diminished expectations for the economy and the markets going forward. These factors, combined with volatile oil prices, declining business and consumer confidence and increased unemployment, have precipitated an economic recession and fears of a possible depression. Domestic and international equity markets continue to experience heightened volatility and turmoil. These events and the continuing market upheavals may have an adverse effect on us. In the event of a continuing market downturn, our results of operations could be adversely affected by those factors in many ways, including making it more difficult for us to raise funds if necessary, and our stock price may further decline.

Our investment securities consist primarily of money market funds, corporate debt obligations and U.S. government agency securities. We do not have any auction rate securities. Recently, there has been concern in the credit markets regarding the value of a variety of mortgage-backed securities and the resultant effects on various securities markets. We cannot provide assurance that our investments are not subject to adverse changes in market value. If our investments experience adverse changes in market value, we may have less capital to fund our operations.

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

Our common stock has experienced significant price and volume fluctuations and may continue to experience volatility in the future. As a result, you may not be able to sell your shares quickly or at the latest market price if trading in our stock is not active or the volume is low. In November 2010, we effected a 1-for-6 reverse stock split. We believe the reverse stock split will have the effect of increasing the per share trading price of our common stock. Many factors may have a significant impact on the market price of our common stock, including, but not limited to, the following factors: results of or delays in our preclinical studies and clinical trials; the success of our collaboration agreements; publicity regarding actual or potential medical results relating to products under development by us or others; announcements of technological innovations or new commercial products by us or others; developments in patent or other proprietary rights by us or others; comments or opinions by securities analysts or major stockholders; future sales of our common stock by existing stockholders; regulatory developments or changes in regulatory guidance; litigation or threats of litigation; economic and other external factors or other disaster or crises; the departure of any of our officers, directors or key employees; period-to-period fluctuations in financial results; and limited daily trading volume.

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

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Impairment charges pertaining to goodwill, identifiable intangible assets or other long-lived assets from our mergers could have an adverse impact on our results of operations and the market value of our common stock.

The total purchase price pertaining to our mergers with Pharmacoepia, Neurogen, Metabasis and CyDex have been allocated to net tangible assets, identifiable intangible assets, in process research and development and goodwill. To the extent the value of goodwill or identifiable intangible assets or other long-lived assets become impaired, we will be required to incur material charges relating to the impairment. Any impairment charges could have a material adverse impact on our results of operations and the market value of our common stock.

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The occurrence of a catastrophic disaster could damage our facilities beyond insurance limits or we could lose key data which could cause us to curtail or cease operations.

We are vulnerable to damage and/or loss of vital data from natural disasters, such as earthquakes, tornadoes, power loss, fire, floods and similar events. If any disaster were to occur, our ability to operate our business could be seriously impaired. We have property, liability, and business interruption insurance which may not be adequate to cover our losses resulting from disasters or other similar significant business interruptions, and we do not plan to purchase additional insurance to cover such losses due to the cost of obtaining such coverage. Any significant losses that are not recoverable under our insurance policies could seriously impair our business, financial condition and prospects.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

The Index to Exhibits on page 49 is incorporated herein by reference as the list of exhibits required as part of this Quarterly Report.

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LIGAND PHARMACEUTICALS INCORPORATED

SIGNATURE

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

Date: August 8, 2012

By: /s/ John P. Sharp
John P. Sharp
Vice President, Finance and Chief Financial Officer

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INDEX TO EXHIBITS

| Exhibit Number | Description |
|-----------------------|--|
| 2.1(1) | Agreement and Plan of Merger, by and among the Company, Pharmacoepia, Inc., Margaux Acquisition Corp. and Latour Acquisition, LLC, dated as of September 24, 2008 (Filed as Exhibit 2.1). |
| 2.2(2) | Agreement and Plan of Merger, by and among the Company, Neurogen Corporation and Neon Signal, LLC, dated as of August 23, 2009 (Filed as Exhibit 10.1). |
| 2.3(3) | Amendment to Agreement and Plan of Merger, by and among the Company, Neurogen Corporation, and Neon Signal, LLC, dated September 18, 2009 (Filed as Exhibit 10.1). |
| 2.4(3) | Amendment No. 2 to Agreement and Plan of Merger, by and among the Company, Neurogen Corporation, and Neon Signal, LLC, dated November 2, 2009 (Filed as Exhibit 10.2). |
| 2.5(4) | Amendment No. 3 to Agreement and Plan of Merger, by and among the Company, Neurogen Corporation, and Neon Signal, LLC, dated December 17, 2009 (Filed as Exhibit 10.1). |
| 2.6(5) | Certificate of Merger for acquisition of Neurogen Corporation (Filed as Exhibit 2.1). |
| 2.7(6) | Agreement and Plan of Merger, dated as of October 26, 2009, by and among the Company, Metabasis Therapeutics, Inc., and Moonstone Acquisition, Inc (Filed as Exhibit 10.1). |
| 2.8(7) | Amendment to Agreement and Plan of Merger, by and among the Company, Metabasis Therapeutics, Inc., Moonstone Acquisition, Inc., and David F. Hale as Stockholders Representative, dated November 25, 2009 (Filed as Exhibit 10.1). |
| 2.9(8) | Certificate of Merger for acquisition of Metabasis Therapeutics, Inc. dated January 27, 2010 (Filed as Exhibit 2.1). |
| 2.10(9) | Certificate of Merger, dated and filed January 24, 2011 (Filed as Exhibit 2.1). |
| 2.11(9) | Agreement and Plan of Merger, by and among the Company, CyDex Pharmaceuticals, Inc., and Caymus Acquisition, Inc., dated January 14, 2011 (Filed as Exhibit 10.1). |
| 3.1(10) | Amended and Restated Certificate of Incorporation of the Company (Filed as Exhibit 3.1). |
| 3.2(10) | Bylaws of the Company, as amended (Filed as Exhibit 3.3). |
| 3.3(11) | Amended Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of the Company (Filed as Exhibit 3.3). |
| 3.4(12) | Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Company dated June 14, 2000 (Filed as Exhibit 3.5). |
| 3.5(13) | Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Company dated September 30, 2004 (Filed as Exhibit 3.6). |
| 3.6(14) | Amendment of the Bylaws of the Company dated November 8, 2005 (Filed as Exhibit 3.1). |
| 3.7(15) | Amendment of Bylaws of the Company dated December 4, 2007 (Filed as Exhibit 3.1). |
| 4.1(16) | Specimen stock certificate for shares of Common Stock of the Company. |
| 4.4(17) | 2006 Preferred Shares Rights Agreement, by and between the Company and Mellon Investor Services LLC, dated as of October 13, 2006 (Filed as Exhibit 4.1). |
| 10.1(18) | Second Amendment to Loan and Security Agreement, by and between the Company and Square 1 Bank, dated March 29, 2012. |
| 10.2 | Research license and option agreement, by and between the Company and Ares Trading SA, dated as of April 27, 2012 |
| 10.3 | Separation Agreement, by and between the Company and Dr. Syed Kazmi, dated May 4, 2012 |
| 31.1 | |

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Certification by Principal Executive Officer, Pursuant to Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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| Exhibit Number | Description |
|----------------|---|
| 31.2 | Certification by Principal Financial Officer, Pursuant to Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1* | Certification by Principal Executive Officer, Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2* | Certification by Principal Financial Officer, Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.1** | The following financial information from the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations, (iii) Condensed Consolidated Statements of Cash Flows, and (iv) the Notes to Condensed Consolidated Financial Statements, tagged as blocks of text. |

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

- (1) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on September 26, 2008.
- (2) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on August 24, 2009.
- (3) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on November 6, 2009.
- (4) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on December 17, 2009.
- (5) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on December 24, 2009.
- (6) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on October 28, 2009.
- (7) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on December 1, 2009.
- (8) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on January 28, 2010.
- (9) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on January 26, 2011.
- (10) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Registration Statement on Form S-4 (No. 333-58823) filed on July 9, 1998.
- (11) This exhibit was previously filed as part of and is hereby incorporated by reference to same numbered exhibit filed with the Company's Quarterly Report on Form 10-Q for the period ended March 31, 1999.
- (12) This exhibit was previously filed as part of, and are hereby incorporated by reference to the numbered exhibit filed with the Company's Annual Report on Form 10-K for the year ended December 31, 2000.
- (13) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2004.
- (14) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on November 14, 2005.
- (15) This exhibit was previously filed as part of, and is hereby incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on December 6, 2007.
- (16) This exhibit was previously filed as part of, and is hereby incorporated by reference to the same numbered exhibit filed with the Company's Registration Statement on Form S-1 (No. 33-47257) filed on April 16, 1992 as amended.

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- (17) This exhibit was previously filed as part of, and is being incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on October 17, 2006.
- (18) This exhibit was previously filed as part of, and is being incorporated by reference to the numbered exhibit filed with the Company's Current Report on Form 8-K filed on April 4, 2012.
- * These certifications are being furnished solely to accompany this quarterly report pursuant to 18 U.S.C. Section 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and are not to be incorporated by reference into any filing of Ligand Pharmaceuticals, Incorporated, whether made before or after the date hereof, regardless of any general incorporation language in such filing. Signed originals of these certifications have been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.
- ** Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under these sections.