LIGAND PHARMACEUTICALS INC
Form 10-Q
May 15, 2006

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**
**FORM 10-Q**

**Mark One**

þ **Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
**For the quarterly period ended March 31, 2006 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: 0-20720**
**LIGAND PHARMACEUTICALS INCORPORATED**
**(Exact Name of Registrant as Specified in its Charter)**

| | |
|---|---|
| **Delaware** | **77-0160744** |
| **(State or Other Jurisdiction of Incorporation or Organization)** | **(I.R.S. Employer Identification No.)** |
| **10275 Science Center Drive San Diego, CA** | **92121-1117** |
| **(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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. Large Accelerated Filer o Accelerated Filer þ Non-Accelerated Filer 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 þ

As of April 30, 2006, the registrant had 78,509,410 shares of common stock outstanding.

---

**LIGAND PHARMACEUTICALS INCORPORATED**
**QUARTERLY REPORT**
**FORM 10-Q**
**TABLE OF CONTENTS**


**PART I. FINANCIAL INFORMATION**

**ITEM 1.** Financial Statements (Unaudited)

Condensed Consolidated Balance Sheets as of March 31, 2006 and December 31, 2005 — 3

Condensed Consolidated Statements of Operations for the three months ended March 31, 2006 and 2005 — 4

Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2006 and 2005 — 5

Notes to Condensed Consolidated Financial Statements — 6

**ITEM 2.** Management s Discussion and Analysis of Financial Condition and Results of Operations — 24

**ITEM 3.** Quantitative and Qualitative Disclosures about Market Risk — 37

**ITEM 4.** Controls and Procedures — 38

**PART II. OTHER INFORMATION**

**ITEM 1.** Legal Proceedings — 44

**ITEM 1A.** Risk Factors — 46

**ITEM 2.** Unregistered Sales of Equity Securities and Use of Proceeds — 58

**ITEM 3.** Defaults upon Senior Securities — *

**ITEM 4.** Submission of Matters to a Vote of Security Holders — 59

**ITEM 5.** Other Information — *

**ITEM 6.** Exhibits — 60

**SIGNATURE** — 62

Exhibit 10.267
Exhibit 31.1
Exhibit 31.2
Exhibit 32.1
Exhibit 32.2


* No information provided due to

inapplicability
of item.

Table of Contents

**PART I. FINANCIAL INFORMATION**
**ITEM 1. FINANCIAL STATEMENTS**

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

| | March 31, 2006 | December 31, 2005 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 49,808 | $ 66,756 |
| Short-term investments | 17,897 | 20,174 |
| Accounts receivable, net | 20,046 | 20,954 |
| Current portion of inventories, net | 8,232 | 9,333 |
| Other current assets | 16,357 | 15,750 |
| Total current assets | 112,340 | 132,967 |
| Restricted investments | 1,826 | 1,826 |
| Long-term portion of inventories, net | 5,486 | 5,869 |
| Property and equipment, net | 21,758 | 22,483 |
| Acquired technology, product rights and royalty buy-down, net | 143,268 | 146,770 |
| Other assets | 4,011 | 4,704 |
| Total assets | $ 288,689 | $ 314,619 |
| LIABILITIES AND STOCKHOLDERS DEFICIT | | |
| Current liabilities: | | |
| Accounts payable | $ 16,325 | $ 15,360 |
| Accrued liabilities | 43,502 | 59,587 |
| Current portion of deferred revenue, net | 151,021 | 157,519 |
| Current portion of co-promote termination liability | 42,533 | |
| Current portion of equipment financing obligations | 2,298 | 2,401 |
| Current portion of long-term debt | 350 | 344 |
| Total current liabilities | 256,029 | 235,211 |
| Long-term debt | 140,553 | 166,745 |
| Long-term portion of co-promote termination liability | 93,708 | |
| Long-term portion of equipment financing obligations | 3,251 | 3,430 |
| Long-term portion of deferred revenue, net | 4,124 | 4,202 |
| Other long-term liabilities | 3,037 | 3,105 |
| Total liabilities | 500,702 | 412,693 |
| Commitments and contingencies | | |
| Common stock subject to conditional redemption; 997,568 shares issued and outstanding at March 31, 2006 and December 31, 2005 | 12,345 | 12,345 |

| | | |
|---|---|---|
| Stockholders deficit: | | |
| Convertible preferred stock, $0.001 par value; 5,000,000 shares authorized; none issued | | |
| Common stock, $0.001 par value; 200,000,000 shares authorized; 77,496,166 and 73,136,340 shares issued at March 31, 2006 and December 31, 2005, respectively | 78 | 73 |
| Additional paid-in capital | 748,742 | 720,988 |
| Accumulated other comprehensive income | 1,021 | 490 |
| Accumulated deficit | (973,288) | (831,059) |
| | (223,447) | (109,508) |
| Treasury stock, at cost; 73,842 shares | (911) | (911) |
| Total stockholders deficit | (224,358) | (110,419) |
| | $ 288,689 | $ 314,619 |

*See accompanying notes.*

Table of Contents

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

| | Three Months Ended March 31, | |
|---|---|---|
| | **2006** | **2005** |
| Revenues: | | |
| Product sales | $ 47,984 | $ 35,045 |
| Collaborative research and development and other revenues | 2,972 | 1,940 |
| Total revenues | 50,956 | 36,985 |
| Operating costs and expenses: | | |
| Cost of products sold | 9,740 | 11,065 |
| Research and development | 12,218 | 14,735 |
| Selling, general and administrative | 22,201 | 19,215 |
| Co-promotion | 10,957 | 7,740 |
| Co-promote termination charges | 132,941 | |
| Total operating costs and expenses | 188,057 | 52,755 |
| Loss from operations | (137,101) | (15,770) |
| Other income (expense): | | |
| Interest income | 573 | 444 |
| Interest expense | (6,067) | (3,127) |
| Other, net | 383 | 1 |
| Total other expense, net | (5,111) | (2,682) |
| Loss before income taxes | (142,212) | (18,452) |
| Income tax expense | (17) | (20) |
| Net loss | $ (142,229) | $ (18,472) |
| Basic and diluted per share amounts: | | |
| Net loss | $ (1.84) | $ (0.25) |
| Weighted average number of common shares | 77,496,969 | 73,916,470 |

*See accompanying notes.*

Table of Contents

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

| | Three Months Ended March 31, | |
|---|---|---|
| | **2006** | **2005** |
| **Operating activities** | | |
| Net loss | $ (142,229) | $ (18,472) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Amortization of acquired technology and license rights | 3,570 | 3,236 |
| Depreciation and amortization of property and equipment | 913 | 969 |
| Amortization of debt issue costs | 244 | 254 |
| Gain on sale of Exelixis stock | (343) | |
| Stock-based compensation | 814 | |
| Non-cash interest expense converted into additional paid-in capital | 57 | |
| Other | (8) | 28 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 908 | 12,523 |
| Inventories, net | 1,484 | (1,144) |
| Other current assets | (144) | 637 |
| Accounts payable and accrued liabilities | (14,912) | (958) |
| Other liabilities | (3) | (2) |
| Deferred revenue, net | (6,576) | 332 |
| Co-promote termination liability | 136,241 | |
| Net cash used in operating activities | (19,984) | (2,597) |
| **Investing activities** | | |
| Purchases of short-term investments | (4,726) | (21,425) |
| Proceeds from sale of short-term investments | 7,884 | 2,945 |
| Purchases of property and equipment | (190) | (597) |
| Payment to buy-down ONTAK royalty obligation | | (20,000) |
| Capitalized portion of payment of lasofoxifene royalty rights | | (558) |
| Other, net | 27 | 60 |
| Net cash provided by (used in) investing activities | 2,995 | (39,575) |
| **Financing activities** | | |
| Principal payments on equipment financing obligations | (680) | (723) |
| Proceeds from equipment financing arrangements | 398 | 880 |
| Repayment of long-term debt | (86) | (82) |
| Proceeds from issuance of common stock | 468 | 773 |
| Decrease in other long-term liabilities | (59) | (30) |
| Net cash provided by financing activities | 41 | 818 |
| Net decrease in cash and cash equivalents | (16,948) | (41,354) |

| | | | | |
|---|---|---|---|---|
| Cash and cash equivalents at beginning of period | | 66,756 | | 92,310 |
| Cash and cash equivalents at end of period | $ | 49,808 | $ | 50,956 |
| **Supplemental disclosure of cash flow information** | | | | |
| Interest paid | $ | 517 | $ | 328 |
| **Non-cash impact of the conversion of 6% convertible subordinated notes into common stock:** | | | | |
| Conversion of principal amount of convertible notes | $ | 26,100 | $ | |
| Conversion of unamortized debt issue costs | | (351) | | |
| Conversion of unpaid accrued interest | | 264 | | |
| | $ | 26,013 | $ | |
| **Non-cash impact of stock option exercises where cash was received subsequent to quarter-end** | $ | 469 | $ | |

*See accompanying notes.*

Table of Contents

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

**1. Basis of Presentation**

The accompanying condensed consolidated financial statements of Ligand Pharmaceuticals Incorporated (the Company or Ligand ) were prepared in accordance with instructions for Form 10-Q and, therefore, do not include all information necessary for a complete presentation of financial condition, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America. However, all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for a fair presentation of the condensed consolidated financial statements, have been included. The results of operations for the three-month periods ended March 31, 2006 and 2005 are not necessarily indicative of the results that may be expected for the entire fiscal year or any other future period. These statements should be read in conjunction with the consolidated financial statements and related notes, which are included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

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

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

*Loss Per Share.* Net loss per share is computed using the weighted average number of common shares outstanding. Basic and diluted net loss per share amounts are equivalent for the periods presented as the inclusion of potential common shares in the number of shares used for the diluted computation would be anti-dilutive. Potential common shares, the shares that would be issued upon the conversion of convertible notes and the exercise of outstanding warrants and stock options were 28.9 million and 32.7 million at March 31, 2006 and December 31, 2005, respectively.

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

Under its bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer s or director s serving in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. However, the Company has a directors and officers liability insurance policy that limits its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal and has no liabilities recorded for these agreements as of March 31, 2006 and December 31, 2005.

**Table of Contents**

The Company enters into indemnification provisions under its agreements with other companies in its ordinary course of business, typically with business partners, contractors, customers and landlords. Under these provisions the Company generally indemnifies and holds harmless the indemnified party for direct losses suffered or incurred by the indemnified party as a result of the Company s activities or, in some cases, as a result of the indemnified party s activities under the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of March 31, 2006 and December 31, 2005.

*Accounting for Stock-Based Compensation*. Prior to January 1, 2006, the Company accounted for stock-based compensation in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. The pro forma effects of employee stock options were disclosed as required by *Financial Accounting Standard Board Statement* No. 123, *Accounting for Stock-Based Compensation* (SFAS 123).

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), using the modified prospective transition method. No stock-based employee compensation cost was recognized prior to January 1, 2006, as all options granted prior to 2006 had an exercise price equal to the market value of the underlying common stock on the date of the grant. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ( SAB 107 ) relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R). Under the transition method, compensation cost recognized in 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted in the first quarter 2006, based on grant-date fair value estimated in accordance with the provisions of SFAS 123(R).

Additionally, the Company accounts for the fair value of options granted to non-employee consultants under Emerging Issues Task Force (EITF) 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction With Selling, Goods or Services*.

Total compensation expense for stock-based compensation for the three months ended March 31, 2006 was approximately $0.8 million. There was no deferred tax benefit recognized in connection with this cost.

Results for the quarter ended March 31, 2005 have not been retrospectively adjusted. The fair value of the options was estimated using a Black-Scholes option-pricing formula and amortized to expense over the options vesting periods.

Table of Contents

The following table illustrates the pro forma effect of share-based compensation on net loss and loss per share for the quarter ended March 31, 2005 (in thousands, except per share data):

| | | Three Months Ended March 31, 2005 |
|---|---|---|
| Net loss, as reported | $ | (18,472) |
| Stock-based employee compensation expense included in reported net loss | | |
| Less: total stock-based compensation expense determined under fair value based method for all awards continuing to vest | | (757) |
| Less: total stock-based compensation expense determined under fair value based method for options accelerated in January 2005 (1) | | (12,455) |
| Net loss, pro forma | $ | (31,684) |
| Basic and diluted per share amounts: | | |
| Net loss per share as reported | $ | (0.25) |
| Net loss per share pro forma | $ | (0.43) |

(1) Represents pro forma unrecognized expense for accelerated options as of the date of acceleration.

On January 31, 2005, Ligand accelerated the vesting of certain unvested and out-of-the-money stock options previously awarded to the executive officers and other employees under the Company s 1992 and 2002 stock option plans which had an exercise price greater than $10.41, the closing price of the Company s stock on that date. The vesting for options to purchase approximately 1.3 million shares of common stock (of which approximately 450,000 shares were subject to options held by the executive officers) were accelerated. Options held by non-employee directors were not accelerated.

Holders of incentive stock options (ISOs) within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, were given the election to decline the acceleration of their options if such acceleration would have the effect of changing the status of such option for federal income tax purposes from an ISO to a non-qualified stock option. In addition, the executive officers plus other members of senior management agreed that they will not sell any shares acquired through the exercise of an accelerated option prior to the date on which the exercise would have been permitted under the option s original vesting terms. This agreement does not apply to a) shares sold in order to pay applicable taxes resulting from the exercise of an accelerated option or b) upon the officers retirement or other termination of employment.

The purpose of the acceleration was to eliminate any future compensation expense the Company would have otherwise recognized in its statement of operations with respect to these options upon the implementation of SFAS 123(R).

Other Stock-Related Information

The 2002 Stock Incentive Plan contains four separate equity programs Discretionary Option Grant Program, Automatic Option Grant Program, Stock Issuance Program and Director Fee Option Grant Program ( the 2002

Table of Contents

Plan ). On January 31, 2006, shareholders of the Company approved an amendment to the 2002 Plan to increase the number of shares of the Company s common stock authorized for issuance by 750,000 shares, from 8.3 million shares to 9.1 million shares. As of March 31, 2006, options for 7,370,866 shares of common stock were outstanding under the 2002 plan and 304,674 shares remained available for future option grant or direct issuance.

The Company grants options to employees, non-employees consultants, and non-employee directors. Additionally, the Company granted restricted stock to non-employee directors in the first quarter of 2006. Non-employee directors are accounted for as employees under SFAS 123(R). Options and restricted stock granted to certain directors vest in equal monthly installments over one year. Options granted to employees vests 1/8 on the six month anniversary and 1/48 each month thereafter for forty-two months. Options granted to non-employee consultants generally vest between 24 and 36 months. All option awards generally expire ten years from the date of the grant.

Stock-based compensation cost for awards to employees and non-employee directors is recognized on a straight-line basis over the vesting period until the last tranche vests. Compensation cost for consultant awards is recognized over each separate tranche s vesting period. The Company recognized compensation expense of approximately $0.8 million for the three months ended March 31, 2006 associated with option awards and restricted stock. Of the total compensation expense associated with option awards, approximately $0.2 million related to options granted to non-employee consultants.

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 March 31** | |
|---|---|---|
| | **2006** | **2005** |
| Risk-free interest rate | 4.7% | 4.2% |
| Dividend yield | | |
| Expected volatility | 70% | 75% |
| Expected term | 5.94 years | 5 years |

The expected term of the employee and non-employee director options is the estimated weighted-average period until exercise or cancellation of vested options (forfeited unvested options are not considered). SAB 107 guidance permits companies to use a safe harbor expected term assumption for grants up to December 31, 2007 based on the mid-point of the period between vesting date and contractual term, averaged on a tranche-by-tranche basis. The Company used the safe harbor in selecting the expected term assumption in 2006. 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. SFAS 123(R) requires an estimate of future volatility. In selecting this assumption, the Company used the historical volatility of the Company s stock price over a period equal to the expected term.

**Table of Contents**

Stock Option Activity

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term in Years | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Balance at December 31, 2005 | 7,001,657 | $ 11.76 | | |
| Granted | 595,617 | 11.96 | | |
| Exercised | 116,315 | 8.01 | | |
| Forfeited | 43,288 | 8.60 | | |
| Cancelled | 66,805 | 14.73 | | |
| Balance at March 31, 2006 | 7,370,866 | $ 11.82 | 6.01 | $ 14,273 |
| Exercisable at March 31, 2006 | 5,671,045 | $ 12.44 | 5.11 | $ 9,022 |
| Options expected to vest as of March 31, 2006 | 7,172,385 | $ 11.87 | 5.92 | $ 13,688 |

The weighted-average grant-date fair value of all stock options granted during the three months ended March 31, 2006 was $7.87 per share. The total intrinsic value of all options exercised during the three months ended March 31, 2006 was $4.69 per share. As of March 31, 2006, there was approximately $9.0 million of total unrecognized compensation cost related to nonvested stock options. That cost is expected to be recognized over a weighted average period of 2.91 years.

Cash received from options exercised for each of the quarters ended March 31, 2006 and 2005 was approximately $0.5 million for each period. An additional $0.5 million was received subsequent to March 31, 2006 for options exercised during the three months ended March 31, 2006. There is no current tax benefit related to options exercised because of net operating losses (NOLs) for which a full valuatation allowance has been established.

Restricted Stock Activity

| | Shares | Weighted-Average Stock Price |
|---|---|---|
| Balance at December 31, 2005 | | $ |
| Granted | 15,566 | 11.56 |
| Vested | 3,895 | 11.56 |
| Forfeited | | |
| Nonvested at March 31, 2006 | 11,671 | $ 11.56 |

The weighted-average grant-date fair value of restricted stock granted during the three months ended March 31, 2006 was $11.56 per share. As of March 31, 2006, there was $137,574 of total unrecognized compensation cost related to nonvested restricted stock. That cost is expected to be recognized over the remainder of 2006.

Employee Stock Purchase Plan

The Company also has an employee stock purchase plan (the ESPP ). Since its adoption in 2002, a total of 510,248 shares of common stock have been reserved for issuance under the ESPP. As of March 31, 2006, 362,738 shares of common stock had been issued under the ESPP, and 147,510 shares are available for future issuance. For the quarter ended March 31, 2006, there were no issuances of common shares under the ESPP.

*Accounts Receivable.* Accounts receivable consist of the following (in thousands):

| | March 31, 2006 | December 31, 2005 |
|---|---|---|
| Trade accounts receivable | $ 2,739 | $ 1,344 |
| Due from finance company (Note 2) | 18,243 | 20,464 |
| Less: discounts and allowances | (936) | (854) |
| | $ 20,046 | $ 20,954 |

*Inventories.* Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. Inventories consist of the following (in thousands):

| | March 31, 2006 | December 31, 2005 |
|---|---|---|
| Raw materials | $ 1,655 | $ 1,508 |
| Work-in-process | 8,671 | 9,115 |
| Finished goods | 5,388 | 6,324 |
| Less: inventory reserves | (1,996) | (1,745) |
| | 13,718 | 15,202 |
| Less: current portion | (8,232) | (9,333) |
| Long-term portion of inventories, net | $ 5,486 | $ 5,869 |

In 2005, the Company completed a multi-year process of transferring its filling and finishing of ONTAK from Eli Lilly and Company (Lilly) to Hollister-Stier. In anticipation of this transfer, the Company used Lilly to fill and finish, in 2003, a higher than normal number of ONTAK lots each of which required a forward dating determination. ONTAK otherwise has a shelf life projection of up to 36 months. If commercial and clinical usage of these lots does not approximate the estimated pattern of usage as determined for purposes of dating, the Company could be required to write-off the value of one or more of these lots. In this regard, as of March 31, 2006 and December 31, 2005, inventory reserves relating to ONTAK finished goods inventory totaled approximately $1.1 million and $0.7 million, respectively. As of March 31, 2006 and December 31, 2005, total ONTAK inventory amounted to approximately $7.4 million and $7.8 million, respectively, of which $3.0 million and $2.7 million is classified as long-term, respectively.

During 2005, the Company manufactured a higher than normal amount of drug substance (bexarotene) for Targretin capsules in the event the Company s non-small cell lung cancer (NSCLC) clinical trials were successful. In March 2005, the Company disclosed that the trials did not meet their endpoints of improved overall survival and projected two year survival. The Company believes, however, that the additional manufactured bexarotene, which has a shelf life projection of approximately 10 years, will be fully used for ongoing production of the Company s marketed products, Targretin capsules and Targretin gel. As of March 31, 2006 and December 31, 2005, total Targretin capsules inventory amounted to $3.9 million and $4.2 million, respectively, of which $2.5 million and $3.2 million is classified as long-term, respectively.

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

| | March 31, | December 31, |
|---|---|---|

| | 2006 | 2005 |
|---|---|---|
| Land | $ 5,176 | $ 5,176 |
| Equipment, building, and leasehold improvements | 61,832 | 61,732 |
| Less accumulated depreciation and amortization | (45,250) | (44,425) |
| | $ 21,758 | $ 22,483 |

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

11

*Other Current Assets.* Other current assets consist of the following (in thousands):