RIGEL PHARMACEUTICALS INC
Form 10-Q
November 02, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2010

OR

o 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 0-29889

Rigel Pharmaceuticals, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**94-3248524**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1180 Veterans Blvd. South San Francisco, CA	**94080**
(Address of principal executive offices)	(Zip Code)

(650) 624-1100

(Registrant s telephone number, including area code)

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 x No o

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 o No o

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of October 28, 2010, there were 52,148,367 shares of the registrant s Common Stock outstanding.

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RIGEL PHARMACEUTICALS, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2010

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Financial Statements

RIGEL PHARMACEUTICALS, INC.

CONDENSED BALANCE SHEETS

(In thousands, except share and per share amounts)

	September 30, 2010 (unaudited)	December 31, 2009 (1)
Assets		
Current assets:		
Cash and cash equivalents	$ 22,058	$ 14,717
Available-for-sale securities	145,477	118,601
Accounts receivable	25,000	
Prepaid expenses and other current assets	2,179	2,650
Total current assets	194,714	135,968
Property and equipment, net	3,999	2,291
Other assets	2,291	2,485
	$ 201,004	$ 140,744
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 2,990	$ 3,154
Accrued compensation	4,187	6,840
Other accrued liabilities	4,891	6,718
Capital lease obligations	871	1,061
Total current liabilities	12,939	17,773
Long-term portion of capital lease obligations	194	883
Long-term portion of deferred rent	8,845	12,064
Other long-term liabilities	142	157
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.001 par value; 10,000,000 shares authorized; none issued and outstanding as of September 30, 2010 and December 31, 2009		
Common stock, $0.001 par value; 100,000,000 shares authorized; 52,145,159 and 51,956,140 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively	52	52
Additional paid-in capital	736,979	723,151
Accumulated other comprehensive income (loss)	48	(12)
Accumulated deficit	(558,195)	(613,324)
Total stockholders equity	178,884	109,867
	$ 201,004	$ 140,744

(1) The balance sheet at December 31, 2009 has been derived from the audited financial statements at that date included in Rigel s Annual Report on Form 10-K for the year ended December 31, 2009.

See Accompanying Notes.

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RIGEL PHARMACEUTICALS, INC.

CONDENSED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Contract revenues	$ 72,282	$	$ 125,000	$
Costs and expenses:				
Research and development	16,394	21,082	50,634	70,568
General and administrative	5,530	5,573	19,380	15,226
Restructuring charges				1,141
Total costs and expenses	21,924	26,655	70,014	86,935
Income (loss) from operations	50,358	(26,655)	54,986	(86,935)
Interest income	90	48	213	554
Interest expense	(15)	(44)	(70)	(166)
Income (loss) before income taxes	50,433	(26,651)	55,129	(86,547)
Income tax benefit				93
Net income (loss)	$ 50,433	$ (26,651)	$ 55,129	$ (86,454)
Net income (loss) per share:				
Basic	$ 0.97	$ (0.70)	$ 1.06	$ (2.32)
Diluted	$ 0.96	$ (0.70)	$ 1.05	$ (2.32)
Weighted-average shares used in computing net income (loss) per share:				
Basic	52,127	38,135	52,022	37,185
Diluted	52,769	38,135	52,536	37,185

See Accompanying Notes.

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RIGEL PHARMACEUTICALS, INC.

CONDENSED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Nine Months Ended September 30,	
	2010	**2009**
Operating activities		
Net income (loss)	$ 55,129	$ (86,454)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	924	1,057
Stock-based compensation expense	12,635	9,657
Changes in assets and liabilities:		
Accounts receivable	(25,000)	
Prepaid expenses and other current assets	471	544
Other assets	194	274
Accounts payable	(164)	(2,480)
Accrued compensation	(2,653)	2,219
Other accrued liabilities	(1,827)	(181)
Deferred rent and other long-term liabilities	(3,234)	(4,141)
Net cash provided by (used in) operating activities	36,475	(79,505)
Investing activities		
Purchases of available-for-sale securities	(175,005)	(82,871)
Maturities and sales of available-for-sale securities	148,189	109,632
Capital expenditures	(2,632)	(95)
Net cash (used in) provided by investing activities	(29,448)	26,666
Financing activities		
Payments on capital lease obligations	(879)	(1,123)
Net proceeds from issuances of common stock	1,193	102,702
Net cash provided by financing activities	314	101,579
Net increase in cash and cash equivalents	7,341	48,740
Cash and cash equivalents at beginning of period	14,717	46,005
Cash and cash equivalents at end of period	$ 22,058	$ 94,745
Supplemental disclosure of cash flow information		
Interest paid	$ 70	$ 142
Schedule of non cash transactions		
Issuance of warrant with lease amendment	$	$ 616

See Accompanying Notes.

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Rigel Pharmaceuticals, Inc.

Notes to Condensed Financial Statements

(unaudited)

In this report, Rigel, we, us and our refer to Rigel Pharmaceuticals, Inc.

1. Nature of Operations

We were incorporated in the state of Delaware on June 14, 1996. We are engaged in the discovery and development of novel, small-molecule drugs for the treatment of inflammatory and autoimmune disorders, as well as muscle and metabolic diseases.

2. Basis of Presentation

Our accompanying unaudited condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP, for interim financial information and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. These unaudited condensed financial statements include all normal and recurring adjustments that we believe are necessary to fairly state our financial position and the results of our operations and cash flows. Interim-period results are not necessarily indicative of results of operations or cash flows for a full-year. The balance sheet at December 31, 2009 has been derived from audited financial statements at that date, but does not include all disclosures required by U.S. GAAP for complete financial statements. Because all of the disclosures required by U.S. GAAP for complete financial statements are not included herein, these interim unaudited condensed financial statements and the notes accompanying them should be read in conjunction with our audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from these estimates.

3. Recent Accounting Pronouncements

In April 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update, or ASU, No. 2010-17 thereby amending Accounting Standards Codification (ASC) 605 for revenue recognition related to the milestone method of revenue recognition. ASU No. 2010-17 provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development arrangements. A company may make an accounting policy election to use the milestone method of

revenue recognition for transactions within the scope of the amendments. The amendments will be effective in fiscal years beginning on or after June 15, 2010, and early adoption is permitted. We evaluated the impact of adopting ASU No. 2010-17 and believe it will have no material effect on our financial statements.

4. Basic and Diluted Net Income (Loss) Per Share

Basic earnings per share, or EPS, is computed by dividing net income (loss) by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is computed by dividing net income (loss) by the weighted-average number of shares of common stock outstanding during the period and the number of additional shares of common stock that would have been outstanding if potentially dilutive securities had been issued. Potentially dilutive securities include stock options and warrants and shares under our 2000 Employee Stock Purchase Plan, or ESPP. The dilutive effect of potentially dilutive securities is reflected in diluted earnings per share by application of the treasury stock method. Under the treasury stock method, an increase in the fair market value of our common stock can result in a greater dilutive effect from potentially dilutive securities.

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The following table sets forth the computation of basic and diluted earnings per share (in thousands except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
EPS Numerator:				
Net income (loss)	$ 50,433	$ (26,651)	$ 55,129	$ (86,454)
EPS Denominator - Basic:				
Weighted-average common shares outstanding	52,127	38,135	52,022	37,185
EPS Denominator - Diluted:				
Weighted-average common shares outstanding	52,127	38,135	52,022	37,185
Dilutive effect of stock options, shares under ESPP and warrants	642		514	
Weighted-average shares outstanding and common stock equivalents	52,769	38,135	52,536	37,185
Net income (loss) per common share:				
Basic	$ 0.97	$ (0.70)	$ 1.06	$ (2.32)
Diluted	$ 0.96	$ (0.70)	$ 1.05	$ (2.32)

For the three and nine months ended September 30, 2010, the calculation of diluted earnings per share excluded stock options to purchase 7,484,111 and 7,139,434 shares, respectively, that had exercise prices greater than the average market price, because their effect would have been anti-dilutive. For the three and nine months ended September 30, 2009, the calculation of diluted net loss per share excluded shares of potential common stock, consisting of stock options, shares under our ESPP, and warrants because their effect would have been anti-dilutive.

5. Stock Award Plans

Total stock-based compensation expense related to all of our stock-based awards that we recognized was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Research and development	$ 2,017	$ 2,356	$ 7,017	$ 6,309
General and administrative	1,750	1,176	5,618	3,226
Restructuring charges				122
Total stock-based compensation expense	$ 3,767	$ 3,532	$ 12,635	$ 9,657

The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. We have segregated option awards into three homogenous groups for purposes of determining fair values of options: officers and directors, all other employees, and consultants.

We determined weighted-average valuation assumptions separately for each of these groups as follows:

- Volatility We estimated volatility using the historical share price performance over the expected life of the option up to the point where we have historical market data. We also considered other factors, such as implied volatility, our current clinical trials and other company activities that may affect the volatility of our stock in the future. We determined that at this time historical volatility is more indicative of our expected future stock performance than implied volatility.

- Expected term For options granted to consultants, we use the contractual term of the option, which is typically ten years, for the initial valuation of the option and the remaining contractual term of the option for succeeding periods. We worked with various historical data to determine the applicable expected term for each of the other option groups. This data included: (1) for exercised options, the term of the options from option grant date to exercise date; (2) for cancelled options, the term of the options from option grant date to cancellation date, excluding unvested option forfeitures; and (3) for options that remained outstanding at the balance sheet date, the term of the options from option grant date to the end of the reporting period and the estimated remaining term of the options. The consideration and calculation of the above data gave us reasonable estimates of the expected term for each employee group. We also considered the vesting schedules of the options granted and factors surrounding exercise behavior of the option groups, our current market price

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and company activity that may affect our market price. In addition, we considered the optionee type (i.e., officers and directors or all other employees) and other factors that may affect the expected term of the option.

- Risk-free interest rate The risk-free interest rate is based on U.S. Treasury constant maturity rates with similar terms to the expected term of the options for each option group.

- Forfeiture rate We estimated the forfeiture rate using our historical experience with pre-vesting options. We review our forfeiture rates each quarter and make changes as factors affecting our forfeiture rate calculations and assumptions change.

- Dividend yield The expected dividend yield is 0% as we have not paid and do not expect to pay dividends.

We did not issue any stock options during the three months ended September 30, 2010. The following table summarizes the weighted-average assumptions relating to options granted pursuant to our equity incentive plans for the nine months ended September 30, 2010 and 2009 and for the three months ended September 30, 2009:

	Equity Incentive Plans Three Months Ended September 30,		Equity Incentive Plans Nine Months Ended September 30,	
	2010	2009	2010	2009
Risk-free interest rate		2.5%	2.4%	1.8%
Expected term (in years)		4.0	5.4	4.4
Dividend yield		0.0%	0.0%	0.0%
Expected volatility		103.5%	90.1%	98.4%

Options are priced at the market price of our common stock on the date immediately preceding the date of grant, become exercisable at varying dates and generally expire ten years from the date of grant. We granted options to purchase 1,894,400 shares of common stock during the nine months ended September 30, 2010, with a grant-date weighted-average fair value of $6.17 per share. We granted options to purchase 2,066,708 shares of common stock during the nine months ended September 30, 2009, with a grant-date weighted-average fair value of $4.65 per share. As of September 30, 2010, there was approximately $8.1 million of total unrecognized stock-based compensation cost, net of estimated forfeitures, related to unvested options granted under our equity incentive plans. At September 30, 2010, 2,588,181 shares of common stock were available for future grant under our equity incentive plans and options to purchase 72,938 shares were exercised during the nine months ended September 30, 2010.

Employee Stock Purchase Plan (ESPP)

The fair value of awards granted under our ESPP is estimated on the date of grant using the Black-Scholes option pricing model, which uses weighted-average assumptions. Our ESPP provides for a twenty-four month offering period comprised of four six-month purchase periods with

a look-back option. A look-back option is a provision in our ESPP under which eligible employees can purchase shares of our common stock at a price per share equal to the lesser of 85% of the fair market value on the first day of the offering period or 85% of the fair market value on the purchase date. Our ESPP also includes a feature that provides for a new offering period to begin when the fair market value of our common stock on any purchase date during an offering period falls below the fair market value of our common stock on the first day of such offering period. This feature is called a reset. Participants are automatically enrolled in the new offering period. We had a reset on July 1, 2010 because the fair market value of our stock on June 30, 2010 was lower than the fair market value of our stock on January 2, 2009, the first day of the offering period. We applied modification accounting in accordance with ASC Topic No. 718, *Stock Compensation*, to determine the incremental fair value associated with this ESPP reset and recognized the related stock-based compensation expense according to the FASB ASC Subtopic No. 718-50, *Employee Share Purchase Plan*. The total incremental fair value for this ESPP reset was approximately $1.4 million, and is being recognized from July 1, 2010 to June 30, 2012.

As of September 30, 2010, there were approximately 1,097,812 shares reserved for future issuance under the ESPP. The following table summarizes the weighted-average assumptions related to our ESPP for the nine months ended September 30, 2010 and 2009. Expected volatilities for our ESPP are based on the historical volatility of our stock. Expected term represents the weighted-average of the purchase periods within the offering period. The risk-free interest rate for periods within the expected term is based on U.S. Treasury constant maturity rates.

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	Employee Stock Purchase Plan Nine Months Ended September 30,	
	2010	2009
Risk-free interest rate	0.7%	1.1%
Expected term (in years)	1.4	1.3
Dividend yield	0.0%	0.0%
Expected volatility	81.1%	112.0%

6. Revenue Recognition

We present revenue from our collaboration arrangements under FASB ASC 808, *Collaboration Arrangements*. Our revenue arrangements with multiple elements are evaluated under FASB ASC 605-25, *Multiple-Element Arrangements*, and are divided into separate units of accounting if certain criteria are met, including whether the delivered element has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of any undelivered items. The consideration we receive is allocated among the separate units based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. Advance payments received in excess of amounts earned are classified as deferred revenue until earned.

Non-refundable, up-front payments received in connection with research and development collaboration agreements, including technology access fees, are deferred and recognized on a straight-line basis over the relevant periods of continuing involvement, generally the research term. When a research term is not specified, we estimate the time it will take us to complete our deliverables under the contract and recognize the upfront fee using the straight-line method over that time period. We review our estimates every quarter for reasonableness.

Revenues related to collaborative research with our corporate collaborators are recognized as research services are performed over the related development periods for each agreement. Under these agreements, we are required to perform research and development activities as specified in each respective agreement. The payments received are not refundable and are generally based on a contractual cost per full-time equivalent employee working on the project. Our research and development expenses under the collaborative research agreements approximate the revenue recognized under such agreements over the term of the respective agreements. It is our policy to recognize revenue based on our level of effort expended, however, revenue recognized will not exceed amounts billable under the agreement.

Revenues associated with substantive, at-risk milestones pursuant to collaborative agreements are recognized upon achievement of the milestones.

7. Research and Development Accruals

We have various contracts with third parties related to our research and development activities. Costs that are incurred but not billed to us as of the end of the period are accrued. We make estimates of the amounts incurred in each period based on the information available to us and our knowledge of the nature of the contractual activities generating such costs. Clinical trial contract expenses are accrued based on units of activity reported by third parties. Expenses related to other research and development contracts, such as research contracts, toxicology study contracts and manufacturing contracts are estimated to be incurred generally on a straight-line basis over the duration of the contracts. Raw materials and study materials purchased by third parties are expensed at the time of purchase.

8. Cash, Cash Equivalents and Available-For-Sale Securities

Cash, cash equivalents and available-for-sale securities consisted of the following (in thousands):

	September 30, 2010	December 31, 2009
Checking account	$ 937	$ 158
Money market funds	11,122	8,859
U. S. treasury bills	8,841	44,483
Government-sponsored enterprise securities	78,146	39,167
Corporate bonds and commercial paper	68,489	40,651
	$ 167,535	$ 133,318

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Reported as:		
Cash and cash equivalents	$ 22,058	$ 14,717
Available-for-sale securities	145,477	118,601
	$ 167,535	$ 133,318

Cash equivalents and available-for-sale securities include the following securities with unrealized gains and losses (in thousands):

September 30, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U. S. treasury bills	$ 8,840	$ 1	$	$ 8,841
Government-sponsored enterprise securities	78,127	22	(3)	78,146
Corporate bonds and commercial paper	68,461	33	(5)	68,489
Total	$ 155,428	$ 56	$ (8)	$ 155,476

December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U. S. treasury bills	$ 44,489	$ 3	$ (9)	$ 44,483
Government-sponsored enterprise securities	39,184	7	(24)	39,167
Corporate bonds and commercial paper	40,640	12	(1)	40,651
Total	$ 124,313	$ 22	$ (34)	$ 124,301

As of September 30, 2010, the contractual maturities of our cash equivalents and available-for-sale securities were (in thousands):

	Years to Maturity	
	Within One Year	After One Year Through Five Years
Money market funds	$ 11,122	$
U. S. treasury bills	8,841	
Government-sponsored enterprise securities	74,614	3,532
Corporate bonds and commercial paper	68,489	
	$ 163,066	$ 3,532

As of September 30, 2010, our cash equivalents and available-for-sale securities had a weighted-average time to maturity of approximately 125 days. We view our available-for-sale portfolio as available for use in current operations. Accordingly, we have classified certain investments as available-for-sale securities on our balance sheet even though the stated maturity date of these securities may be more than one year from the current balance sheet date. We have the ability to hold all investments as of September 30, 2010 to maturity. At September 30, 2010 and December 31, 2009, we had no investments that had been in a continuous unrealized loss position for more than twelve months. As of September 30, 2010, a total of 9 individual securities were in an unrealized loss position for twelve months or less and the losses were deemed to be temporary.

The following table shows the fair value and gross unrealized losses of our investments in individual securities that are in an unrealized loss position, aggregated by investment category (in thousands):

September 30, 2010	Fair Value	Gross Unrealized Losses
Government-sponsored enterprise securities	$ 13,642	$ (3)
Corporate bonds and commercial paper	11,659	(5)
Total	$ 25,301	$ (8)

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9. Fair Value

Under FASB ASC 820, *Fair Value Measurements and Disclosures*, fair value is defined as the price at which an asset could be exchanged or a liability transferred in a transaction between knowledgeable, willing parties in the principal or most advantageous market for the asset or liability. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or parameters are not available, valuation models are applied.

Assets and liabilities recorded at fair value in our financial statements are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities, are as follows:

Level 1 Inputs are unadjusted, quoted prices in active markets for identical assets at the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

The fair valued assets we hold that are generally included under this Level 1 are money market securities where fair value is based on publicly quoted prices.

Level 2 Are inputs, other than quoted prices included in Level 1, that are either directly or indirectly observable for the asset or liability through correlation with market data at the reporting date and for the duration of the instrument s anticipated life.

The fair valued assets we hold that are generally assessed under Level 2 included government-sponsored enterprise securities, U. S. treasury bills and corporate bonds and commercial paper where fair value is based on valuation methodologies such as models using observable market inputs, including benchmark yields, reported trades, broker/dealer quotes, bids, offers and other reference data.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities and which reflect management s best estimate of what market participants would use in pricing the asset or liability at the reporting date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

Fair Value on a Recurring Basis

Financial assets measured at fair value on a recurring basis are categorized in the tables below based upon the lowest level of significant input to the valuations (in thousands):

	Assets at Fair Value as of September 30, 2010			
	Level 1	Level 2	Level 3	Total
Money market funds	$ 11,122	$	$	$ 11,122
U. S. treasury bills		8,841		8,841
Government-sponsored enterprise securities		78,146		78,146
Corporate bonds and commercial paper		68,489		68,489
Total	$ 11,122	$ 155,476	$	$ 166,598

	Assets at Fair Value as of December 31, 2009			
	Level 1	Level 2	Level 3	Total
Money market funds	$ 8,859	$	$	$ 8,859
U. S. treasury bills		44,483		44,483
Government-sponsored enterprise securities		39,167		39,167
Corporate bonds and commercial paper		40,651		40,651
Total	$ 8,859	$ 124,301	$	$ 133,160

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10. AstraZeneca Collaboration

In February 2010, we entered into an exclusive worldwide license agreement with AstraZeneca AB (AZ) for the global development and commercialization of our oral syk inhibitors for the treatment of human diseases other than those primarily involving respiratory or pulmonary dysfunction. The agreement includes a license of rights to fostamatinib (previously referred to as R788), our late-stage investigational product candidate for the treatment of RA and other indications. AZ is responsible for conducting and funding all future development, regulatory filings, manufacturing and global commercialization of products containing oral syk inhibitors.

The agreement became effective on March 26, 2010 and, in connection with the effectiveness of the agreement, we received an upfront payment of $100.0 million in April 2010 from AZ. We recognized the upfront payment ratably over the transition period from the effective date until the deliverables were completed in September 2010. On September 29, 2010, we announced that we earned $25.0 million from AZ in consideration with the fulfillment of two major milestones in the agreement. The first milestone payment earned was for the initiation of the Phase 3 clinical trial program with fostamatinib in patients with RA that was announced by AZ on September 29, 2010. The second milestone payment earned was for the completion of the transfer of the fostamatinib long-term open label extension study to AZ which was also completed in September 2010. AZ is required to pay us up to an additional $320.0 million if specified development, regulatory and launch milestones are achieved for fostamatinib. We are also eligible to receive up to an additional $800.0 million if specified sales performance milestones are achieved for fostamatinib, as well as significant stepped double-digit royalties on net worldwide sales.

11. Contingencies

On February 6, 2009, a purported securities class action lawsuit was commenced in the United States District Court for the Northern District of California, naming as defendants us and certain of our officers, directors and underwriters for our February 2008 stock offering. An additional purported securities class action lawsuit containing similar allegations was subsequently filed in the United States District Court for the Northern District of California on February 20, 2009. By order of the Court dated March 19, 2009, the two lawsuits were consolidated into a single action. On June 9, 2009, the Court issued an order naming the Inter-Local Pension Fund GCC/IBT as lead plaintiff and Robbins Geller Rudman & Dowd LLP (formerly Coughlin Stoia) as lead counsel. The lead plaintiff filed a consolidated complaint on July 24, 2009. We filed a motion to dismiss on September 8, 2009. On December 21, 2009, the Court granted our motion and dismissed the consolidated complaint with leave to amend. Plaintiff filed its consolidated amended complaint on January 27, 2010. The lawsuit alleges violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 in connection with allegedly false and misleading statements made by us related to the results of the Phase 2a clinical trial of our product candidate fostamatinib. The plaintiffs seek damages, including rescission or rescissory damages for purchasers in the stock offering, an award of their costs and injunctive and/or equitable relief for purchasers of our common stock during the period between December 13, 2007 and February 9, 2009, including purchasers in the stock offering. We filed a motion to dismiss the consolidated amended complaint on February 16, 2010. On August 24, 2010, the Court issued an order granting our motion and dismissed the consolidated complaint with leave to amend. On September 22, 2010, plaintiff filed a notice informing the Court that it will not amend its complaint and requested that the Court enter a final judgment. On October 28, 2010, plaintiff submitted a proposed judgment requesting entry of a final judgment in favor of the defendants. On November 1, 2010, the Court entered a final judgment. Now that a final judgment has been entered in the action, plaintiff may and is expected to appeal the Court s decision to grant our motion to dismiss.

This lawsuit and any other related lawsuits are subject to inherent uncertainties and the actual costs to be incurred relating to the lawsuit will depend upon many unknown factors. The outcome of the litigation is necessarily uncertain and we could be forced to expend significant resources in the defense of this suit, and we may not prevail. We are not currently able to estimate the possible cost to us from this matter, and we cannot ascertain how long it may take to resolve this matter. We have not established any reserve for any potential liability relating to this lawsuit. We believe that we have meritorious defenses and intend to defend this lawsuit vigorously.

12. Subsequent Event

We were recently notified by the Internal Revenue Service that we have been certified to receive a total cash grant of approximately $2.4 million related to the previously filed applications under the Qualifying Therapeutic Discovery Projects (Section 48D of the Internal Revenue Code). Of this amount, approximately $2.1 million will be received in 2010 with the remainder to be received in 2011.

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

This discussion and analysis should be read in conjunction with our financial statements and the accompanying notes included in this report and the audited financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2009. Operating results for the nine months ended September 30, 2010 are not necessarily indicative of results that may occur in future periods.

This Quarterly Report on Form 10-Q contains statements indicating expectations about future performance and other forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that involve risks and uncertainties. We usually use words such as may, will, should, could, expect, plan, anticipate, believe, estimate, predict, intend, or the negative of these terms or similar expressions to identify these forward-looking statements. These statements appear throughout this Quarterly Report on Form 10-Q and are statements regarding our current expectation, belief or intent, primarily with respect to our operations and related industry developments. Examples of these statements include, but are not limited to, statements regarding the following: our business and scientific strategies; the progress of our product development programs, including clinical testing, and the timing of results thereof; our corporate collaborations and revenues that may be received from our collaborations; our drug discovery technologies; our research and development expenses; protection of our intellectual property; sufficiency of our cash resources; and our operations and legal risks. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including as a result of the risks and uncertainties discussed under the heading Risk Factors in Item 1A of Part II of this Quarterly Report on Form 10-Q. Any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict which factors will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Overview

We are a clinical-stage drug development company that discovers and develops novel, small-molecule drugs for the treatment of inflammatory and autoimmune disorders, as well as muscle and metabolic diseases. Our pioneering research focuses on intracellular signaling pathways and related targets that are critical to disease mechanisms. Our productivity has resulted in strategic collaborations with large pharmaceutical partners to develop and market our product candidates. Current product development programs include fostamatinib (previously referred to as R788), an oral syk inhibitor that started its Phase 3 clinical trial program for rheumatoid arthritis (RA) in September 2010, and R343, an inhaled syk inhibitor that is in clinical trials for asthma.

Since inception, we have financed our operations primarily through the sale of equity securities, contract payments under our collaboration agreements and equipment financing arrangements. Our research and development activities, including preclinical studies and clinical trials, consume substantial amounts of capital. As of September 30, 2010, we had approximately $167.5 million in cash, cash equivalents and available-for-sale securities. We believe that our existing capital resources will be sufficient to support our current and projected funding requirements through at least the next twelve months. Until we are able to generate sufficient amounts of product revenues and royalty revenues, we expect to finance future cash needs through collaboration and licensing arrangements or public and/or private equity or debt offerings, as well as through interest income earned on the investment of our cash balances and short-term investments.

Product Development Programs

Our product development portfolio features multiple novel, small-molecule drug candidates whose specialized mechanisms of action are intended to provide therapeutic benefit for a range of inflammatory and autoimmune disorders, as well as muscle and metabolic diseases.

Partnered Clinical Programs

Fostamatinib (previously referred to as R788) Rheumatoid Arthritis

Disease background. RA is a systemic autoimmune inflammatory disease that causes damage to the joints and other organs, affecting approximately 1 in 100 people. It is a major cause of disability and is also associated with reduced life expectancy, especially if it is not adequately treated. Despite current treatment options, many patients still experience significant disease activity, including continued joint destruction leading to pain and disability, so new treatment options are needed.

The current treatment options for RA have significant potential side effects and other shortfalls, including gastrointestinal complications and kidney damage. RA patients receive multiple drugs depending on the extent and aggressiveness of their disease. Most RA patients eventually require some form of disease modifying anti-rheumatic drugs (DMARD). This category of drugs includes methotrexate, and/or a variety of intravenously-delivered immunomodulatory agents (anti-tumor necrosis factor, or TNF, inhibitors and co-stimulation inhibitors).

Orally-available syk inhibitor program. Fostamatinib is an orally bio-available syk inhibitor. It has a novel mechanism of action for the treatment of RA in which it reversibly blocks signaling in multiple cell types involved in inflammation and tissue degradation in RA (e.g., macrophages, osteoclasts, mast cells and B cells). RA is an autoimmune disease characterized by chronic inflammation that affects multiple tissues, but typically produces its most pronounced symptoms in the joints.

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TASKi2

In July 2009, we announced that fostamatinib produced significant clinical improvement in RA patients in the *TASKi2* Phase 2b clinical trial in which 457 RA patients were treated for up to six months. *TASKi2* was a multi-center, randomized, double blind, placebo controlled, parallel dose clinical trial involving RA patients in the U.S., Latin America and Europe who had failed to respond to methotrexate alone. Patients received either 100 mg of fostamatinib b.i.d. (twice a day), 150 mg q.d. (once a day) or placebo.

Efficacy assessments for each participant were based on the American College of Rheumatology (ACR) criteria, which denotes at least 20% (ACR 20), at least 50% (ACR 50), or at least 70% (ACR 70) improvement, in addition to improvement denoted in the Disease Activity Score (DAS28), from each patient s baseline assessment at the end of the six month treatment period. The groups treated with 100 mg of fostamatinib b.i.d. and 150 mg q.d. reported higher response rates than the placebo group in all aforementioned criteria levels. The efficacy results for the two dosing groups were comparable, although the response rates for the 100 mg b.i.d. group was uniformly greater.

Consistent with the previous Phase 2a clinical trial *(TASKi1)*, the onset effect of fostamatinib occurred within one week after the initiation of therapy and was maintained. The most frequent adverse events were expected based on *TASKi1* and appear to be manageable. The most common clinically meaningful drug-related adverse events noted in *TASKi2* were diarrhea and hypertension. Dose reduction options were pre-specified in the trial protocol and, in cases where doses were reduced, patients generally completed the clinical trial with minimal safety issues. The mean increase in blood pressure from baseline at six months, using a last observation carry forward methodology, was less than 0.5 mmHg for the 150 mg q.d. dose group and approximately 1 mmHg for the 100mg b.i.d. dose group. In patients that had a history of high blood pressure, an elevated blood pressure level at screening or baseline, or were on blood pressure medication, approximately 29% and 39% of these patients in the 150 mg q.d. dose and the 100 mg b.i.d. dose groups, respectively, had blood pressure medication adjusted or initiated during the course of the study, compared with 12% of these patients from the placebo group. In patients that did not have a history of high blood pressure, were not on blood pressure medication or did not have an elevated blood pressure level at screening or baseline, approximately 4% and 9% of these patients from the 150 mg q.d. dose and the 100 mg b.i.d. dose groups, respectively, had blood pressure medication initiated during the course of the study, compared with 3% of these patients from the placebo group. For those patients who had their dose of blood pressure medications adjusted or initiated, their blood pressure was successfully reduced and was generally well controlled throughout the remainder of the trial. The blood pressure medications were standard doses of common blood pressure medication such as angiotensin-converting enzyme (ACE) inhibitors or diuretics.

The most common adverse events in the trial overall were related to infections, though these were generally evenly distributed among the placebo and fostamatinib groups.

Data for *TASKi2* was recently published in the *New England Journal of Medicine* in September 2010.

TASKi3

In July 2009, we also announced results for the *TASKi3* Phase 2b clinical trial involving 219 RA patients who had failed to respond to at least one biologic treatment. In the *TASKi3* clinical trial, patients received either 100 mg of fostamatinib b.i.d. or placebo b.i.d. for up to three months. The group treated with fostamatinib did not report significantly higher ACR 20, ACR 50, ACR 70 and DAS28 response rates than the placebo

group at three months, and therefore, the trial failed to meet its efficacy endpoints. The objective components (C-Reactive Protein and Erythrocyte Sedimentation Rate) of these ACR scores did show a statistically significant difference; however, the subjective reported response rate components did not as compared to placebo. Although the ACR scores for the fostamatinib group were within the expected range in this patient population, the reported placebo response rates were considerably higher than seen in any other previous study of RA biologic failure patients and rose unaccountably between week six (at which point the reported response rates between fostamatinib and placebo were significantly different) and month three (when such reported response rates were no longer significantly different).

TASKi3 was the first clinical trial for fostamatinib in which anatomical changes in the patients wrists and hands were evaluated using Magnetic Resonance Imaging and scored using the RAMRIS (Rheumatoid Arthritis Magnetic Resonance Imaging Scoring) system. Those results showed improvements in the treated group versus the placebo group in the Synovitis and Osteitis scores, while the Erosion scores, known to be the slowest to change, showed no significant effect at three months.

Similar to *TASKi2*, the most common clinically meaningful drug-related adverse events noted in *TASKi3* were diarrhea and hypertension. Dose reduction options were pre-specified in the trial protocol and, in cases where doses were reduced, patients generally completed the clinical trial with minimal safety issues. The mean increase in blood pressure from baseline at three months, using a last observation carry forward methodology, was 3.2 - 3.6 mmHg for the fostamatinib group. In *TASKi3*, patients that had a history of high blood pressure, had an elevated blood pressure level at screening or baseline, or were on blood pressure medication, approximately 26% of these patients had blood pressure medication adjusted or initiated during the course of the study, compared with

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14% of these patients from the placebo group. In patients that did not have a history of high blood pressure, were not on blood pressure medication or did not have an elevated blood pressure level at screening or baseline, approximately 5% of these patients had blood pressure medication initiated during the course of the study, compared with 3% of these patients from the placebo group. For those patients who had their dose of blood pressure medications adjusted or initiated, their blood pressure was successfully reduced and was generally well controlled throughout the remainder of the trial. The blood pressure medications were standard doses of common blood pressure medications such as ACE inhibitors or diuretics.

The most common adverse events in the trial overall were related to infections, though these were generally evenly distributed among the placebo and fostamatinib groups.

OSKIRA

The Phase 3 clinical program, called OSKIRA (Oral Syk Inhibition in Rheumatoid Arthritis), is designed to investigate fostamatinib as a treatment for RA in patients with an inadequate response to DMARDs, including methotrexate (MTX). AZ announced that the OSKIRA clinical trial program will include three pivotal Phase 3 studies assessing the efficacy and tolerability of fostamatinib; two 12-month studies examining the effect of fostamatinib on patients responding inadequately to DMARDs (including MTX), and a six-month study assessing the effect of fostamatinib on patients who have previously responded inadequately to anti-TNF (or tumor necrosis factor) therapy. The fostamatinib program is also expected to include long-term safety extension studies involving more than 2,000 of the patients recruited during the course of the Phase 2 and 3 programs. The first anticipated filings of new drug applications with the U.S. Food and Drug Administration (FDA) and the European Medicines Agency (EMA) based on the OSKIRA program are planned for 2013.

Fostamatinib - Other Indications

In addition to RA, fostamatinib has been studied in patients for other immune indications and oncology. Under our collaboration with AZ, AZ has sole responsibility for all development decisions for all indications under its license except for one of the oncology studies, a solid tumor study announced in June 2009, which is funded, designed and implemented by the National Cancer Institute (NCI). Any decisions regarding this study are the responsibility of the NCI.

R343 Asthma

Disease background. Allergic asthma is a chronic inflammatory disorder of the airways. Asthma affects the lower respiratory tract and is marked by episodic flare-ups, or attacks, that can be life threatening. In some patients, allergens, such as pollen, trigger the production of immunoglobulin E, or IgE, antibodies, which then bind to mast cells and cause an intracellular signal that results in the release of various chemical mediators. When this process occurs repeatedly over time, it creates persistent inflammation of the airway passages, resulting in the chronic congestion and airway obstruction associated with allergic rhinitis and asthma, respectively.

Inhaled syk inhibitor program. R343 is a potent syk inhibitor that blocks IgE receptor signaling. Allergic asthma is a potentially life-threatening chronic inflammatory disorder of the airways which, in some patients, is mediated by allergen-induced IgE antibodies that trigger intracellular signaling in mast cells via IgE receptors. Mast cells play important roles in both early and late phase allergic reactions, and syk inhibitors could potentially prevent both phases.

In the first quarter of 2005, we announced a collaborative research and license agreement with Pfizer, Inc., or Pfizer, for the development of inhaled products for the treatment of allergic asthma and other respiratory diseases, such as chronic obstructive pulmonary disease. The collaboration was focused on our pre-clinical small molecule compounds which inhibit syk. The collaboration is now centered on the development of R343. Pfizer has completed the Phase 1a clinical trial of an inhaled formulation of R343, which commenced in December 2007, resulting in a milestone payment of $5.0 million to us. Pfizer initiated a Phase 1b allergen challenge clinical trial in the second quarter of 2009. We expect that Pfizer will initiate a Phase 2 clinical trial in 2011.

Research/Preclinical Programs

We are conducting proprietary research in three broad disease areas: inflammation/immunology, metabolism and muscle wasting. Within each disease area, our researchers are investigating mechanisms of action as well as screening compounds against potential novel targets and optimizing those leads that appear to have the greatest potential.

We have a lead candidate in our oral janus kinase 3, or Jak3, inhibitor program and expect to begin clinical studies in the first half of 2011. This program is focused on the treatment of transplant rejection, but could also extend to indications including RA and psoriasis. We are also currently investigating potential opthomalogical indications for our topical Jak3 inhibitor. Additionally, we expect to select a compound for preclinical development by the end of 2010 from our protein kinase C, or PKC, theta program initially focusing on multiple sclerosis.

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In the area of metabolism, we are investigating adiponectin mimetics for the treatment of type 2 diabetes mellitus and other potential indications. Type 2 diabetes is the most common form of diabetes, affecting more than 23 million people in the United States. In this disease, the body either produces low amounts of insulin or does not respond to the insulin it makes. Insulin is a hormone that helps the body regulate metabolism by causing cells to take up glucose from the blood. Adiponectin is a less-well characterized hormone that has insulin-sensitizing and anti-diabetic properties. We have identified several classes of compounds with adiponectin mimetic activity and are currently performing structure-activity relationship studies, as well as mechanism of action studies on these classes of compounds. We expect to nominate a lead development candidate in 2011 - 2012.

In the muscle atrophy program, we are focusing on several signaling pathways important for muscle homeostasis. Muscle atrophy, or the loss of muscle mass, is associated with several disease states and excessive loss of muscle in the context of illness can contribute significantly to both morbidity and mortality rates. Many conditions that have associated muscle loss, including cancer, chronic heart failure, chronic kidney disease, mechanical ventilation and aging (sarcopenia) have significant patient populations that may benefit from therapeutics that counter such muscle loss. One of our core programs in this area is focused on myostatin signaling. Myostatin is a cytokine that signals via the type II activin receptors (ACVR2A and ACVR2B) and has been shown to inhibit muscle growth. We are currently performing structure activity relationship studies on several hit molecules from initial ACVR2A/2B screens, and are developing new screens and models for this program. We expect to nominate a lead development candidate in 2011 - 2012.

Corporate Collaborations

We conduct research and development programs independently and in connection with our corporate collaborators. We currently have the following active collaborations with three major pharmaceutical/biotechnology companies: AstraZeneca AB, relating to fostamatinib for the treatment of RA and other indications, Pfizer, Inc., relating to intrapulmonary asthma and allergy therapeutics and associated with the clinical compound R343, and Daiichi Sankyo Co., Ltd., relating to oncology. None of these collaborations currently provide us with regular research reimbursement. In all of these collaborations, if certain conditions are met, we are entitled to receive future milestone payments and royalties. We cannot guarantee that these conditions will be met or that research and development efforts will be successful. As a result, we may not receive any further milestone payments or royalties under these agreements.

AstraZeneca

In February 2010, we entered into an exclusive worldwide license agreement with AZ for the global development and commercialization of our oral syk inhibitors for the treatment of human diseases other than those primarily involving respiratory or pulmonary dysfunction. The agreement includes a license of rights to fostamatinib, our late-stage investigational product candidate for the treatment of RA and other indications. AZ started its Phase 3 clinical trial program in patients with RA in September 2010. AZ is responsible for conducting and funding all future development, regulatory filings, manufacturing and global commercialization of products containing oral syk inhibitors.

The agreement became effective on March 26, 2010 and, in connection with the effectiveness of the agreement, we received an upfront payment of $100.0 million in April 2010 from AZ. On September 29, 2010, we announced that we earned $25.0 million from AZ in connection with the fulfillment of two major milestones in the agreement. The first milestone payment earned was for the initiation of the Phase 3 clinical trial program with fostamatinib in patients with RA that was announced by AZ on September 29, 2010. The second milestone payment earned was for the completion of the transfer of the fostamatinib long-term open label extension study to AZ which was also completed in September 2010. AZ is required to pay us up to an additional $320.0 million if specified development, regulatory and launch milestones are achieved for fostamatinib. We are also eligible to receive up to an additional $800.0 million if specified sales performance milestones are achieved for

fostamatinib, as well as significant stepped double-digit royalties on net sales worldwide.

Either party may terminate the agreement if the other party materially breaches the agreement and such breach remains uncured within sixty days from the date of notice, or in the event of insolvency of the other party. We may also terminate the agreement in its entirety if AZ challenges the validity, enforceability or scope of any of our patents licensed to AZ by us under the agreement. AZ may also terminate the agreement either without cause upon one hundred eighty-days written notice, or in the event of any change of control of Rigel upon thirty days written notice. If neither party terminates the agreement, then the agreement will remain in effect until the cessation of all commercial sales of all products subject to the agreement, including fostamatinib.

Pfizer

In January 2005, we entered into a research collaboration with Pfizer that has a license component. The collaboration is for the development of inhaled products for the treatment of allergic asthma and other respiratory diseases such as chronic obstructive pulmonary disease. The collaboration was primarily focused on our preclinical small molecule compounds, which inhibit IgE receptor signaling in respiratory tract mast cells by blocking the signaling enzyme syk. A goal of the collaboration was for Pfizer to nominate a

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licensed compound to commence advanced preclinical development. Pfizer is responsible for the manufacture of all preclinical and clinical materials for each compound/product and all costs associated with development and commercialization. We did not have any further obligations to Pfizer after the research phase of the collaboration ended in February 2007.

In connection with this collaboration, Pfizer paid us upfront fees of $10.0 million and purchased $5.0 million of our common stock at a premium in 2005. We have earned and will continue to earn milestone payments in connection with certain clinical events, should they occur, as well as royalties from sales of the resulting products upon marketing approval. Under the terms of the collaboration agreement, the aggregate of potential milestone amounts payable to us is $175.0 million and mid-single-digit to low double-digit royalties on sales. In May 2006, we achieved the first milestone upon selection of the licensed compound and received a $5.0 million milestone payment when Pfizer nominated R343 to commence advanced preclinical development in allergic asthma. In December 2007, we received the second milestone payment of $5.0 million when Pfizer initiated a Phase 1 clinical trial on R343. No milestone payments were received in either 2008 or 2009 as no further milestones were achieved. We expect Pfizer to initiate a Phase 2 clinical trial in 2011 as a result of which we will be entitled to receive a milestone payment of $5.0 million. Pfizer remains obligated to pay us various milestones and royalties in the future if certain conditions are achieved.

Pfizer may terminate the collaboration agreement for any reason upon prior written notice to us, or for cause if we materially breach the agreement and such breach remains uncured, or if we become insolvent. We may terminate the collaboration agreement for cause if Pfizer fails to meet certain diligence efforts, materially breaches the agreement and such breach remains uncured, or becomes insolvent. If neither party exercises its option to terminate the collaboration agreement, then the agreement automatically terminates on the later of: 1) the last valid claim to expire covering a licensed product and 2) after a specified period from the launch of a licensed product.

Daiichi Sankyo

In August 2002, we signed an agreement for a collaboration with Daiichi Sankyo, or Daiichi, to pursue research related to a specific target from a novel class of drug targets called ligases that control cancer cell proliferation through protein degradation. Daiichi paid us $0.9 million at the time we entered into the agreement. Under the terms of the collaboration agreement, the aggregate of potential milestone amounts payable to us is $33.9 million and low to mid-single-digit royalties on sales. We have earned to date milestone payments totaling $5.7 million, including a milestone payment of $750,000 for the first designation of a rational design lead compound that we received in December 2009, and may earn additional milestone payments in connection with certain clinical events. The research phase of this three-year collaboration expired in August 2005. In addition, we are entitled to receive royalties on any commercialized products to emerge from the collaboration at low to mid-single-digit royalties on sales. Under the terms of the agreement, we retain the rights to co-develop and co-promote certain products resulting from this collaboration in North America, while Daiichi retains co-development and promotion rights in the remainder of the world. Daiichi may become obligated to pay us certain other milestone payments, and we are also entitled to receive royalties on any commercialized products to emerge from the collaboration.

Either party may terminate the collaboration agreement if the other party materially breaches the agreement and such breach remains uncured, or after a specified period from the end of a designated research period if no product is commercialized (unless the parties agree to extend the collaboration). The collaboration agreement can also be terminated by mutual written consent of the parties. If neither party exercises its option to terminate the collaboration agreement, then the agreement automatically terminates on the later of: 1) the expiration of the last patent with a claim that covers the composition of matter of a product (or manufacture or use of a product under certain circumstances) and 2) after a specified period from the initial commercialization of a licensed product.

Research and Development Expense

Our research and development expenditures include costs related to preclinical and clinical trials, scientific personnel, supplies, equipment, consultants, sponsored research, stock-based compensation, and allocated facility costs.

We do not track fully burdened research and development costs separately for each of our drug candidates. We review our research and development expense by focusing on three categories: research, development, and other. Our research team is focused on creating a portfolio of product candidates that can be developed into small molecule therapeutics in our own proprietary programs or with potential collaborative partners and utilizes our robust discovery engine to rapidly discover and validate new product candidates in our focused range of therapeutic indications. Research expenses relate primarily to personnel expenses, lab supplies, fees to third party research consultants, and compounds. Our development group leads the implementation of our clinical and regulatory strategies and prioritizes disease indications in which our compounds may be studied in clinical trials. Development expenses relate primarily to clinical trials, personnel expenses, lab supplies, and fees to third party research consultants. Other expenses primarily include allocated stock-based compensation expense relating to personnel in research and development groups and allocated facilities costs.

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In addition to reviewing the three categories of research and development expense described in the preceding paragraph, we principally consider qualitative factors in making decisions regarding our research and development programs, which include enrollment in clinical trials and the results thereof, the clinical and commercial potential for our drug candidates and competitive dynamics. We also make our research and development decisions in the context of our overall business strategy, which includes the evaluation of potential collaborations for the development of our drug candidates.

The following table presents our total research and development expense by category.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Expense Categories:				
Research	$ 4,956	$ 4,348	$ 14,952	$ 13,536
Development	5,335	10,088	16,397	38,084
Other	6,103	6,646	19,285	18,948
	$ 16,394	$ 21,082	$ 50,634	$ 70,568

Other expenses mainly represent allocated stock-based compensation expenses of approximately $2.0 million and $2.4 million for the three months ended September 30, 2010 and 2009, respectively, and allocated facilities costs of approximately $4.1 million and $4.3 million for the three months ended September 30, 2010 and 2009, respectively. For the nine months ended September 30, 2010 and 2009, allocated stock-based compensation expenses were approximately $7.0 million and $6.3 million, respectively, and allocated facilities costs were approximately $12.3 million and $12.6 million, respectively. For the period from January 1, 2007 to September 30, 2010, accumulated research and development costs by category are $81.2 million, $144.0 million, and $96.2 million, for research, development, and other, respectively.

For the three and nine months ended September 30, 2010, a major portion of our research and development expense was associated with our extension trials in RA patients and our oral JAK3 inhibitor program. For the three and nine months ended September 30, 2009, a major portion of our research and development expense was associated with our two Phase 2b clinical trials (*TASKi2* and *TASKi3*), as well as the related extension trials in RA patients. The expenses for these programs are included in Development expenses in the table above.

We licensed the rights to fostamatinib to AZ in February 2010. Phase 2 clinical trials of fostamatinib in RA were completed in 2009. On September 29, 2010, AZ announced the enrollment of the first patient in the Phase 3 clinical program for fostamatinib, called OSKIRA. The first anticipated filings of new drug applications with the FDA and the EMA based on the OSKIRA program are planned for 2013. AZ will be responsible for conducting and funding all future development, regulatory filings, manufacturing and global commercialization of products containing oral syk inhibitors.

The scope and magnitude of future research and development expense are difficult to predict given the number of clinical trials that we will need to conduct for any of our potential products, as well as our limited capital resources. Preclinical testing and clinical development are long, expensive and uncertain processes. In general, biopharmaceutical development involves a series of steps, beginning with identification of a potential target and including, among others, proof of concept in animals and Phase 1, 2 and 3 clinical trials in humans. Each of these steps is typically more expensive than the previous step. Success in early stages of development often results in increasing expenditures for a given product candidate. Significant delays in clinical testing could materially impact our product development costs and timing of completion of the clinical trials. We do not know whether planned clinical trials will begin on time, will need to be halted or revamped or will be completed on

schedule, or at all. Clinical trials can be delayed for a variety of reasons, including delays in obtaining regulatory approval to commence a trial, delays from scale up, delays in reaching agreement on acceptable clinical trial agreement terms with prospective clinical sites, delays in obtaining institutional review board approval to conduct a trial at a prospective clinical site or delays in recruiting subjects to participate in a study.

We currently do not have reliable estimates of total costs for a particular drug candidate to reach the market. Our potential products are subject to a lengthy and uncertain regulatory process that may involve unanticipated additional clinical trials and may not result in receipt of the necessary regulatory approvals. Failure to receive the necessary regulatory approvals would prevent us from commercializing the product candidates affected. In addition, clinical trials of our potential products may fail to demonstrate safety and efficacy, which could prevent or significantly delay regulatory approval. We do not have a reasonable basis to determine when or if material net cash inflows from the commercialization and sale of our drug candidates will occur. Commercialization of our product candidates depends upon successful completion of extensive preclinical studies and clinical trials to demonstrate their safety and efficacy for humans. We do not know whether we, or any of our current or potential future collaborative partners, will undertake

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clinical trials of potential products beyond the trials already concluded and the trials currently in process. It will take us, or our current or potential future collaborative partners, several years to complete any such testing, and failure can occur at any stage of testing. Interim results of trials do not necessarily predict final results, and acceptable results in early trials may not be repeated in later trials. Moreover, we or our current or potential future collaborative partners may decide to discontinue development of any project at any time for regulatory, commercial, scientific or other reasons. To date, we have not commercialized any of our drug candidates, and we may never do so.

For a discussion of the risks and uncertainties associated with the timing and costs of completing the development of our drug candidates, see Item 1A. Risk Factors, including in particular the following risks:

- If our corporate collaborations or license agreements are unsuccessful, our research and development efforts could be delayed.

- If conflicts arise between our collaborators or advisors and us, any of them may act in their self-interest, which may be adverse to our stockholders interests.

- We might not be able to commercialize our product candidates successfully if problems arise in the clinical testing and approval process.

- There is a high risk that drug discovery and development efforts might not successfully generate good product candidates.

- Our future funding requirements will depend on many uncertain factors.

- Because we expect to be dependent upon collaborative and license agreements, we might not meet our strategic objectives.

- Delays in clinical testing could result in increased costs to us.

For further discussion on research and development activities, see Research and Development Expense under Results of Operations below.

Recent Accounting Pronouncements

In April 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update, or ASU, No. 2010-17 thereby amending Accounting Standards Codification (ASC) 605 for revenue recognition related to the milestone method of revenue recognition. ASU No. 2010-17 provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development arrangements. A company may make an accounting policy election to use the milestone method of revenue recognition for transactions within the scope of the amendments. The amendments will be effective in fiscal years beginning on or after June 15, 2010, and early adoption is permitted. We evaluated the impact of adopting ASU No. 2010-17 and believe it will have no material effect on our financial statements.

Critical Accounting Policies and the Use of Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate our estimates, including those related to the terms of our research and development collaborations (i.e. revenue recognition of upfront fees and certain milestone payments), investments, stock-based compensation, impairment issues, the estimated useful life of assets, estimated accruals and contingencies, on an on-going basis. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements:

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Revenue Recognition

We present revenue from our collaboration arrangements under FASB ASC, 808, *Collaboration Arrangements*. Our revenue arrangements with multiple elements are evaluated under FASB ASC 605-25, *Multiple-Element Arrangements*, and are divided into separate units of accounting if certain criteria are met, including whether the delivered element has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of any undelivered items. The consideration we receive is allocated among the separate units based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. Advance payments received in excess of amounts earned are classified as deferred revenue until earned.

Non-refundable, up-front payments received in connection with research and development collaboration agreements, including technology access fees, are deferred and recognized on a straight-line basis over the relevant periods of continuing involvement, generally the research term. When a research term is not specified, we estimate the time it will take us to complete our deliverables under the contract and recognize the upfront fee using the straight-line method over that time period. We review our estimates every quarter for reasonableness.

Revenues related to collaborative research with our corporate collaborators are recognized as research services are performed over the related development periods for each agreement. Under these agreements, we are required to perform research and development activities as specified in each respective agreement. The payments received are not refundable and are generally based on a contractual cost per full-time equivalent employee working on the project. Our research and development expenses under the collaborative research agreements approximate the revenue recognized under such agreements over the term of the respective agreements. It is our policy to recognize revenue based on our level of effort expended, however, revenue recognized will not exceed amounts billable under the agreement.

Revenues associated with substantive, at-risk milestones pursuant to collaborative agreements are recognized upon achievement of the milestones.

Stock-based Compensation

The determination of the fair value of stock-based payment awards on the date of grant using the Black-Scholes option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, volatility, expected term, risk-free interest rate and dividends. We estimate volatility using our historical stock price performance over the expected life of the option up to the point where we have historical market data. For expected term, among other things, we take into consideration our historical data of options exercised, cancelled and expired. The risk-free rate is based on the U.S. Treasury constant maturity rate. We have not paid and do not expect to pay dividends in the foreseeable future. In order to calculate stock-based compensation expense, we also estimate the forfeiture rate using our historical experience with options that cancel before they vest.

Research and Development Accruals

We have various contracts with third parties related to our research and development activities. Costs that are incurred but not billed to us as of the end of the period are accrued. We make estimates of the amounts incurred in each period based on the information available to us and our knowledge of the nature of the contractual activities generating such costs. Clinical trial contract expenses are accrued based on units of activity reported by third parties. Expenses related to other research and development contracts, such as research contracts, toxicology study contracts and manufacturing contracts are estimated to be incurred generally on a straight-line basis over the duration of the contracts. Raw materials and study materials purchased by third parties are expensed at the time of purchase. Many of our estimates are based significantly or in part on information provided by third parties. If such information were not reported properly, our research and development expense amounts could be misstated.

Results of Operations

Three and Nine Months Ended September 30, 2010 and 2009

Revenues

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2010	2009	Aggregate Change	2010	2009	Aggregate Change
		(in thousands)			(in thousands)	
Contract revenues	$ 72,282	$	$ 72,282	$ 125,000	$	$ 125,000

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Contract revenues from collaborations in 2010 consisted of amortization of upfront fees and milestone payments. Contract revenues of $72.3 million for the three months ended September 30, 2010 consisted of $47.3 million of amortization of the $100.0 million upfront payment from AZ pursuant to the exclusive worldwide license agreement for fostamatinib and $25.0 million in milestone payments earned from AZ for the initiation of the Phase 3 clinical program with fostamatinib in patients with RA and for the completion of transferring the fostamatinib long-term open label extension study to AZ.

Contract revenues of $125.0 million for the nine months ended September 30, 2010 consisted of amortization of the $100.0 million upfront payment from AZ pursuant to the exclusive worldwide license agreement for fostamatinib and $25.0 million of milestone payments earned from AZ for the fulfillment of two major milestones in the agreement as discussed above. There were no revenues reported during the three and nine months ended September 30, 2009. We do not expect any further revenue to be recognized for the remainder of 2010. Our potential future revenues in 2011 may include certain milestone payments from our current collaboration partners and upfront payments from new collaboration partners we enter into agreements with in the future.

Research and Development Expense

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2010	2009	Aggregate Change	2010	2009	Aggregate Change
	(in thousands)			(in thousands)		
Research and development expense	$ 16,394	$ 21,082	$ (4,688)	$ 50,634	$ 70,568	$ (19,934)
Stock-based compensation expense included in research and development expense	2,017	2,356	(339)	7,017	6,309	708

The decrease in research and development expense for the three months ended September 30, 2010, compared to the same period in 2009, was primarily due to the elimination of certain costs as a result of our entering into a worldwide license agreement with AZ in March 2010, and the completion of *TASKi2* and *TASKi3* trials in July 2009. The decrease in research and development expense for the nine months ended September 30, 2010, compared to the same period in 2009, was primarily due to the completion of *TASKi2* and *TASKi3* trials in July 2009.

General and Administrative Expense

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2010	2009	Aggregate Change	2010	2009	Aggregate Change
	(in thousands)			(in thousands)		
General and administrative expense	$ 5,530	$ 5,573	$ (43)	$ 19,380	$ 15,226	$ 4,154
Stock-based compensation expense included in general and administrative expense	1,750	1,176	574	5,618	3,226	2,392

The decrease in general and administrative expense for the three months ended September 30, 2010, as compared to the same period in 2009, was primarily due to the insurance reimbursement of certain legal costs incurred in connection with the purported securities class action lawsuit filed against us (as discussed under Item 1. Legal Proceedings of Part II. Other Information below), and the elimination of contingency interest costs related to the deferral of certain rental obligations as of September 22, 2009, partially offset by an increase in stock-based compensation expense related to options granted in the second quarter of 2010 as discussed under Stock-Based Compensation Expense below. The increase in general and administrative expense for the nine months ended September 30, 2010, as compared to the same period in 2009, was primarily due to the increase in stock-based compensation expense as discussed under Stock-Based Compensation Expense below, and certain one-time investment banking fees associated with the closing of our transaction with AZ.

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Restructuring Charges

Three Months Ended September 30,			Nine Months Ended September 30,
2010	2009	Aggregate Change	