LIGAND PHARMACEUTICALS INC
Form 424B3
March 16, 2007

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PROSPECTUS FILED PURSUANT TO RULE 424(B)(3)

LIGAND PHARMACEUTICALS INCORPORATED

Filed Pursuant to Rule 424(b)(3)
Registration No. 333-131029

Prospectus Supplement No. 22

(to Prospectus dated April 12, 2006, as supplemented and amended by that Prospectus Supplement No. 1 dated May 15, 2006, that Prospectus Supplement No. 2 dated June 12, 2006, that Prospectus Supplement No. 3 dated June 29, 2006, that Prospectus Supplement No. 4 dated August 4, 2006, that Prospectus Supplement No. 5 dated August 9, 2006, that Prospectus Supplement No. 6 dated August 30, 2006, that Prospectus Supplement No. 7 dated September 11, 2006, that Prospectus Supplement No. 8 dated September 12, 2006, that Prospectus Supplement No. 9 dated October 2, 2006, that Prospectus Supplement No. 10 dated October 17, 2006, that Prospectus Supplement No. 11 dated October 20, 2006, that Prospectus Supplement No. 12 dated October 31, 2006, that Prospectus Supplement No. 13 dated November 14, 2006, that Prospectus Supplement No. 14 dated November 15, 2006, that Prospectus Supplement No. 15 dated December 14, 2006, that Prospectus Supplement No. 16 dated January 5, 2007, that Prospectus Supplement No. 17 dated January 16, 2007, that Prospectus Supplement No. 18 dated February 5, 2007, that Prospectus Supplement No. 19 dated February 28, 2007, that Prospectus Supplement No. 20 dated March 5, 2007, and that Prospectus Supplement No. 21 dated March 15, 2007)

This Prospectus Supplement No. 22 supplements and amends the prospectus dated April 12, 2006 (as supplemented and amended by that Prospectus Supplement No. 1 dated May 15, 2006, that Prospectus Supplement No. 2 dated June 12, 2006, that Prospectus Supplement No. 3 dated June 29, 2006, that Prospectus Supplement No. 4 dated August 4, 2006, that Prospectus Supplement No. 5 dated August 9, 2006, that Prospectus Supplement No. 6 dated August 30, 2006, that Prospectus Supplement No. 7 dated September 11, 2006, that Prospectus Supplement No. 8 dated September 12, 2006, that Prospectus Supplement No. 9 dated October 2, 2006, that Prospectus Supplement No. 10 dated October 17, 2006, that Prospectus Supplement No. 11 dated October 20, 2006, that Prospectus Supplement No. 12 dated October 31, 2006, that Prospectus Supplement No. 13 dated November 14, 2006, that Prospectus Supplement No. 14 dated November 15, 2006, that Prospectus Supplement No. 15 dated December 14, 2006, that Prospectus Supplement No. 16 dated January 5, 2007, that Prospectus Supplement No. 17 dated January 16, 2007, that Prospectus Supplement No. 18 dated February 5, 2007, that Prospectus Supplement No. 19 dated February 28, 2007, that Prospectus Supplement No. 20 dated March 5, 2007, and that Prospectus Supplement No. 21 dated March 15, 2007), or the Prospectus, relating to the offer and sale of up to 7,790,974 shares of our common stock to be issued pursuant to awards granted or to be granted under our 2002 Stock Incentive Plan, or our 2002 Plan, up to 147,510 shares of our common stock to be issued pursuant to our 2002 Employee Stock Purchase Plan, or our 2002 ESPP, and up to 50,309 shares of our common stock which may be offered from time to time by the selling stockholders identified on page 110 of the Prospectus for their own accounts. Each of the selling stockholders named in the Prospectus acquired the shares of common stock upon exercise of options previously granted to them as an employee, director or consultant of Ligand or as restricted stock granted to them as a director of Ligand, in each case under the terms of our 2002 Plan. We will not receive any of the proceeds from the sale of the shares of our common stock by the selling stockholders under the Prospectus. We will receive proceeds in connection with option exercises under the 2002 Plan and shares issued under the 2002 ESPP which will be based upon each granted option exercise price or purchase price, as applicable.

On March 16, 2007, we filed with the Securities and Exchange Commission our Annual Report on Form 10-K for the fiscal year ended December 31, 2006. The information set forth below supplements and amends the information contained in the Prospectus.

This Prospectus Supplement No. 22 should be read in conjunction with, and delivered with, the Prospectus and is qualified by reference to the Prospectus except to the extent that the information in this Prospectus Supplement No. 22 updates or supersedes the information contained in the Prospectus.

Our common stock is traded on The Nasdaq Global Market under the symbol LGND. On March 15, 2007, the closing price of our common stock was $10.92 per share.

Investing in our common stock involves risk. See Risk Factors beginning on page 7 of the Prospectus and beginning on page 17 of this Prospectus Supplement No. 22.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if the Prospectus or this Prospectus Supplement No. 22 is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this Prospectus Supplement No. 22 is March 16, 2007.

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

Mark One

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 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 No. 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)	**(IRS 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
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, par value $.001 per share	The NASDAQ Global Market of The NASDAQ Stock Market LLC
Preferred Share Purchase Rights	The NASDAQ Global Market of The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 of Section 15(d) of the Securities Exchange Act of 1934. Yes o No þ

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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 Exchange Act Rule 12b-2 of the Exchange Act). Yes o No þ

The aggregate market value of the Registrant s voting and non-voting stock held by non-affiliates was approximately $597.4 million based on the last sales price of the Registrant s Common Stock on the NASDAQ Global Market of the NASDAQ Stock Market LLC on June 30, 2006. For purposes of this calculation, shares of Common Stock held by directors, officers and 10% stockholders known to the Registrant have been deemed to be owned by affiliates which should not be construed to indicate that any such person possesses the power, direct or indirect, to direct or cause the direction of the management or policies of the Registrant or that such person is controlled by or under common control with the Registrant.

As of February 28, 2007, the Registrant had 101,008,348 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Registrant s 2007 Annual Meeting of Stockholders to be filed with the Commission on or before April 30, 2007 are incorporated by reference in Part III of this Annual Report on Form 10-K. With the exception of those portions that are specifically incorporated by reference in this Annual Report on Form 10-K, such Proxy Statement shall not be deemed filed as part of this Report or incorporated by reference herein.

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AVAILABLE INFORMATION:

We file electronically with the Securities and Exchange Commission (or SEC) our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and, as necessary, amendments to these reports, pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. The public may read or copy any materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that site is <http://www.sec.gov>.

You may obtain a free copy of our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and amendments to those reports which are posted as soon as reasonably practicable after filing on our website at <http://www.ligand.com>, by contacting the Investor Relations Department at our corporate offices by calling (858) 550-7500 or by sending an e-mail message to investors@ligand.com. You may also request

information via the Investor Relations page of our website.

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Glossary
PRODUCTS AND INDICATIONS

AVINZA®	Approved in March 2002 for sale in the U.S. for the once-daily treatment of moderate-to-severe pain in patients who require continuous, around-the-clock opioid therapy for an extended period of time.**
ONTAK® (denileukin diftitox) ONZAR	Approved in February 1999 for sale in the U.S. for the treatment of patients with persistent or recurrent cutaneous T-cell lymphoma whose malignant cells express the CD25 component of the Interleukin-2 receptor.*
Targretin® (bexarotene) capsules	Approved in December 1999 for sale in the U.S. and in March 2001 for sale in Europe for the treatment of cutaneous manifestations of cutaneous T-cell lymphoma in patients who are refractory to at least one prior systemic therapy.*
Targretin® (bexarotene) gel 1%	Approved in June 2000 for sale in the U.S. for the topical treatment of cutaneous lesions in patients with cutaneous T-cell lymphoma (Stage 1A and 1B) who have refractory or persistent disease after other therapies or who have not tolerated other therapies.*
Panretin® gel (alitretinoin) 0.1%	Approved in February 1999 for sale in the U.S. and in October 2000 for sale in Europe for the topical treatment of cutaneous lesions of patients with AIDS-related Kaposi s sarcoma.*
CTCL	Cutaneous T-Cell Lymphoma
HIV	Human Immunodeficiency Virus
HT	Hormone Therapy
NSCLC	Non-Small Cell Lung Cancer

SCIENTIFIC TERMS

AR	Androgen Receptor
ER	Estrogen Receptor
IR	Intracellular Receptor
PPAR	Peroxisome Proliferation Activated Receptor
PR	Progesterone Receptor
RAR	Retinoic Acid Receptor
RR	Retinoid Responsive Intracellular Receptor
RXR	Retinoid X Receptor
SARM	Selective Androgen Receptor Modulator
SERM	Selective Estrogen Receptor Modulator
SGRM	Selective Glucocorticoid Receptor Modulator
TPO	Thrombopoietin

REGULATORY TERMS

EMEA	European Agency for the Evaluation of Medicinal Products
FDA	United States Food and Drug Administration

IND	Investigational New Drug Application (United States)
MAA	Marketing Authorization Application (Europe)
NDA	New Drug Application (United States)

* ONTAK, Targretin, and Panretin were acquired by Eisai, Inc. in October 2006 in the sale of the Company s oncology product line.

** AVINZA was acquired by King Pharmaceuticals, Inc. in February 2007 in the sale of the Company s pain product line.

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PART I

Item 1. Business

Caution: This discussion and analysis may contain predictions, estimates and other forward-looking statements that involve a number of risks and uncertainties, including those discussed in Item 1A. Risk Factors. This outlook represents our current judgment on the future direction of our business. These statements include those related to our restructuring process, AVINZA royalty revenues, product returns, product development, our 2005 restatement, and material weaknesses or deficiencies in internal control over financial reporting. Actual events or results may differ materially from Ligand s expectations. For example, there can be no assurance that our recognized revenues or expenses will meet any expectations or follow any trend(s), that our internal control over financial reporting will be effective or produce reliable financial information on a timely basis, or that our restructuring process will be successful or yield preferred results. We cannot assure you that the Company will be able to successfully or timely complete its restructuring, that we will receive expected AVINZA royalties to support our ongoing business, or that our internal or partnered pipeline products will progress in their development, gain marketing approval or success in the market. In addition, the Company s ongoing SEC investigation may have an adverse effect on the Company. Such risks and uncertainties, and others, could cause actual results to differ materially from any future performance suggested. We undertake no obligation to release publicly the results of any revisions to these forward-looking statements to reflect events or circumstances arising after the date of this annual report. This caution is made under the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934 as amended.

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

We were incorporated in Delaware in 1987. Our principal executive offices are located at 10275 Science Center Drive, San Diego, California, 92121. Our telephone number is (858) 550-7500.

Overview

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

In October 2006, we completed the sale of our oncology product line to Eisai Co., LTD (Tokyo) and Eisai Inc. (New Jersey) for approximately $205.0 million. Of this amount, $185.0 million was received in cash and $20.0 million was funded into an escrow account to support any indemnification claims made by Eisai following the closing of the sale. Such cash proceeds are exclusive of transaction fees and costs. The sale included our four marketed oncology drugs: ONTAK, Targretin capsules, Targretin gel and Panretin gel. In addition, certain of our employees were offered employment by Eisai.

In February 2007, we completed the sale of our AVINZA product line to King Pharmaceuticals, Inc (King). We received $280.4 million in net cash proceeds at the closing from King which is net of $15.0 million that was funded into an escrow account to support any indemnification claims made by King following the closing of the sale. The net cash amount represents a purchase price of $246.3 million which includes certain inventory-related adjustments, plus approximately $49.1 million in reimbursement of payments to Organon and others. Such net cash proceeds are exclusive of transaction fees and costs. We have now completed the sale of our commercial businesses, thus allowing us to focus our business strategy on a targeted internal research and development effort. We have what we believe are promising products through our internal development programs, including the potential of LGD-4665, which is currently in clinical development.

We have formed research and development collaborations for our products with numerous global pharmaceutical companies with ongoing clinical programs at GlaxoSmithKline, Wyeth, Pfizer Inc. and TAP Pharmaceutical

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Products, Inc. (TAP). These partnered products are being studied for the treatment of large market indications such as thrombocytopenia, osteoporosis, menopausal symptoms and frailty.

Eltrombopag (Promacta), a small-molecule TPO mimetic, is being developed by GlaxoSmithKline for thrombocytopenia. Eltrombopag (Promacta) advanced to Phase III in February 2006, in patients with Immune Thrombocytopenic Purpura. Additional Phase I and II studies are ongoing in patients with hepatitis C and chemotherapy-induced thrombocytopenia.

Wyeth is developing bazedoxifene (Viviant) as a monotherapy for osteoporosis and Aprela which is bazedoxifene in combination with Wyeth s PREMARIN for osteoporosis prevention, and vasomotor symptoms of menopause. Wyeth filed an NDA for bazedoxifene (Viviant) in June 2006. Another partnered product, lasofoxifene (Oporia), is being developed by Pfizer for osteoporosis and vaginal atrophy. Pfizer filed an NDA with the FDA in August 2004 for the use of lasofoxifene (Oporia) in the prevention of osteoporosis and then filed a supplemental NDA in December 2004 for the use of lasofoxifene (Oporia) in the treatment of vaginal atrophy. In September 2005 and February 2006, respectively, Pfizer announced the receipt of non-approvable letters from the FDA for both indications. However, lasofoxifene (Oporia) continues in Phase III clinical trials by Pfizer for the treatment of osteoporosis.

In June 2005, GlaxoSmithKline commenced Phase I studies of SB-559448, a second product for thrombocytopenia and in April 2005, TAP commenced Phase I studies for LGD-2941 for the treatment of osteoporosis and frailty.

Internal and collaborative research and development programs are built around our proprietary science technology, which is based on our leadership position in gene transcription technology. LGD-4665 as well as our partnered products currently in human development, are modulators of gene transcription, working through key cellular or intracellular receptor targets discovered using our IR technology.

Business Strategy

We aim to create value for shareholders by advancing our internally developed programs through early clinical development and then entering licensing agreements with larger pharmaceutical and biotechnology companies with substantially greater development and commercialization infrastructure. In addition to advancing our R&D programs, we expect to collect licensing and royalties from existing and future license agreements. We aim to build a profitable company by generating income from our corporate licenses. The principal elements of our strategy are:

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

Discover and Develop Targeted Modulators that are Promising Drug Candidates. We discover, synthesize and test numerous compounds to identify those that are most promising for clinical development. We perform extensive target profiling and base our selection of promising development candidates on product characteristics such as initial indications of safety and efficacy. We believe that this focused strategy allows us to eliminate unpromising candidates from consideration sooner without incurring substantial clinical costs.

License Drug Candidates to Other Parties. We generally plan to advance drug candidates through initial and/or early-stage drug development. For larger disease indications requiring complex clinical trials, our strategy is to license drug candidates to pharmaceutical or biotechnology partners for final development and global marketing. We believe partnerships are a good source of development payments, license fees, future event payments and royalties. They also provide considerable benefit regarding late-stage product development, regulatory approval, manufacturing and marketing. We believe that focusing on discovery and early-stage drug development while

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benefiting from our partners proven development and commercialization expertise will reduce our internal expenses and allow us to have a larger number of drug candidates progress to later stages of drug development. However, after establishing a lead product candidate, we are willing to license that candidate during any stage of the development process we determine to be beneficial to the company and to the ultimate development and commercialization of that drug candidate.

Generate Revenue through Partnerships to Fund Our Business and Drive Future Profitability. We have multiple sources of potential license and royalty revenue from existing corporate agreements and we may enter additional partnerships that will provide additional revenue opportunities. In particular, in February 2007, we divested our AVINZA product line to King in exchange for cash and ongoing royalties from product revenues. With the close of that transaction, we expect immediately to begin generating royalty revenue based on King s sales with the product. We have numerous collaborations, including our agreement with GlaxoSmithKline for eltrombopag (Promacta) that has the potential to generate future royalties for Ligand. The revenue generated from these and future potential collaborations will fund our business and potentially provide profits to our shareholders.

General Product Development Process

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

The preclinical phase includes pharmacology and toxicology testing in preclinical models (*in vitro* and *in vivo*), formulation work and manufacturing scale-up to gather necessary data to comply with applicable regulations prior to commencing human clinical trials. Development candidates are lead compounds that have successfully undergone *in vitro* and *in vivo* evaluation to demonstrate that they have an acceptable profile that justifies taking them through preclinical development with the intention of filing an IND and initiating human clinical testing.

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

Ligand Product Development Programs

We are developing several proprietary products for which we have worldwide rights for a variety of cancers, thrombocytopenia and inflammation and hormonal disorders, as summarized in the table below. Our development programs are primarily based on products discovered through our IR technology. See Technology for a discussion of our IR technology.

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Program	Disease/Indication	Development Phase
LGD-4665 (Thrombopoietin oral mimetic)	Idiopathic Thrombocytopenia Purpura; other thrombocytopenias	Phase I
Selective androgen receptor modulators (agonists)	Hypogonadism, osteoporosis, sexual dysfunction, frailty, cachexia	Pre-clinical
Selective glucocorticoid receptor modulators	Inflammation, cancer	Research
Selective androgen receptor modulators (antagonists)	Prostate cancer Research	Research

Thrombopoietin (TPO) Research Programs

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

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

In 1997, we formed a joint research and development alliance with SmithKline Beecham (now GlaxoSmithKline) to focus on the discovery and development of small molecule TPO mimetics. Our partner has two TPO mimetics that were part of our collaboration with them in clinical trials: eltrombopag (Promacta) in Phase II and Phase III trials for multiple indications and SB-559448 in Phase I. For a discussion of these clinical trials, see Collaborative Research and Development Programs Thrombopoietin (TPO) Mimetics Collaborative Program GlaxoSmithKline Collaboration.

After a wash-out period following the termination of the research collaboration with GlaxoSmithKline, each party retained rights to perform research and development of new drugs to control hematopoiesis. This wash-out period ended in February 2003 at which time we began to research and later selected a TPO mimetic, LGD-4665, as a clinical candidate and completed preclinical studies in 2006. We initiated Phase I clinical studies in November 2006. We may pursue the specialty applications emerging from our TPO mimetics internally, but may seek collaborations with major pharmaceutical companies to exploit broader clinical applications.

Selective Androgen Receptor Modulators (SARM) Research and Development Programs

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

prostate cancer, acne, androgenetic alopecia and other diseases. The use of androgen antagonists has shown efficacy in the treatment of prostate cancer, with three androgen antagonists currently approved by the FDA

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for use in the treatment of the disease. However, we believe there is a substantial medical need for improved androgen modulators for use in the treatment of prostate cancer due to the significant side effects seen with currently available drugs.

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

Consistent with this strategy, we formed in 2001 a joint research and development alliance with TAP Pharmaceutical Products to focus on the discovery and development of SARMs. The research component of this collaboration ended in June 2006. TAP continues to develop the lead SARM compound in Phase I. Please see the Selective Androgen Receptor Modulators (SARM) Collaborative Programs section below for more details on this alliance.

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

Selective Glucocorticoid Receptor Modulators (SGRM) Research and Development Program

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

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Collaborative Research and Development Programs

We have several major collaborative programs to further develop the research and development of compounds based on our IR technologies. These collaborations focus on numerous large market indications. As of December 31, 2006, several of our collaborative product candidates were in varying stages of human development. Please see Note 15 of the consolidated financial statements for a description of the financial terms of our key collaboration agreements. The table below summarizes our collaborative research and development programs, but is not intended to be a comprehensive summary of these programs.

LEADING PARTNERED DEVELOPMENT PROGRAMS

Program	Disease/Indication	Development Phase	Marketing Rights
THROMBOPOIETIN (TPO) MIMETICS			
Eltrombopag (Promacta) (TPO agonist)	Thrombocytopenia (Idiopathic Thrombocytopenic Purpura, ITP)	Phase III	GlaxoSmithKline
	Thrombocytopenia (hepatitis C)	Phase II	GlaxoSmithKline
	Thrombocytopenia (Chemotherapy-Induced, CIT)	Phase II	GlaxoSmithKline
	Thrombocytopenia (hepatic, renal, CITs)	Phase I	GlaxoSmithKline
SB-559448 (TPO agonist)	Thrombocytopenia	Phase I	GlaxoSmithKline
SELECTIVE ESTROGEN RECEPTOR MODULATORS (SERMs)			
Bazedoxifene (Viviant)	Osteoporosis	NDA filed	Wyeth
Bazedoxifene CE (Aprela)	Osteoporosis prevention Vasomotor symptoms	Phase III	Wyeth
Lasofoxifene (Oporia)(1)	Osteoporosis prevention, vaginal atrophy	NDA and SNDA filed (1)	Pfizer
	Osteoporosis treatment	Phase III	Pfizer
SELECTIVE ANDROGEN RECEPTOR MODULATORS (SARMs)			
LGD-2941 (androgen agonist)	Osteoporosis, frailty and sexual dysfunction	Phase I	TAP

(1) In September 2005 and February 2006, respectively, Pfizer announced receipt of non-approvable

letters from the FDA for the prevention of osteoporosis and vaginal atrophy. Pfizer also indicated that the NDAs may be resubmitted with additional clinical data.

Thrombopoetin (TPO) Mimetics Collaborative Program

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

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A number of lead molecules have been found that mimic the activity of natural growth factors for white cells and platelets. In 2002, we earned a $2.0 million milestone payment from GlaxoSmithKline, in connection with the commencement of human trials of eltrombopag (Promacta), an oral, small molecule drug that mimics the activity of thrombopoietin, a protein factor that promotes growth and production of blood platelets. In 2005, we announced that we had earned a $1.0 million milestone payment from GlaxoSmithKline with that company s commencement of Phase II trials of eltrombopag (Promacta). In 2005, we earned a $2.0 million milestone payment as SB-559448, a second TPO agonist, began Phase I development. Additionally, in February 2006, we earned a $2.0 million milestone in connection with the commencement of Phase III trials of eltrombopag (Promacta). There are no approved oral TPO mimetic agents for the treatment or prevention of thrombocytopenias (decreased platelet count). Investigational use of injectable forms of recombinant human TPO has been effective in raising platelet levels in cancer patients undergoing chemotherapy, and has led to accelerated hematopoietic recovery when given to stem cell donors. Some of these investigational treatments have not moved forward to registration due to the development of neutralizing antibodies. Thus, a small molecule TPO mimetic with no apparent immunogenic potential and oral activity that may facilitate dosing may provide an attractive therapeutic profile for a major unmet medical need.

The research phase of the GlaxoSmithKline collaboration concluded in February 2001. After a wash-out period following the termination of the research collaboration, each party has rights to perform research and development of new drugs to control hematopoiesis. This wash-out period ended in February 2003 at which time we began to research and later selected a TPO mimetic, LGD-4665, as a clinical candidate and completed preclinical studies in 2006. We initiated Phase I clinical studies in November 2006. In addition, under the collaboration we have the right to select, but have not selected up to three compounds related to hematopoietic targets for development as anti-cancer products other than those compounds selected for development by GlaxoSmithKline. GlaxoSmithKline has the option to co-promote any selected products with us in North America and to develop and market such products outside North America. We may pursue the specialty applications emerging from our TPO mimetics internally, but may seek collaborations with major pharmaceutical companies to exploit broader clinical applications (see Ligand Product Development Programs).

Selective Estrogen Receptor Modulators (SERM) Collaborative Programs

The primary objective of our estrogen receptor modulators collaborative programs is to develop drugs for hormonally responsive cancers, hormone therapies, the treatment and prevention of diseases affecting women s health, and hormonal disorders prevalent in men. Our programs, both collaborative and internal, target development of tissue-selective modulators of the progesterone receptor the estrogen receptor and the androgen receptor. Through our collaborations with Wyeth and Pfizer, three SERM compounds are in development for osteoporosis, vaginal atrophy and vasomotor symptoms of menopause.

Wyeth Collaboration. In 1994, we entered into a research and development collaboration with Wyeth-Ayerst Laboratories (now Wyeth) to discover and develop drugs that interact with estrogen and progesterone receptors for use in hormone therapy, anti-cancer therapy, gynecological diseases and central nervous system disorders associated with menopause and fertility control. We granted Wyeth exclusive worldwide rights to all products discovered in the collaboration that are agonists or antagonists to the progesterone and estrogen receptors for application in the fields of women s health and cancer therapy.

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

In December 2005, the Company entered into an Amended and Restated Agreement with Wyeth to better define, simplify and clarify: the universe of research compounds resulting from the research and development efforts of the parties; combine and clarify categories of those compounds as well as related milestones, royalties and resolve a number of milestone payment issues.

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

In June 2006, Wyeth announced that an NDA for bazedoxifene (Viviant) had been submitted to the FDA. Wyeth is developing bazedoxifene CE (Aprela) as a progesterone-free treatment for menopausal symptoms. Bazedoxifene (Viviant) is a synthetic drug that was specifically designed to increase bone density and reduce cholesterol levels while at the same time protecting breast and uterine tissue.

Pfizer Collaboration. We have a research and development collaboration with Pfizer to develop therapies for osteoporosis. The collaboration produced a drug candidate, lasofoxifene (Oporia), that Pfizer has advanced through late-stage clinical development.

Lasofoxifene (Oporia) is an estrogen partial agonist being developed for osteoporosis prevention and other diseases. Pfizer has retained marketing rights to the drug. We have milestone and royalty rights to lasofoxifene (Oporia). Portions of these royalty rights have been sold to Royalty Pharma AG. See Royalty Pharma Agreement.

In 2004, Pfizer submitted an NDA to the FDA for lasofoxifene (Oporia) for the prevention of osteoporosis in postmenopausal women. We earned a development milestone of approximately $2.0 million from Pfizer in connection with the filing. In September 2005, Pfizer announced the receipt of a non-approvable letter from the FDA for the prevention of osteoporosis. However, lasofoxifene (Oporia) continues in Phase III clinical trials by Pfizer for the treatment of osteoporosis.

In 2004, Pfizer filed a supplemental NDA for the use of lasofoxifene (Oporia) for the treatment of vaginal atrophy for which no additional milestone was due. In February 2006, Pfizer announced the receipt of a non-approval letter from the FDA for this indication.

Selective Androgen Receptor Modulators (SARM) Collaborative Programs

TAP Collaboration. In June 2001, we entered into a joint research and development alliance with TAP Pharmaceutical Products to focus on the discovery and development of SARMs. SARMs may contribute to the prevention and treatment of diseases including sexual dysfunction, osteoporosis and frailty. The three-year collaboration carried an option to extend by up to two additional one-year terms. In December 2004, we announced the second extension of this collaboration for an additional year, which was successfully concluded in June 2006.

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

In addition, we had an option at the expiration of the original three-year term to develop one compound not developed by TAP in its field, with TAP retaining an option to negotiate to co-develop and co-promote such compounds with Ligand. We exercised our option to select one compound and a back-up for development, LGD-3303 and LGD-3129, out of a pool of compounds available for development in the TAP field. TAP retains certain royalty rights and an option to negotiate to co-develop and co-promote such compounds with us up to the end of Phase II development (see Ligand Product Development Programs).

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Metabolic and Cardiovascular Disease Collaborative Programs

We have collaborative partnerships with GlaxoSmithKline and Eli Lilly and Company (Lilly) in the areas of cardiovascular and metabolic diseases. Multiple PPAR modulators have entered clinical development under these partnerships. However, further studies with these compounds are either on hold or have been discontinued.

GlaxoSmithKline Collaboration. In 1992, we entered into a research and development collaboration with Glaxo Wellcome plc (now GlaxoSmithKline) to discover and develop drugs for the prevention or treatment of atherosclerosis and other disorders affecting the cardiovascular system. The research phase was successfully completed in 1997 with the identification of a novel lead structure that activates selected PPAR subfamily members and the identification of a different lead compound that shows activity in preclinical models for lowering LDL cholesterol by up-regulating LDL receptor gene expression in liver cells. We retain the right to develop and commercialize products arising from the collaboration in markets not exploited by GlaxoSmithKline, or where GlaxoSmithKline is not developing a product for the same indication.

In 1999, several PPAR leads were advanced to exploratory development. GW501516 was selected for clinical development and Phase II trials were initiated for cardiovascular disease and dyslipidemia. GW501516 is currently on hold pending the review of preclinical studies.

Eli Lilly Collaboration. In 1997, we entered into a research and development collaboration with Lilly for the discovery and development of products for metabolic disorders. The research phase of the collaboration ended in November 2004.

Lilly selected three PPAR modulators, naveglitazar, LY929 and LY674, for clinical development. Ligand earned milestone payments for IND filings and initiation of Phase II studies. Naveglitazar entered Phase II studies early in 2003, resulting in a $1.5 million milestone payment. In 2004, Lilly announced its decision to move naveglitazar into Phase III registration studies. However, in May 2006, after review of all preclinical and clinical data including two year animal safety studies, Lilly informed us that it had decided not to pursue further development of naveglitazar at this time. This decision was specific with regard to naveglitazar.

In 2002, Lilly filed with the FDA an IND for LY929, a PPAR modulator for the treatment of Type II diabetes, metabolic diseases and dyslipidemias. A third IND was filed with the FDA in November 2002 for LY674, a PPAR modulator for the treatment of atherosclerosis. In July 2005, LY674 entered Phase II studies. In September 2006, Lilly informed us that it had suspended an ongoing mid-stage human trial of LY674 in order to assess unexpected findings noted during animal safety studies of the same compound and evaluate collective clinical efficacy and safety from the human data already gathered.

Royalty Pharma Agreement

In March 2002, we announced an agreement with Royalty Pharma AG, which purchased rights to a share of future royalty payments from our collaborative partners sales of three SERMs then in Phase III development. The SERM products included in the transaction are Oporia, which is being developed for osteoporosis and other indications at Pfizer, bazedoxifene (Viviant) and bazedoxifene CE, PREMARIN combo (Aprela) which are in development at Wyeth for osteoporosis and for vasomotor symptoms of menopause (see the detailed discussions of these products under the Pfizer and Wyeth collaborations above). Since March 2002, and following certain amendments to the original agreement, Royalty Pharma has acquired cumulative rights to 3.0125% of the potential future net sales of the three SERM products for an aggregate of $63.3 million.

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

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Technology

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

Intracellular Receptor Technology

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

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

In 1999, we invested in and exclusively licensed particular IR technology to a new corporation, X-Ceptor Therapeutics, Inc. (X-Ceptor). X-Ceptor was subsequently acquired by Exelixis Inc. in October 2004. Under the 1999 license agreement, we will receive a royalty on net sales of any products that are discovered using the licensed technologies.

Fusion Protein Technology

Our fusion protein technology was developed by Seragen, which we acquired in 1998. Seragen s fusion proteins consist of a fragment of diphtheria toxin genetically fused to a ligand that binds to specific receptors on the surface of target cells. Once bound to the cell, the fusion proteins are designed to enter the cell and destroy the ability of the cell to manufacture proteins, resulting in cell death. Using this platform, Seragen genetically engineered six fusion proteins, each of which consists of a fragment of diphtheria toxin fused to a different targeting ligand, such as a polypeptide hormone or growth factor. Fusion proteins may have utility in oncology, dermatology, infectious diseases and autoimmune diseases.

Academic Collaborations

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

The Salk Institute of Biological Studies. In 1988, we established an exclusive relationship with The Salk Institute, which is one of the research centers in the area of IR technology. We amended and restated this agreement in April 2002. Under our agreement, we have an exclusive, worldwide license to certain IR technology developed in the laboratory of Dr. Ronald Evans, a Salk professor and Howard Hughes Medical Institute Investigator. Dr. Evans

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cloned and characterized the first IR in 1985 and is an inventor of the co-transfection assay we use to screen for IR modulators. Under the agreement, we are obligated to make royalty payments based on sales of certain products developed using the licensed technology, as well as certain minimum annual royalty payments and a percentage of milestones and certain other payments received. The agreement also provides that we have the option of buying out future royalty payments as well as milestone and other payment-sharing obligations on a product-by-product basis by paying the Salk a lump sum calculated using a formula in the agreement. In March 2004, we paid The Salk Institute $1.1 million to exercise this buyout option with respect to lasofoxifene (Oporia), a product under development by Pfizer for the prevention of osteoporosis in postmenopausal women. In December 2004 Pfizer filed a supplemental NDA for the use of lasofoxifene (Oporia) for the treatment of vaginal atrophy. As a result of the supplemental lasofoxifene (Oporia) NDA filing, we exercised an option in January 2005 to pay The Salk Institute $1.1 million to buy out royalty payments due on future sales of the product in this additional indication. See the discussion above regarding Collaborative Research and Development Programs.

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

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

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

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

Manufacturing

We currently have no manufacturing facilities and, accordingly, rely on third parties, including our collaborative partners, for clinical production of any products or compounds.

Quality Assurance

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

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

Commercial

Through September 2006, we promoted AVINZA, our pain product, with approximately 102 sales representatives and our oncology products with approximately 32 sales representatives . On September 7, 2006, we announced the sale of our ONTAK, Targretin capsules, Targretin gel and Panretin products to Eisai, Inc. (Eisai). The Eisai sales transaction subsequently closed on October 25, 2006.

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AVINZA was also co-promoted by Organon Pharmaceuticals USA Inc. (Organon). On January 17, 2006, we signed an agreement with Organon that terminated the AVINZA co-promotion agreement between the two companies and returned AVINZA rights to Ligand. The effective date of the termination agreement is January 1, 2006; however, the parties agreed to continue to cooperate during a transition period that ended September 30, 2006 to promote the product. The transition period co-operation included a minimum number of product sales calls per quarter (100,000 for Organon and 30,000 for Ligand with an aggregate of 375,000 and 90,000, respectively, for the transition period) as well as the transition of ongoing promotions, managed care contracts, clinical trials and key opinion leader relationships to Ligand. During the transition period, we paid Organon an amount equal to 23% of AVINZA net sales as reported by us. We also paid and were responsible for the design and execution of all clinical, advertising and promotion expenses and activities. Additionally, in consideration of the early termination and return of rights under the terms of the agreement, we unconditionally paid Organon $37.8 million in October 2006. We further paid Organon $10.0 million on January 16, 2007. In addition, after the termination, we agreed to make quarterly royalty payments to Organon equal to 6.5% of AVINZA net sales through December 31, 2012 and thereafter 6% through patent expiration, currently anticipated to be November of 2017.

On September 7, 2006 we announced the sale of AVINZA and related assets to King Pharmaceuticals, Inc. (King) and we closed that sale on February 26, 2007. Under the asset purchase agreement with King (the AVINZA Purchase Agreement), King acquired all of our rights in and to AVINZA, assumed certain liabilities, and reimbursed us the $47.8 million paid to Organon. King also assumed our co-promote termination obligation to make payments to Organon based on net sales of AVINZA (approximately $93.3 million as of December 31, 2006). Under the agreement with Organon, we remain liable to Organon in the event of King s default of this royalty obligation.

On September 6, 2006, we entered into a contract sales agreement with King whereby King agreed to perform certain minimum monthly product details (i.e. sales calls) which commenced effective October 1, 2006 and continued until the closing of the AVINZA sales transaction. In connection with the sales call agreement, on January 3, 2007, we executed an amendment to the AVINZA Purchase Agreement with King whereby the parties agreed that King could make offers to the Ligand sales representatives and its regional business managers, such offers to be contingent on the closing. The parties agreed on certain related termination, bonus and severance terms with respect to those employees who did not receive employment offers from King. Accordingly, 23 Ligand sales representatives and regional business managers were informed of their termination and related benefits on December 6, 2006. The termination was effective January 2, 2007. This contract sales agreement terminated with the closing of the AVINZA asset sale to King.

Substantially all of our revenues were attributable to customers in the United States; likewise, substantially all of our long-lived assets are located in the United States. For the year ended December 31, 2006, shipments to three wholesale distributors each accounted for more than 10% of total shipments and in the aggregate represented 79% of total shipments. These wholesale distributors were AmerisourceBergen Corporation, Cardinal Health, Inc. and McKesson Corporation.

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

Research and Development Expenses

Research and development expenses from continuing operations were $41.9 million, $33.1 million and $32.7 million in 2006, 2005 and 2004, respectively, of which approximately 95%, 89% and 76%, respectively, we sponsored, and the remainder of which was funded pursuant to collaborative research and development arrangements.

Research and development expenses from discontinued operations were $12.9 million, $23.0 million and $32.5 million in 2006, 2005 and 2004 respectively.

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Competition

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

Many of our existing or potential competitors, particularly large pharmaceutical companies, have greater financial, technical and human resources than we do and may be better equipped to develop, manufacture and market products. Many of these companies also have extensive experience in preclinical testing and human clinical trials, obtaining FDA and other regulatory approvals and manufacturing and marketing pharmaceutical products. For example, GlaxoSmithKline is developing eltrombopag (Promacta), a TPO mimetic that could compete with our LGD-4665 if both were to be approved for marketing.

Our competitive position also depends upon our ability to attract and retain qualified personnel, obtain patent protection or otherwise develop proprietary products or processes, and secure sufficient capital resources for the often substantial period between technological conception and commercial sales. For a discussion of the risks associated with competition, see below under Item 1A. Risk Factors.

Government Regulation

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

The steps required before a pharmaceutical agent may be marketed in the United States include (1) preclinical laboratory tests, (2) the submission to the FDA of an IND, which must become effective before human clinical trials may commence, (3) adequate and well-controlled human clinical trials to establish the safety and efficacy of the drug, (4) the submission of a NDA to the FDA and (5) the FDA approval of the NDA prior to any commercial sale or shipment of the drug. A company must pay a one-time user fee for NDA submissions, and annually pay user fees for each approved product and manufacturing establishment. In addition to obtaining FDA approval for each product, each domestic drug-manufacturing establishment must be registered with the FDA and, in California, with the Food and Drug Branch of California. Domestic manufacturing establishments are subject to pre-approval inspections by the FDA prior to marketing approval, then to biennial inspections, and must comply with current Good Manufacturing Practices (cGMP). To supply products for use in the United States, foreign manufacturing establishments must comply with cGMP and are subject to periodic inspection by the FDA or by regulatory authorities in such countries under reciprocal agreements with the FDA.

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

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

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We are also increasingly subject to regulation by the states. A number of states now regulate, for example, pharmaceutical marketing practices and the reporting of marketing activities, controlled substances, clinical trials and general commercial practices. We have developed and are developing a number of policies and procedures to ensure our compliance with these state laws, in addition to the federal regulations described above. Significant resources are now required on an ongoing basis to ensure such compliance. For a discussion of the risks associated with government regulations, see below under Item 1A. Risk Factors.

Patents and Proprietary Rights

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

As of December 31, 2006, we have filed or participated as licensee in the filing of approximately 37 currently pending patent applications in the United States relating to our technology, as well as foreign counterparts of certain of these applications in multiple countries. In addition, we own or have licensed rights covered by approximately 260 patents issued or applications, granted or allowed worldwide, including United States patents and foreign counterparts to United States patents. Except for a few patents and applications that are not material to our commercial success, these patents and applications will expire between 2008 and 2023. Starting in 2007, we receive royalties from King Pharmaceuticals Inc. on AVINZA representing substantially all of our ongoing revenue. AVINZA is expected to have patent protection in the United States until November 2017. Subject to compliance with the terms of the respective agreements, our rights under our licenses with our exclusive licensors extend for the life of the patents covering such developments. For a discussion of the risks associated with patent and proprietary rights, see below under Item 1A. Risk Factors.

Human Resources

As of March 12, 2007, we had 122 full-time employees including 37 employees who will be supporting the Company providing transitional services for various time periods throughout 2007, following the restructuring announced in January 2007. Following the termination of the transitional employees, we expect to have approximately 85 full time employees of whom 55 will be involved directly in scientific research and development activities. Of these employees, 32 hold Ph.D. or M.D. degrees.

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ITEM 1A. RISK FACTORS

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

Risks Related To Us and Our Business.

Failure to timely or successfully restructure our business could have adverse consequences for the Company.

We completed the sale of our commercial businesses in February 2007. In connection with these sales we are also restructuring our remaining businesses, principally our research and development. We will also be consolidating our staff and facilities. If we are unable to successfully and timely complete this restructuring, our remaining assets could lose value, we may not be able to retain key employees, we may not have sufficient resources to successfully manage those assets or our business, and we may not be able to perform our obligations under various contracts and commitments. Any of these could have substantial negative impacts on our business and our stock price.

We are substantially dependent on AVINZA royalties for our revenues.

We recently completed the sale of our two commercial product lines, oncology and pain, which in recent years provided substantially all of our continuing revenue. In each sale we received a one-time upfront cash payment. The consideration for the sale of the pain (AVINZA) franchise also included royalties that we will receive in the future from sales of AVINZA by King Pharmaceuticals, Inc., who acquired the AVINZA rights from us. These consist of a 15% royalty on AVINZA sales for the first 20 months, and then royalty payments ranging from 5-15% of AVINZA sales, depending on the level of total annual sales. These royalties represent and will represent substantially all of our ongoing revenue for the foreseeable future. Although we may also receive royalties and milestones from our partners in various past and future collaborations, the amount of revenue from these royalties and milestones is unknown and highly uncertain.

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

AVINZA was licensed from Elan Corporation which is its sole manufacturer. Any problems with Elan s manufacturing operations or capacity could reduce sales of AVINZA, as could any licensing or other contract disputes with Elan, raw materials suppliers, or others.

Similarly, King s AVINZA sales efforts could be affected by a number of factors and decisions regarding its organization, operations, and activities as well as events both related and unrelated to AVINZA. Historically, AVINZA sales efforts, including our own and our prior co-promotion partners, have encountered a number of difficulties, uncertainties and challenges, including sales force reorganizations and lower than expected sales call and prescription volumes, which have hurt and could continue to hurt AVINZA sales growth. AVINZA could also face stiffer competition from existing or future pain products. The negative impact on the product s sales growth in turn may cause our royalties, revenues and earnings to be disappointing.

AVINZA sales also may be susceptible to higher than expected discounts (especially PBM/GPO rebates and Medicaid rebates, which can be substantial), returns and chargebacks and/or slower than expected market penetration that could reduce sales. Other setbacks that AVINZA could face in the sustained-release opioid market include product safety and abuse issues, regulatory action, intellectual property disputes and the inability to obtain sufficient quotas of morphine from the Drug Enforcement Agency (DEA) to support production requirements.

In particular, with respect to regulatory action and product safety issues, the FDA previously requested expanded warnings on the AVINZA label to alert doctors and patients to the dangers of using AVINZA with alcohol.

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Changes were made to the label, however, the FDA also requested clinical studies to investigate the risks associated with taking AVINZA with alcohol. Any additional warnings, studies and any further regulatory action could have significant adverse effects on AVINZA sales.

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

Under our agreements to sell our commercial businesses, we remain financially responsible for returns of our products sold before those businesses were transferred to their respective buyers. Thus if returns of those products are higher than expected, we could incur substantial expenses for processing and issuing refunds for those returns which, in turn, could hurt our operating results. The amount of returns could be affected by a number of factors including ongoing product demand, product rotation at distributors and wholesalers, and product stability issues.

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

We have not paid any cash dividends on our common stock to date. In general, we intend to retain any earnings to support the expansion of our business. We have announced that our Board of Directors is considering a special dividend of a substantial portion of the net proceeds from our product line asset sales. However, other than this special dividend, we do not anticipate paying cash dividends on any of our securities in the foreseeable future. The Board has not determined the amount of any such special dividend, and the amount available for such a dividend depends on a number of factors including our capital surplus, cash on hand and estimated cash needs for our continuing business. In addition, such a special dividend would reduce our assets and could reduce our stock price by a proportional amount. Because the amount of any special dividend and the amount of any associated stock price reduction are both unknown, the investment return from such a dividend is speculative. Thus, any returns you receive from our stock will be highly dependent on increases in the market price for our securities, if any. The price for our common stock has been highly volatile and may decrease.

We will have continuing obligations to indemnify the buyers of our commercial businesses, and may be subject to other liabilities as a result of the sale of our commercial product lines.

In connection with the sale of our AVINZA product line, we have agreed to indemnify King for a period of 16 months after the closing for a number of specified matters including the breach of our representations, warranties and covenants contained in the asset purchase agreement, and in some cases for a period of 30 months following the closing of the asset sale. In addition, we have agreed to indemnify Eisai, the purchaser of our oncology product line, after the closing of the asset sale, for damages suffered by Eisai arising for any breach of any of the representations, warranties, covenants or obligations we have made in the asset purchase agreement. Our obligation to indemnify Eisai survives the closing in some cases up to 18 or 36 months following the closing, and in other cases, until the expiration of the applicable statute of limitations. In a few instances, our obligation to indemnify Eisai survives in perpetuity. Under our agreement with King, $15 million of the total upfront cash payment was deposited into an escrow account to secure our indemnification obligations to King following the closing. Similarly, our agreement with Eisai required that $20 million of the total upfront cash payment be deposited into an escrow account to secure our indemnification obligations to Eisai after the closing.

Our indemnification obligations under the asset purchase agreements could cause us to be liable to King or Eisai under certain circumstances, in excess of the amounts set forth in the escrow accounts. The AVINZA asset purchase agreement also allows King, under certain circumstances, to set off indemnification claims against the royalty payments payable to us. Under the asset purchase agreements, our liability for any indemnification claim brought by King and Eisai is generally limited to $40 million and $30 million, respectively. However, our obligation to provide indemnification on certain matters is not subject to these indemnification limits. For example, we agreed to retain, and provide indemnification without limitation to King for, all liabilities arising under certain agreements with Cardinal Health PTS, LLC related to the manufacture of AVINZA. Similarly, we agreed to retain, and provide indemnification without limitation to Eisai for, all liabilities related to certain claims regarding promotional materials for the ONTAK and Targretin drug products. We cannot predict the liabilities that may arise as a result of these matters. Any liability claims related to these matters or any indemnification claims made by King or Eisai could materially and adversely affect our financial condition.

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We may also be subject to other liabilities related to the products we recently sold. For example, we received a letter in March 2007 from counsel to the Salk Institute for Biological Studies alleging that we owe The Salk Institute royalties on prior sales of Targretin as well as a percentage of the amounts received from Eisai. Salk alleges that they are owed at least 25% of the consideration paid by Eisai for that portion of our oncology product line and associated assets attributable to Targretin. Any successful claim brought against us could cause our stock price to fall and could decrease our cash or otherwise adversely affect our business.

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

We were founded in 1987. We have incurred significant losses since our inception. At December 31, 2006, our accumulated deficit was approximately $862.8 million. We began generating commercial product revenues in 1999; however, we completed the sale of all of our commercial products in February 2007 and are now focused on our product development pipeline.

Most of our products in development will require extensive additional development, including preclinical testing and human studies, as well as regulatory approvals, before we can market them. We cannot predict if or when any of the products we are developing or those being developed with our partners will be approved for marketing. For example, lasofoxifene (Oporia), a partner product being developed by Pfizer received a non-approvable decision from the FDA. There are many reasons why we or our collaborative partners may fail in our efforts to develop our other potential products, including the possibility that:

- preclinical testing or human studies may show that our potential products are ineffective or cause harmful side effects;
- the products may fail to receive necessary regulatory approvals from the FDA or foreign authorities in a timely manner, or at all;
- the products, if approved, may not be produced in commercial quantities or at reasonable costs;
- the products, if approved, may not achieve commercial acceptance;
- regulatory or governmental authorities may apply restrictions to our products, which could adversely affect their commercial success; or
- the proprietary rights of other parties may prevent us or our partners from marketing the products.

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

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

Our drug development programs require substantial additional capital to successfully complete them, arising from costs to:

- conduct research, preclinical testing and human studies;
- establish pilot scale and commercial scale manufacturing processes and facilities; and
- establish and develop quality control, regulatory, marketing, sales and administrative capabilities to support these programs.

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Our future operating and capital needs will depend on many factors, including:

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

We currently estimate our research and development expenditures over the next three years to range between $110 million and $135 million. However, we base our outlook regarding the need for funds on many uncertain variables. Such uncertainties include regulatory approvals, the timing of events outside our direct control such as product launches by partners and the success of such product launches, negotiations with potential strategic partners, possible sale of assets or other transactions and other factors. Any of these uncertain events can significantly change our cash requirements.

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

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

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

The rate at which we complete our clinical trials depends on many factors, including our ability to obtain adequate supplies of the products to be tested and patient enrollment. Patient enrollment is a function of many factors, including the size of the patient population, the proximity of patients to clinical sites and the eligibility criteria for the trial. Delays in patient enrollment for our trials may result in increased costs and longer development times. In addition, our collaborative partners have rights to control product development and clinical programs for products developed under the collaborations. As a result, these collaborators may conduct these programs more

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slowly or in a different manner than we had expected. Even if clinical trials are completed, we or our collaborative partners still may not apply for FDA approval in a timely manner or the FDA still may not grant approval.

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

We determined that our consolidated financial statements for the years ended December 31, 2002 and 2003, and for the first three quarters of 2004, as described in more detail in our 2004 Annual Report on Form 10-K, should be restated. As a result of these events, we have become subject to a number of additional risks and uncertainties, including:

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

The SEC has instituted a formal investigation of the Company s restated consolidated financial statements identified above. This investigation will likely divert more of our management s time and attention and cause us to incur substantial costs. Such investigations can also lead to fines or injunctions or orders with respect to future activities, as well as further substantial costs and diversion of management time and attention.

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

As disclosed in the Company s 2005 Annual Report on Form 10-K, management s assessment of the Company s internal control over financial reporting identified material weaknesses in the Company s internal controls surrounding (i) the accounting for revenue recognition; (ii) record keeping and documentation; (iii) accounting personnel; (iv) financial statement close procedures; (v) the inability of the Company to maintain an effective independent Internal Audit Department; (vi) the existence of ineffective spreadsheet controls used in connection with the Company s financial processes, including review, testing, access and integrity controls; (vii) the existence of accounting system access rights granted to certain members of the Company s accounting and finance department that are incompatible with the current roles and duties of such individuals (i.e., segregation of duties); and (viii) the inability of management to properly maintain the Company s documentation of the internal control over financial reporting during 2005 or to substantively commence the process to update such documentation and assessment until December 2005. As of December 31, 2006, these material weaknesses have been fully remediated.

While no material weaknesses were identified as of December 31, 2006, we cannot assure you that material weaknesses will not be identified in future periods. The existence of one or more material weakness or significant deficiency could result in errors in our consolidated financial statements, and substantial costs and resources may be required to rectify any internal control deficiencies. If we fail to achieve and maintain the adequacy of our internal controls in accordance with applicable standards, we may be unable to conclude on an ongoing basis that we have effective internal controls over financial reporting. If we cannot produce reliable financial reports, our business and financial condition could be harmed, investors could lose confidence in our reported financial information, or the market price of our stock could decline significantly. In addition, our ability to obtain additional financing to operate and expand our business, or obtain additional financing on favorable terms, could be materially and adversely affected, which, in turn, could materially and adversely affect our business, our financial condition and the market value of our securities. Also, perceptions of us could also be adversely affected among customers, lenders, investors, securities analysts and others. Any future weaknesses or deficiencies could also hurt our ability to do business with these groups.

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

We have incurred losses since our inception and may not generate positive cash flow to fund our operations for one or more years. As a result, we may need to complete additional equity or debt financings to fund our operations. Our inability to obtain additional financing could adversely affect our business. Financings may not be available at all or on favorable terms. In addition, these financings, if completed, still may not meet our capital needs and could

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result in substantial dilution to our stockholders. For instance, in April 2002 and September 2003 we issued an aggregate of 7.7 million shares of our common stock in private placement offerings. In addition, in November 2002 we issued in a private placement $155.3 million in aggregate principal amount of our 6% convertible subordinated notes due 2007, that converted into approximately 25.1 million shares of our common stock. The conversion of all of the notes was completed in November 2006.

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

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

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

In addition, our collaborators may develop drugs, either alone or with others, that compete with the types of drugs they currently are developing with us. This would result in less support and increased competition for our programs. If products are approved for marketing under our collaborative programs, any revenues we receive will depend on the manufacturing, marketing and sales efforts of our collaborators, who generally retain commercialization rights under the collaborative agreements. Our current collaborators also generally have the right to terminate their collaborations under specified circumstances. If any of our collaborative partners breach or terminate their agreements with us or otherwise fail to conduct their collaborative activities successfully, our product development under these agreements will be delayed or terminated.

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

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

Our success will depend on our ability and the ability of our licensors to obtain and maintain patents and proprietary rights for our potential products and to avoid infringing the proprietary rights of others, both in the United States and in foreign countries. Patents may not be issued from any of these applications currently on file, or, if issued, may not provide sufficient protection. In addition, disputes with licensors under our license agreements may arise which could result in additional financial liability or loss of important technology and potential products and related revenue, if any.

Our patent position, like that of many biotech and pharmaceutical companies, is uncertain and involves complex legal and technical questions for which important legal principles are unresolved. We may not develop or obtain rights to products or processes that are patentable. Even if we do obtain patents, they may not adequately protect the technology we own or have licensed. In addition, others may challenge, seek to invalidate, infringe or circumvent any patents we own or license, and rights we receive under those patents may not provide competitive advantages to us. Further, the manufacture, use or sale of our products may infringe the patent rights of others.

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Several drug companies and research and academic institutions have developed technologies, filed patent applications or received patents for technologies that may be related to our business. Others have filed patent applications and received patents that conflict with patents or patent applications we have licensed for our use, either by claiming the same methods or compounds or by claiming methods or compounds that could dominate those licensed to us. In addition, we may not be aware of all patents or patent applications that may impact our ability to make, use or sell any of our potential products. For example, US patent applications may be kept confidential while pending in the Patent and Trademark Office and patent applications filed in foreign countries are often first published six months or more after filing. Any conflicts resulting from the patent rights of others could significantly reduce the coverage of our patents and limit our ability to obtain meaningful patent protection. While we routinely receive communications or have conversations with the owners of other patents, none of these third parties have directly threatened an action or claim against us. If other companies obtain patents with conflicting claims, we may be required to obtain licenses to those patents or to develop or obtain alternative technology. We may not be able to obtain any such licenses on acceptable terms, or at all. Any failure to obtain such licenses could delay or prevent us from pursuing the development or commercialization of our potential products.

We have had and will continue to have discussions with our current and potential collaborators regarding the scope and validity of our patents and other proprietary rights. If a collaborator or other party successfully establishes that our patent rights are invalid, we may not be able to continue our existing collaborations beyond their expiration. Any determination that our patent rights are invalid also could encourage our collaborators to terminate their agreements where contractually permitted. Such a determination could also adversely affect our ability to enter into new collaborations.

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

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

Our legacy commercial businesses exposes us to product liability risks and we may not have sufficient insurance to cover any claims.

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

In addition, some of the compounds we are investigating may be harmful to humans. For example, retinoids as a class are known to contain compounds which can cause birth defects. We may not be able to maintain our insurance on acceptable terms, or our insurance may not provide adequate protection in the case of a product liability claim. To the extent that product liability insurance, if available, does not cover potential claims, we will be required to self-insure the risks associated with such claims. We believe that we carry reasonably adequate insurance for product liability claims.

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

In connection with our research and development activities, we handle hazardous materials, chemicals and various radioactive compounds. To properly dispose of these hazardous materials in compliance with environmental

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regulations, we are required to contract with third parties at substantial cost to us. Our annual cost of compliance with these regulations is approximately $0.7 million. We cannot completely eliminate the risk of accidental contamination or injury from the handling and disposing of hazardous materials, whether by us or by our third-party contractors. In the event of any accident, we could be held liable for any damages that result, which could be significant. We believe that we carry reasonably adequate insurance for toxic tort claims.

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

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We currently lease and occupy office and laboratory facilities in San Diego, California. These include a 52,800 square foot facility leased through July 2015 and an 82,500 square foot facility leased through November 2021, which is a building we previously owned and sold and leased back on November 9, 2006 (see note 21). We expect to consolidate our ongoing operations into the 82,500 square foot facility in 2007 and believe that this location will be adequate to meet our near-term space requirements. Following this consolidation, we plan to sub-lease the 52,800 square foot facility.

Item 3. Legal Proceedings

Securities Litigation

The Company was involved in several securities class action and shareholder derivative actions which followed announcements by the Company in 2004 and the subsequent restatement of its financial results in 2005. In June 2006, we announced that these lawsuits had been settled, subject to certain conditions such as court approval.

Background

Beginning in August 2004, several purported class action stockholder lawsuits were filed in the United States District Court for the Southern District of California against the Company and certain of its directors and officers. The actions were brought on behalf of purchasers of the Company s common stock during several time periods, the longest of which runs from July 28, 2003 through August 2, 2004. The complaints generally alleged that the Company violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission by making false and misleading statements, or concealing information about the Company s business, forecasts and financial performance, in particular statements and information related to drug development issues and AVINZA inventory levels. These lawsuits were consolidated and lead plaintiffs appointed. A consolidated complaint was filed by the plaintiffs in March 2005. On September 27, 2005, the court granted the Company s motion to dismiss the consolidated complaint, with leave for plaintiffs to file an amended complaint within 30 days. In December 2005, the plaintiffs filed a second amended complaint again alleging claims under Section 10(b) and 20(a) of the Securities Exchange Act against the Company, David Robinson and Paul Maier. The amended complaint also asserted an expanded Class Period of March 19, 2001 through May 20, 2005 and included allegations arising from the Company s announcement on May 20, 2005 that it would restate certain financial results.

Beginning on or about August 13, 2004, several derivative actions were filed on behalf of the Company by individual stockholders in the Superior Court of California. The complaints named the Company s directors and

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certain of its officers as defendants and named the Company as a nominal defendant. The complaints were based on the same facts and circumstances as the purported class actions discussed in the previous paragraph and generally alleged breach of fiduciary duties, abuse of control, waste and mismanagement, insider trading and unjust enrichment.

In October 2005, a shareholder derivative action was filed on behalf of the Company in the United States District Court for the Southern District of California. The complaint named the Company s directors and certain of its officers as defendants and the Company as a nominal defendant. The action was brought by an individual stockholder. The complaint generally alleged that the defendants falsified Ligand s publicly reported financial results throughout 2002 and 2003 and the first three quarters of 2004 by improperly recognizing revenue on product sales. The complaint also alleged breach of fiduciary duty by all defendants and requested disgorgement, e.g., under Section 304 of the Sarbanes-Oxley Act of 2002.

The Settlement Agreements

In June 2006, the Company entered into agreements to resolve all claims by the parties in each of these matters, including those asserted against the Company and the individual defendants in these cases. Under the agreements, the Company agreed to pay a total of $12.2 million in cash for a release and in full settlement of all claims. $12.0 million of the settlement amount and a portion of our total legal expenses were funded by our Directors and Officers Liability insurance carrier while the remainder of the legal fees incurred ($1.4 million for 2006) was paid by us. Of the $12.2 million settlement liability, $4.0 million was paid in October 2006 to us directly from the insurance carrier and then disbursed to the claimants attorneys, while $8.0 million was paid in July 2006 by the insurance carrier directly to an independent escrow agent responsible for disbursing the funds to the class action suit claimants. As part of the settlement of the state derivative action, we have agreed to adopt certain corporate governance enhancements including the formalization of certain Board practices and responsibilities, a Board self-evaluation process, Board and Board Committee term limits (with gradual phase-in) and one-time enhanced independent requirements for a single director to succeed the current shareholder representatives on the Board. Neither we nor any of our current or former directors and officers has made any admission of liability or wrongdoing. On October 12, 2006, the Superior Court of California approved the settlement of the state and federal derivative actions and entered final judgment of dismissal. The United States District Court approved the settlement of the Federal class action in October 2006.

SEC Investigation and Other Matters

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

The Company s subsidiary, Seragen, Inc. and Ligand, were named parties to *Sergio M. Oliver, et al. v. Boston University, et al.*, a shareholder class action filed on December 17, 1998 in the Court of Chancery in the State of Delaware in and for New Castle County, C.A. No. 16570NC, by Sergio M. Oliver and others against Boston University and others, including Seragen, its subsidiary Seragen Technology, Inc. and former officers and directors of Seragen. The complaint, as amended, alleged that Ligand aided and abetted purported breaches of fiduciary duty by the Seragen related defendants in connection with the acquisition of Seragen by Ligand and made certain misrepresentations in related proxy materials and seeks compensatory and punitive damages of an unspecified amount. On July 25, 2000, the Delaware Chancery Court granted in part and denied in part defendants motions to dismiss. Seragen, Ligand, Seragen Technology, Inc. and the Company s acquisition subsidiary, Knight Acquisition Corporation, were dismissed from the action. Claims of breach of fiduciary duty remain against the remaining defendants, including the former officers and directors of Seragen. The court certified a class consisting of shareholders as of the date of the acquisition and on the date of the proxy sent to ratify an earlier business unit sale by Seragen. On January 20, 2005, the Delaware Chancery Court granted in part and denied in part the defendants motion for summary judgment. Prior to trial, several of the Seragen director-defendants reached a settlement with the plaintiffs. The trial in this action then went forward as to the remaining defendants and concluded on

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February 18, 2005. On April 14, 2006, the court issued a memorandum opinion finding for the plaintiffs and against Boston University and individual directors affiliated with Boston University on certain claims. The opinion awards damages on these claims in the amount of approximately $4.8 million plus interest. Judgment, however, has not been entered and the matter is subject to appeal. While Ligand and its subsidiary Seragen have been dismissed from the action, such dismissal is also subject to appeal and Ligand and Seragen may have possible indemnification obligations with respect to certain defendants. As of December 31, 2006, the Company has not accrued an indemnification obligation based on its assessment that the Company s responsibility for any such obligation is not probable or estimable.

The Company also received a letter in March 2007 from counsel to The Salk Institute for Biological Studies alleging the Company owes The Salk Institute royalties on prior product sales of Targretin as well as a percentage of the amounts received from Eisai Co., Ltd. (Tokyo) and Eisai inc. (New Jersey) in the asset sale transaction completed with Eisai in October 2006. Salk alleges that they are owed at least 25% of the consideration paid by Eisai for that portion of the Company s oncology product line and associated assets attributable to Targretin. The Company intends to vigorously oppose any claim that Salk may bring for payment related to these matters.

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

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders in the fourth quarter ended December 31, 2006.

Executive Officers of the Registrant

The names of the executive officers of the Company and their ages, titles and biographies as of March 1, 2007 are set forth below.

John L. Higgins, 36, joined Ligand in January 2007 as President and Chief Executive Officer and he was also appointed to the Board in March 2007. Prior to joining Ligand, Mr. Higgins served as Chief Financial Officer at Connetics Corporation, a specialty pharmaceutical company, since 1997, and also served as Executive Vice President, Finance and Administration and Corporate Development at Connetics since January 2002 until its acquisition by Stiefel Laboratories, Inc. in December 2006. Before joining Connetics, he was a member of the executive management team at BioCryst Pharmaceuticals, Inc., a biopharmaceutical company. Before joining BioCryst in 1994, Mr. Higgins was a member of the healthcare banking team of Dillon, Read & Co. Inc., an investment banking firm. Mr. Higgins is a Director of BioCryst and serves as chairperson of its Audit Committee. He received his A.B. from Colgate University.

Martin D. Meglasson, Ph.D., 56, joined the Company in February 2004 as Vice President, Discovery Research. Prior to joining the Company, Dr. Meglasson was Director of Preclinical Pharmacology and the functional leader for research into urology, sexual dysfunction, and neurological diseases at Pharmacia, Inc. from 1998 to 2003. From 1996 to 1998, Dr. Meglasson served as Director of Endocrine and Metabolic Research and functional leader for diabetes and obesity research at Pharmacia & Upjohn. From 1988 to 1996, he was a researcher in the fields of diabetes and obesity at The Upjohn Co. and Assistant Professor, then Adjunct Associate Professor of Pharmacology at the University of Pennsylvania School of Medicine. Dr. Meglasson received his Ph.D. in pharmacology from the University of Houston.

Tod G. Mertes, CPA, 42, joined Ligand in May 2001 as Director of Finance, was elected Vice President, Controller and Treasurer of the Company in May 2003, and was named Interim Chief Financial Officer in January 2007. Prior to joining Ligand, Mr. Mertes was Chief Financial Officer at Combio Corporation and prior to Combio spent 12 years with PricewaterhouseCoopers in San Diego, California and Paris, France, most recently as an audit senior manager. Mr. Mertes is a Certified Public Accountant and received a B.S. in business administration from California Polytechnic State University at San Luis Obispo.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

(a) Market Information

Prior to September 7, 2005, our common stock was traded on the NASDAQ National Market tier of the NASDAQ Stock Market under the symbols LGND and LGNDE. Our common stock was delisted from the NASDAQ National Market on September 7, 2005. Our common stock was quoted on the Pink Sheets under the symbol LGND from September 7, 2005 through June 13, 2006. Our common stock was relisted on the NASDAQ Global Market (formerly NASDAQ National Market) on June 14, 2006 under the symbol LGND .

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

	Price Range	
	High	**Low**
Year Ended December 31, 2006:		
1st Quarter	$13.70	$11.16
2nd Quarter	14.00	8.35
3rd Quarter	10.74	7.78
4th Quarter	11.89	9.61
Year Ended December 31, 2005:		
1st Quarter	$11.20	$ 4.98
2nd Quarter	7.00	4.75
3rd Quarter	10.14	6.86
4th Quarter	11.65	7.95

As of March 14, 2007, the closing price of our common stock on the NASDAQ Global Market was $10.72.

(b) Holders

As of February 28, 2007, there were approximately 1,571 holders of record of the common stock.

(c) Dividends

We have never declared or paid any cash dividends on our capital stock. We have previously announced that our Board of Directors is considering a special cash dividend in connection with our recent asset sales, but no decision has yet been made regarding such dividend. The Board has not determined the amount of any such special dividend, and the amount available for such a dividend depends on a number of factors including our capital surplus, cash on hand and estimated cash needs for our continuing business. Aside from the consideration of this special one-time dividend, we do not intend to pay any cash dividends in the foreseeable future. We currently intend to retain future earnings, if any, to finance future growth.

(d) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Not applicable.

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(e) Performance Graph

The graph below shows the five-year cumulative total stockholder return assuming the investment of $100 and the reinvestment of dividends, although dividends have not been declared on the common stock, and is based on the returns of the component companies weighted monthly according to their market capitalizations. The graph compares total stockholder returns of the Company s common stock, of all companies traded on the NASDAQ Stock market, as represented by the NASDAQ Composite® Index, and of the NASDAQ Pharmaceutical Stocks, as prepared by the Center for Research in Security Prices (CRSP) at the University of Chicago. The NASDAQ Pharmaceutical Stocks tracks approximately 250 domestic pharmaceutical stocks within SIC Code 2834.

On September 7, 2005, the Company was delisted from the NASDAQ National Market and was quoted on the Pink Sheets from September 7, 2005 through June 13, 2006. The Company s common stock was relisted on the NASDAQ Global Market (formerly National Market) on June 14, 2006.

The stockholder return shown on the graph below is not necessarily indicative of future performance and the Company will not make or endorse any predictions as to future stockholder returns.

PERFORMANCE GRAPH

COMPARISON OF CUMULATIVE TOTAL RETURN*

* Assumes $100 investment in Company s common stock on December 31, 2001.

	12/31/01	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06
Ligand	100%	30.0%	80.4%	65.0%	62.3%	61.2%
NASDAQ Composite	100%	68.4%	102.7%	111.5%	113.1%	123.8%
NASDAQ Pharmaceutical Stocks	100%	64.6%	94.7%	100.9%	111.1%	108.8%

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Item 6. Selected Consolidated Financial Data

The following selected historical consolidated financial and other data are qualified by reference to, and should be read in conjunction with, our consolidated financial statements and the related notes thereto appearing elsewhere herein and Management s Discussion and Analysis of Financial Condition and Results of Operations. Our selected statement of operations data set forth below for each of the five years ended December 31, 2006, 2005, 2004, 2003 and 2002 and the balance sheet data as of December 31, 2006, 2005, 2004, 2003 and 2002 (unaudited) are derived from our consolidated financial statements.

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	Years Ended December 31,				
	2006 (6)	**2005**	**2004**	**2003**	**2002**
	(in thousands, except share data)				
Consolidated Statement of Operations Data:					
Product sales (1)	$ 136,983	$ 112,793	$ 69,470	$ 16,482	$ 1,114
Sale of royalty rights, net (2)			31,342	11,786	17,600
Collaborative research and development and other revenues	3,977	10,217	11,300	13,698	23,533
Cost of products sold (1)	22,642	23,090	18,264	12,383	2,579
Research and development expenses	41,926	33,096	32,720	29,649	37,109
Selling, general and administrative expenses	79,748	56,168	46,431	34,776	18,645
Co-promotion expense (3)	37,455	32,501	30,077	9,360	
Co-promote termination charges (3)	131,078				
Gain on sale leaseback	3,119				
Loss from operations	(168,770)	(21,845)	(15,380)	(44,202)	(16,086)
Loss from continuing operations	(135,859)	(31,470)	(22,764)	(64,474)	(24,445)
Discontinued operations (4)	104,116	(4,929)	(22,377)	(29,992)	(27,812)
Cumulative effect of changing method of accounting for variable interest entity (5)				(2,005)	
Net loss	(31,743)	(36,399)	(45,141)	(96,471)	(52,257)
Basic and diluted per share amounts:					
Loss from continuing operations	$ (1.69)	$ (0.43)	$ (0.31)	$ (0.91)	$ (0.35)
Discontinued operations (4)	1.30	(0.06)	(0.30)	(0.42)	(0.41)
Cumulative effect of changing method of accounting for variable interest entity (5)				(0.03)	
Net loss	$ (0.39)	$ (0.49)	$ (0.61)	$ (1.36)	$ (0.76)
Weighted average number of common shares	80,618,528	74,019,501	73,692,987	70,685,234	69,118,976
Pro forma amounts assuming the changed method of accounting for variable interest entity is applied retroactively (5)					
Loss from continuing operations				$ (64,360)	$ (24,644)

Loss from discontinued operations	(29,992)	(27,812)
Net loss	$ (94,352)	$ (52,456)
Basic and diluted loss from continuing operations per share	$ (0.91)	$ (0.36)
Basic and diluted loss from discontinued operations per share	(0.42)	(0.40)
Basic and diluted net loss per share	$ (1.33)	$ (0.76)

	2006	2005	December 31, 2004 (in thousands)	2003	2002 (Unaudited)
Consolidated Balance Sheet Data:					
Cash, cash equivalents, short-term investments and restricted cash and investments	$ 212,488	$ 88,756	$ 114,870	$ 100,690	$ 74,894
Working capital (deficit) (7)	64,747	(102,244)	(48,505)	(16,930)	18,370
Total assets	326,053	314,619	332,466	314,046	287,709
Current portion of deferred revenue, net	57,981	157,519	152,528	105,719	48,609
Current portion of deferred gain	1,964				
Long-term obligations (excludes long-term portions of deferred revenue, net and deferred gain)	85,780	173,280	174,214	173,851	162,329
Long-term portion of deferred revenue, net	2,546	4,202	4,512	3,448	3,595
Long-term portion of deferred gain	27,220				
Common stock subject to conditional redemption/repurchase	12,345	12,345	12,345	14,595	34,595
Accumulated deficit	(862,802)	(831,059)	(794,660)	(749,519)	(653,048)
Total stockholders equity (deficit)	27,352	(110,419)	(75,317)	(37,554)	8,925

(footnotes on next page)

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(1) AVINZA was approved by the FDA in March 2002 and subsequently launched in the U.S. in June 2002.

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

(3) Represents expense related to our AVINZA co-promotion agreement with Organon Pharmaceuticals USA, Inc. (Organon) entered into in February 2003. See Note 8 to our consolidated financial statements included elsewhere in this annual report. On January 17, 2006, we signed an agreement with Organon that terminated the AVINZA® co-promotion agreement between the two companies and

returned AVINZA rights to us. The termination was effective as of January 1, 2006; however, the parties agreed to continue to cooperate during a transition period ended September 30, 2006 to promote the product. See Management s Discussion and Analysis of Financial Condition and Results of Operations Overview and Business Overview.

(4) On September 7, 2006, we announced the sale of ONTAK, Targretin capsules, Targretin gel, and Panretin to Eisai, Inc. This transaction subsequently closed on October 25, 2006. Accordingly, the results for the Oncology product line have been presented in our consolidated statements of operations as Discontinued Operations . See Note 3 to our

consolidated financial statements included elsewhere in this annual report.

(5) In December 2003, we adopted Financial Accounting Standard Board Interpretation No. 46 (revised December 2003) (FIN46(R)), *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51*. Under FIN 46(R), we were required to consolidate the variable interest entity from which we leased our corporate headquarters. Accordingly, as of December 31, 2003, we consolidated assets with a carrying value of $13.6 million, debt of $12.5 million, and a non-controlling interest of $0.6 million. In connection with the adoption of FIN 46(R), we recorded a charge of $2.0 million as a cumulative effect of the accounting

change on December 31, 2003. In April 2004, we acquired the portion of the variable interest entity that we did not previously own. The acquisition resulted in Ligand assuming the existing loan against the property and making a payment of approximately $0.6 million to the entity s other shareholder.

(6) Effective January 1, 2006, we adopted Statement of Financial Accounting Standards 123(R), *Share-Based Payment*, (SFAS 123(R)), using the modified prospective transition method. The implementation of SFAS123(R) resulted in additional employee stock compensation expense of approximately $4.8 million in 2006 (see Note 2 to our consolidated financial

statements included elsewhere in this annual report).

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

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Caution: This discussion and analysis may contain predictions, estimates and other forward-looking statements that involve a number of risks and uncertainties, including those discussed in Item 1A. Risk Factors. This outlook represents our current judgment on the future direction of our business. These statements include those related to our restructuring process, AVINZA royalty revenues, product returns, product development, our 2005 restatement, and material weaknesses or deficiencies in internal control over financial reporting. Actual events or results may differ materially from Ligand s expectations. For example, there can be no assurance that our recognized revenues or expenses will meet any expectations or follow any trend(s), that our internal control over financial reporting will be effective or produce reliable financial information on a timely basis, or that our restructuring process will be successful or yield preferred results. We cannot assure you that the Company will be able to successfully or timely complete its restructuring, that we will receive expected AVINZA royalties to support our ongoing business, or that our internal or partnered pipeline products will progress in their development, gain marketing approval or success in the market. In addition, the Company s ongoing SEC investigation or future litigation may have an adverse effect on the Company. Such risks and uncertainties, and others, could cause actual results to differ materially from any future performance suggested. We undertake no obligation to release publicly the results of any revisions to these forward-looking statements to reflect events or circumstances arising after the date of this annual report. This caution is made under the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934 as amended.

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

Overview

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

As of December 31, 2006, we marketed one product in the United States: AVINZA, for the relief of chronic, moderate to severe pain. On September 7, 2006, we announced the sale of ONTAK, Targretin capsules, Targretin gel, and Panretin to Eisai, Inc. (Eisai) and the sale of AVINZA to King Pharmaceuticals, Inc. (King). The Eisai sales transaction subsequently closed on October 25, 2006. Accordingly, the results for the Oncology product line have been presented in our consolidated statements of operations for 2006, 2005, and 2004 as Discontinued Operations . The AVINZA sale transaction subsequently closed on February 26, 2007. The AVINZA sale transaction was still subject to stockholder approval as of December 31, 2006. Accordingly, results of operations for the AVINZA product line are included in the continuing operations of the Company as of and for the years ended December 31, 2006, 2005 and 2004.

In February 2003, we entered into an agreement for the co-promotion of AVINZA with Organon Pharmaceuticals USA Inc. (Organon). Under the terms of the agreement, Organon committed to a specified minimum number of primary and secondary product calls delivered to certain high prescribing physicians and hospitals beginning in March 2003. Organon s compensation through 2005 was structured as a percentage of AVINZA net sales based on the following schedule:

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

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In January 2006, we signed an agreement with Organon that terminated the AVINZA co-promotion agreement between the two companies and returned AVINZA rights to Ligand. The termination was effective as of January 1, 2006; however, the parties agreed to continue to cooperate during a transition period that ended September 30, 2006 (the Transition Period) to promote the product. The Transition Period co-operation included a minimum number of product sales calls per quarter (100,000 for Organon and 30,000 for Ligand with an aggregate of 375,000 and 90,000, respectively, for the Transition Period) as well as the transition of ongoing promotions, managed care contracts, clinical trials and key opinion leader relationships to Ligand. During the Transition Period, we paid Organon an amount equal to 23% of AVINZA net sales as reported. We also paid and were responsible for the design and execution of all AVINZA clinical, advertising and promotion expenses and activities.

Additionally, in consideration of the early termination and return of rights to AVINZA under the terms of the agreement, we unconditionally paid Organon $37.8 million in October 2006. We also agreed to and paid Organon $10.0 million in January 2007, in consideration of the minimum sales calls during the Transition Period. In addition, following the Transition Period, we agreed to make quarterly royalty payments to Organon equal to 6.5% of AVINZA net sales through December 31, 2012 and thereafter 6.0% through patent expiration, currently anticipated to be November of 2017.

The unconditional payment of $37.8 million to Organon and the estimated fair value of the amounts to be paid to Organon after the termination ($95.2 million as of January 1, 2006), based on the estimated net sales of the product (currently anticipated to be paid quarterly through November 2017) were recognized as liabilities and expensed as costs of the termination as of the effective date of the agreement, January 2006. Additionally, the conditional payment of $10.0 million, which represents an approximation of the fair value of the service element of the agreement during the Transition Period (when the provision to pay 23% of AVINZA net sales is also considered), was recognized ratably as additional co-promotion expense over the Transition Period. The full $10.0 million of this element of co-promotion expense was recognized in 2006.

Although the quarterly royalty payments to Organon are based on net reported AVINZA product sales, such payments do not result in current period expense in the period upon which the payment is based, but instead are charged against the co-promote termination liability. The liability is adjusted at each reporting period to fair value and is recognized, utilizing the interest method, as additional co-promote termination charges for that period at a rate of 15%, the discount rate used to initially value this component of the termination liability. Any changes to our estimate of future net AVINZA product sales would result in a change to the liability which is recognized as an increase or decrease to co-promote termination charges in the period such changes are identified. For example, in the fourth quarter of 2006, we recorded an adjustment of $15.7 million to lower the fair value of the termination liability based on our updated estimate of future AVINZA sales.

On February 26, 2007, we closed the AVINZA sale transaction pursuant to which King acquired all of our rights in and to AVINZA, assumed certain liabilities, and reimbursed us the $47.8 million paid to Organon. King also assumed Ligand s co-promote termination obligation to make payments to Organon based on net sales of AVINZA (the fair value of which approximates $93.3 million as of December 31, 2006). As Organon has not consented to the legal assignment of the co-promote termination obligation from us to King, we remain liable to Organon in the event of King s default of this obligation.

In June 2006, we concluded the research phase of a research and development collaboration with TAP Pharmaceutical Products Inc. (TAP). Collaborations in the development phase are being pursued by Eli Lilly and Company, GlaxoSmithKline, Pfizer, TAP, and Wyeth. We receive funding during the research phase of the arrangements and milestone and royalty payments as products are developed and marketed by our corporate partners. In addition, in connection with some of these collaborations, we received non-refundable up-front payments.

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

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Recent Developments

Sale of AVINZA Product

On September 6, 2006, Ligand and King entered into a purchase agreement (the AVINZA Purchase Agreement), pursuant to which King agreed to acquire all of our rights in and to AVINZA in the United States, its territories and Canada, including, among other things, all AVINZA inventory, records and related intellectual property, and assume certain liabilities as set forth in the AVINZA Purchase Agreement (collectively, the Transaction). In addition, subject to the terms and conditions of the AVINZA Purchase Agreement, King agreed to offer employment following the closing of the Transaction (the Closing) to certain of our existing AVINZA sales representatives or otherwise reimburse us for certain agreed upon severance arrangements offered to any such non-hired representatives.

Pursuant to the terms of the AVINZA Purchase Agreement, we received $280.4 million in net cash proceeds at the Closing on February 26, 2007 (the Closing Date), which represents the purchase price of $246.3 million, which is net of certain inventory adjustments of approximately $18.7 million as set forth in the AVINZA Purchase Agreement, as amended, plus approximately $49.1 million in reimbursement of payments previously made to Organon and others. Additionally, the net proceeds are less $15.0 million that was funded into an escrow account to support potential indemnity claims by King following the Closing. Of the escrowed amounts not required for claims to King, 50% of the then existing amount will be released on August 26, 2007 with the remaining available balance to be released on February 26, 2008. King also assumed our co-promote termination obligation to make payments to Organon based on net sales of AVINZA (approximately $93.3 million as of December 31, 2006). As Organon has not consented to the legal assignment of the co-promote termination obligation from Ligand to King, we remain liable to Organon in the event of King s default of this obligation. We also incurred approximately $7.2 million in transaction fees and other costs associated with the sale that are not reflected in the net cash proceeds. This amount includes approximately $3.6 million for investment banking services and related expenses which have not yet been paid. We are disputing that these fees are owed to the investment banking firm.

In addition to the assumption of existing royalty obligations, King will pay us a 15% royalty on AVINZA net sales during the first 20 months after Closing. Subsequent royalty payments will be based upon calendar year net sales. If calendar year net sales are less than $200.0 million, the royalty payment will be 5% of all net sales. If calendar year net sales are greater than $200.0 million, the royalty payment will be 10% of all net sales less than $250.0 million, plus 15% of net sales greater than $250.0 million.

In connection with the Transaction, King committed to loan us, at our option, $37.8 million (the Loan) to be used to pay our co-promote termination obligation to Organon due October 15, 2006. This loan was drawn, and the $37.8 million co-promote liability settled in October 2006. Amounts due under the loan were subject to certain market terms, including a 9.5% interest rate. In addition, and as a condition of the $37.8 million loan received from King, $38.6 million of the funds received from Eisai was deposited into a restricted account to be used to repay the loan to King, plus interest. We repaid the loan plus interest on January 8, 2007. Pursuant to the AVINZA Purchase Agreement, King refunded the interest to us on the Closing Date.

Also on September 6, 2006, we entered into a contract sales force agreement (the Sales Call Agreement) with King, pursuant to which King agreed to conduct a sales detailing program to promote the sale of AVINZA for an agreed upon fee, subject to the terms and conditions of the Sales Call Agreement. Pursuant to the Sales Call Agreement, King agreed to perform certain minimum monthly product details (i.e. sales calls), which commenced effective October 1, 2006 and continued until the Closing Date. The amount due to King under the Sales Call Agreement as of December 31, 2006 is approximately $3.8 million.

Sale of Oncology Product Line

On September 7, 2006, we, Eisai Inc., a Delaware corporation and Eisai Co., Ltd., a Japanese company (together with Eisai Inc., Eisai), entered into a purchase agreement (the Oncology Purchase Agreement) pursuant to which Eisai agreed to acquire all of our worldwide rights in and to our oncology products, including, among other things, all related inventory, equipment, records and intellectual property, and assume certain liabilities (the Oncology Product Line) as set forth in the Oncology Purchase Agreement. The Oncology Product Line included our four

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marketed oncology drugs: ONTAK, Targretin capsules, Targretin gel and Panretin gel. Pursuant to the Oncology Purchase Agreement, at closing on October 25, 2006, we received approximately $185.0 million in net cash proceeds which is net of $20.0 million that was funded into an escrow account to support any indemnification claims made by Eisai following the closing of the sale, and Eisai assumed certain liabilities. Of the escrowed amounts not required for claims to Eisai, 50% of the then existing amount will be released on April 25, 2007 with the remaining available balance to be released on October 25, 2007. We incurred approximately $1.7 million of transaction fees and costs associated with the sale that are not reflected in the net cash proceeds.

Additionally, $38.6 million of the proceeds received from Eisai were deposited into a restricted account to repay a loan received from King, the proceeds of which were used to pay our co-promote termination obligation to Organon in October 2006. Such amounts were released and the loan repaid to King in January 2007.

In connection with the Oncology Purchase Agreement with Eisai, we entered into a transition services agreement whereby we agreed to perform certain transition services for Eisai, in order to effect, as rapidly as practicable, the transition of purchased assets from Ligand to Eisai. In exchange for these services, Eisai pays us a monthly service fee. The term of the transition services provided is generally three months; however, certain services will be provided for a period of up to eight months. Fees earned under the transition services agreement, which were recorded as an offset to operating expenses in the fourth quarter of 2006, were approximately $1.9 million.

The Salk Institute for Biological Studies (Salk) Allegations

In March 2007, we received a letter from legal counsel to The Salk Institute for Biological Studies alleging that we owe Salk royalties on prior product sales of Targretin as well as a percentage of the amounts received from Eisai Co., Ltd. (Tokyo) and Eisai Inc. (New Jersey) that are attributable to Targretin with respect to our sale of the Oncology Product Line to Eisai that was completed in October 2006. Salk alleges that they are owed at least 25% of the consideration paid by Eisai for that portion of Ligand s oncology product line and associated assets attributable to Targretin. We have reviewed these matters and do not believe we have any financial obligations to Salk pertaining to Targretin. Accordingly, we intend to vigorously oppose any Salk claim for payment related to these matters.

Resignation of CEO and Appointment of New CEO

On July 31, 2006, we entered into a separation agreement with David Robinson providing for Mr. Robinson s resignation as Chairman, President, and Chief Executive Officer of the Company. Under the separation agreement, Mr. Robinson received his base salary and certain benefits for 24 months, payable in five equal monthly installments beginning August 1, 2006 and ending December 1, 2006. In addition, the agreement provided for the immediate vesting of Mr. Robinson s unvested stock options and an extension of the exercise period of his options to January 15, 2007. In connection with the resignation, we recognized expense of approximately $1.9 million in 2006, comprised of cash payments of $1.4 million and stock-based compensation of $0.5 million associated with the modification of the vesting and exercise period of the stock options.

On August 1, 2006, we announced that current director Henry F. Blissenbach had been named Chairman and interim Chief Executive Officer. We agreed to pay Dr. Blissenbach $40,000 per month, commencing August 1, 2006 for his services as Chairman and interim Chief Executive Officer. In addition, Dr. Blissenbach was eligible to receive incentive compensation of up to 50% of his base salary, but not more than $100,000, based upon his performance of certain objectives incorporated within the employment agreement which we and Dr. Blissenbach entered into. Also, Dr. Blissenbach received a stock option grant to purchase 150,000 shares of our common stock at an exercise price of $9.20 per share. These stock options vested upon the appointment of a new chief executive officer in January 2007 as further discussed below. Finally, we reimbursed Dr. Blissenbach for all reasonable expenses incurred in discharging his duties as interim Chief Executive Officer, including, but not limited to commuting costs to San Diego and living and related costs during the time he spent in San Diego.

On January 16, 2007, we announced that John L. Higgins had joined the Company as Chief Executive Officer and President. Mr. Higgins succeeded Dr. Blissenbach, who continued to serve as Chairman of the Board of Directors until March 1, 2007. We agreed to pay Mr. Higgins an annual salary of $400,000, with his employment

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commencing as of January 10, 2007. In addition, Mr. Higgins has a performance bonus opportunity with a target of 50% of his salary, up to a maximum of 75%, and received a restricted stock award grant of 150,000 shares of our common stock which vests over two years. We also provided Mr. Higgins with a lump-sum relocation benefit of $100,000. Mr. Higgins employment agreement provides for severance payments and benefits in the event that employment is terminated under various scenarios, such as a change in control of the Company.

Reductions in Workforce

In December 2006, and following the sale of our Oncology Product Line to Eisai, we entered into a plan to eliminate 40 employee positions, across all functional areas, which were no longer deemed necessary considering our decision to sell our commercial assets. Additionally, we terminated 23 AVINZA sales representatives and regional business managers who were not offered positions with King or declined King s offer of employment. The affected employees were informed of the plan in December 2006 with an effective termination date of January 2, 2007. In connection with the termination plan, we recognized operating expenses of approximately $2.9 million in the fourth quarter of 2006, comprised of one-time severance benefits of $2.3 million, stock compensation of $0.3 million, and other costs of $0.3 million. The stock compensation charge resulted from the accelerated vesting and extension of the exercise period of stock options in accordance with severance arrangements of certain senior management members. We paid $0.5 million in December 2006 and the remaining balance in January 2007.

On January 31, 2007 we announced an additional restructuring plan calling for the further elimination of approximately 204 positions across all functional areas. This reduction was made in connection with our efforts to refocus the Company, following the sale of our commercial assets, as a smaller, highly focused research and development and royalty-driven biotech company. Associated with the restructuring and refocused business model, several of our executive officers agreed to step down including our Chief Financial Officer, Chief Scientific Officer and General Counsel. We also announced that our primary operations are expected to be consolidated into one building with the goal to sublet unutilized space. In connection with the restructuring, we expect to take a charge to earnings, the majority of which will be recorded in the first quarter of 2007, of approximately $10.8 million, comprised of one-time severance benefits of $7.5 million, stock compensation of $2.2 million, and other costs of $1.1 million. The stock compensation charge results from the accelerated vesting and extension of the exercise period of stock options in accordance with severance arrangements of certain senior management members.

Sale and Leaseback of Premises

On October 25, 2006, we, along with our wholly-owned subsidiary Nexus Equity VI, LLC (Nexus) entered into an agreement with Slough Estates USA, Inc. (Slough) for the sale of our real property located in San Diego, California for a purchase price of approximately $47.6 million. This property, with a net book value of approximately $14.5 million, includes one building totaling approximately 82,500 square feet, the land on which the building is situated, and two adjacent vacant lots. As part of the sale transaction, we agreed to leaseback the building for a period of 15 years, as further described below. In connection with the sale transaction, on November 6, 2006, we also paid off the existing mortgage on the building of approximately $11.6 million. The early payment triggered a prepayment penalty of approximately $0.4 million. The sale transaction subsequently closed on November 9, 2006.

Under the terms of the lease, we will pay a basic annual rent of $3.0 million (subject to an annual fixed percentage increase, as set forth in the agreement), plus a 1% annual management fee, property taxes and other normal and necessary expenses associated with the lease such as utilities, repairs and maintenance, etc. We will have the right to extend the lease for two five-year terms and will have the first right of refusal to lease, at market rates, any facilities built on the sold lots.

In accordance with SFAS 13, *Accounting for Leases*, we recognized an immediate pre-tax gain on the sale transaction of approximately $3.1 million and deferred a gain of approximately $29.5 million on the sale of the building. The deferred gain will be recognized on a straight-line basis over the 15 year term of the lease at a rate of approximately $2.0 million per year.

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Conversion of 6% Convertible Subordinated Notes

The noteholders of our 6% convertible subordinated notes, in the aggregate principal amount of $155.3 million, converted all of the notes into approximately 25.1 million shares of our common stock in 2006. Accrued interest and unamortized debt issue costs related to the converted notes of $0.5 million and $1.4 million, respectively, were recorded as additional paid-in capital.

Accounting for Stock-Based Compensation

Effective January 1, 2006, we adopted 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. Under the modified prospective 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 2006, based on grant-date fair value estimated in accordance with the provisions of SFAS 123(R). Results for 2005 and 2004 have not been retrospectively adjusted. For 2006, we recognized additional compensation expense of $4.8 million due to the implementation of SFAS 123(R).

Employee Retention Agreements and Severance Arrangements

In March 2006, we entered into letter agreements with approximately 67 of our key employees, including a number of our executive officers. In September 2006, we entered into letter agreements with ten additional employees and modified existing agreements with two employees. These letter agreements provided for certain retention or stay bonus payments to be paid in cash under specified circumstances as an additional incentive to remain employed in good standing with the Company through December 31, 2006. The Compensation Committee of the Board of Directors approved the Company s entry into these agreements. In accordance with SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*, the cost of the plan was ratably accrued over the term of the agreements. We recognized approximately $2.6 million of expense under the plan in 2006. As an additional retention incentive, certain employees were also granted stock options to purchase approximately 122,000 shares in the aggregate of our common stock at an exercise price of $11.90 per share.

In August 2006 and October 2006, the Company s Compensation Committee approved and ratified, and began entering into additional severance agreements with certain of our officers and executive officers as additional retention incentives and to provide severance benefits to these officers that are more closely equivalent to severance benefits already in place for other executive officers.

These additional agreements consist of (a) change of control severance agreements (Change of Control Severance Agreement) and b) ordinary severance agreements that apply regardless of a change of control (Ordinary Severance Agreement). Each Change of Control Severance Agreement provides for a payment of certain benefits to the officer in the event his or her employment is terminated without cause in connection with a change of control of the Company.

These benefits include one year of salary, plus the average bonus (if any) for the prior two years and payment of health care premiums for one year. With certain exceptions, the officer must be available for consulting services for one year and must abide by certain restrictive covenants, including non-competition and non-solicitation of our employees. Each Ordinary Severance Agreement provides for payment of six months salary in the event the officer s employment is terminated without cause, regardless of change of control.

Additionally, in October 2006, we implemented a 2006 Employee Severance Plan for those employees who were not covered by another severance arrangement. The plan provides that if such an employee is involuntarily terminated without cause, and not offered a similar or better job by one of the purchasers of our product lines (i.e. King or Eisai) such employee will be eligible for severance benefits. The benefits consist of two months salary, plus one week of salary for every full year of service with the Company plus payment of COBRA health care coverage premiums for that same period.

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Lilly Collaboration Update

In May 2006, after review of all preclinical and clinical data including recently completed two year animal safety studies, Lilly informed us that it had decided not to pursue further development of LY818 (naveglitazar), a compound in Phase II development for the treatment of Type II diabetes, at this time. Naveglitazar, a dual PPAR agonist, was developed through our collaborative research and development agreement with Lilly. This decision was specific with regard to naveglitazar.

In September 2006, Lilly informed us that it had suspended an ongoing mid-stage human trial of LY674 in order to assess unexpected findings noted during animal safety studies of the same compound and evaluate collective clinical efficacy and safety from the human data already gathered. LY674, a PPAR alpha agonist compound in Phase II development for the treatment of atherosclerosis, was developed through our collaborative research and development agreement with Lilly. This decision is specific with regard to LY674.

Agreements to Settle Securities Class Action and Derivative Lawsuits

On June 29, 2006, we announced that we reached agreement to settle the securities class action litigation filed in the United States District Court for the Southern District of California against us and certain of our directors and officers. In addition, we also reached agreement to settle the shareholder derivative actions filed on behalf of the Company in the Superior Court of California and the United States District Court for the Southern District of California.

The settlements resolve all claims by the parties, including those asserted against Ligand and the individual defendants in these cases. Under the agreements, we agreed to pay a total of $12.2 million in cash in full settlement of all claims. $12.0 million of the settlement amount and a portion of our total legal expenses was funded by our Directors and Officers Liability insurance carrier while the remainder of the legal fees incurred ($1.4 million for 2006) was paid by us. Of the $12.2 million settlement liability, $4.0 million was paid in October 2006 to us directly from the insurance carrier and then disbursed to the claimants attorneys, while $8.0 million was paid in July 2006 by the insurance carrier directly to an independent escrow agent responsible for disbursing the funds to the class action suit claimants.

As part of the settlement of the state derivative action, we have agreed to adopt certain corporate governance enhancements including the formalization of certain Board practices and responsibilities, a Board self-evaluation process, Board and Board Committee term limits (with gradual phase-in) and one-time enhanced independent requirements for a single director to succeed the current shareholder representatives on the Board. Neither we nor any of our current or former directors and officers has made any admission of liability or wrongdoing. On October 12, 2006, the Superior Court of California approved the settlement of the state and federal derivative actions and entered final judgment of dismissal. The United States District Court approved the settlement of the Federal class action in October 2006.

The related investigation by the Securities and Exchange Commission is ongoing and is not affected by the settlements discussed above.

Salk Royalty Buyout

In August 2006, we paid The Salk Institute $0.8 million to exercise an option to buy out milestone payments, other payment sharing obligations and royalty payments due on future sales of bazedoxifene, a product being developed by Wyeth. This payment resulted from a bazedoxifene new drug application (NDA) filed by Wyeth for postmenopausal osteoporosis therapy. We recognized the $0.8 million payment as development expense in our third quarter 2006 consolidated financial statements.

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Results of Continuing Operations

Total revenues for 2006 were $141.0 million compared to $123.0 million in 2005 and $112.1 million in 2004. Operating loss from continuing operations was $168.8 million in 2006 compared to $21.9 million in 2005 and $15.4 million in 2004. Loss from continuing operations for 2006 was $135.9 million ($1.69 per share) compared to $31.5 million ($0.43 per share) in 2005 and $22.8 million ($0.31 per share) in 2004.

Product Sales

Our product sales can be influenced by a number of factors including changes in demand, competitive products, the timing of announced price increases, and the level of prescriptions subject to rebates and chargebacks. AVINZA is also included on the formularies (or lists of approved and reimbursable drugs) of many states health care plans, as well as the formulary for certain Federal government agencies. In order to be placed on these formularies, we generally sign contracts which provide discounts to the purchaser off the then-current list price and limit how much of an annual price increase we can implement on sales to these groups. As a result, the discounts off list price for these groups can be significant where we have implemented list price increases. We monitor the portion of our sales subject to these discounts, and accrue for the cost of these discounts at the time of the recognition of product sales.

Net Product Sales

AVINZA product sales are determined on a sell-through basis less allowances for rebates, chargebacks, discounts, and losses to be incurred on returns from wholesalers resulting from increases in the selling price of our products. In addition, we incur certain distributor service agreement fees related to the management of our product by wholesalers. These fees have been recorded within net product sales.

Sales of AVINZA were $137.0 million in 2006 compared to $112.8 million in 2005. According to IMS data, AVINZA prescription market share for 2006 was 3.7% compared to 4.4% for 2005. The increase in sales for 2006 reflects the full year impact of a 7% price increase effective April 1, 2005 and the partial year impact of a 6% price increase effective July 1, 2006, as well as a shift in the mix of prescriptions to the higher doses of AVINZA. Net sales for 2006 also include $1.5 million from the release of an accrual previously recorded for billings received from and the refund of amounts paid to the Department of Veterans Affairs under the Department of Defenses TriCare Retail Pharmacy refund programs. In September 2006, the U.S. Court of Appeals for the Federal Circuit struck down the TriCare program. The increase in AVINZA net sales further reflects a reduction in Medicaid rebates of approximately $13.6 million. This reduction was partially offset by an increase in managed care rebates of approximately $0.7 million in 2006 under contracts with pharmacy benefit managers (PBMs), group purchasing organizations (GPOs) and health maintenance organizations (HMOs), and under Medicare Part D.

The increase in AVINZA net sales for 2006 compared to 2005 was partially offset by a decrease in prescriptions. Specifically, net sales for 2006 reflect an approximate 4% decrease in prescriptions compared to 2005. These trends reflect a continuing decease in prescriptions under Medicaid contracts as marginal contracts were terminated, partially offset by increases in prescriptions under managed care contracts and Medicare Part D. We also believe that the decrease in prescriptions is due in part to a lower level of co-promote activity in the third quarter of 2006, as our previous co-promotion arrangement with Organon terminated in September 2006, and the subsequent transition of co-promote activities to King in the fourth quarter of 2006.

As discussed under Recent Developments , we entered into an agreement to sell the AVINZA product line to King subject to Ligand stockholder approval. Stockholder approval was subsequently obtained in February 2007, and the transaction closed on February 26**,** 2007. In connection with that agreement, we entered into a Contract Sales Force Agreement (the Sales Agreement) with King, pursuant to which King agreed to conduct a detailing program to promote the sale of AVINZA for an agreed upon fee. Pursuant to the Sales Agreement, King agreed to perform certain minimum monthly product details (i.e. sales calls), which commenced effective October 1, 2006 and continued through the closing of the sale transaction. As of December 31, 2006, we owed King approximately $3.8 million for co-promotion activity during the fourth quarter of 2006.

AVINZA net sales for 2006 also reflect an approximate charge of $2.1 million for losses expected to be incurred on product returns resulting from the 6% price increase effective July 1, 2006. This compares to a charge of $3.5

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million recorded for the three months ended March 31, 2005 in connection with a 7% AVINZA price increase effective April 1, 2005. Upon an announced price increase, we revalue our estimate of deferred product revenue to be returned to recognize the potential higher credit a wholesaler may take upon product return determined as the difference between the new price and the previous price used to value the allowance. The decrease in the charge for 2006 reflects lower rates of return on lots that closed out in 2006, thereby lowering the historical weighted average rate of return used for estimating the allowance for return losses. AVINZA net sales for 2006 also benefited from a reduction in the existing allowance for return losses of $4.3 million due to the lower rates of return on lots that closed in 2006.

Any changes to our estimates for Medicaid prescription activity or prescriptions written under our managed care contracts may have an impact on our rebate liability and a corresponding impact on AVINZA net product sales. For example, a 10% variance to our estimated Medicaid and managed care contract rebate accruals for AVINZA as of December 31, 2006 could result in adjustments to our Medicaid and managed care contract rebate accruals and net product sales of approximately $0.1 million and $0.3 million, respectively.

Sales of AVINZA were $112.8 million in 2005 compared to $69.5 million in 2004. This increase is due to higher prescriptions as a result of the increased level of marketing and sales activity under our co-promotion agreement with Organon, a shift in the mix of prescriptions to the higher doses of AVINZA, and the product s success in achieving state Medicaid and commercial formulary status. Demand for AVINZA as measured by prescription levels (or patient consumption for channels with no prescription requirements) increased by 27% in 2005 compared to 2004, as reported by IMS Health. Sales of AVINZA in 2005 also benefited from the full year impact of a 9.0% price increase effective July 1, 2004 and the partial year impact of a 7% price increase effective April 1, 2005.

AVINZA sales for 2005 were negatively impacted by an increase in Medicaid rebates of approximately $4.4 million and an increase in managed care rebates of approximately $ 3.6 million. AVINZA sales in 2005 also reflect an approximate $3.5 million reduction in sales, recorded during the three months ended March 31, 2005, for losses expected to be incurred on product returns resulting from an AVINZA price increase which became effective April 1, 2005. For the year, the impact on sales of the April 1, 2005 price increase was partially offset by a reduction in the allowance for return losses of approximately $2.9 million recorded during the three months ended December 31, 2005. This reduction resulted from lower rates of return on lots that closed out in the fourth quarter of 2005, thereby lowering the historical weighted average rate of return used for estimating the allowance for return losses. This compares to a $2.6 million loss in 2004 on product returns, which was recorded during the three months ended June 30, 2004 for an AVINZA price increase which became effective July 1, 2004. Additionally, product sales in 2005 and for the second half of 2004 are net of fees paid to our wholesaler customers under fee for service agreements entered into during the third and fourth quarters of 2004.

Sale of Royalty Rights

Revenue from the sale of royalty rights represents the sale to third parties of rights and options to acquire future royalties we may earn from the sale of products in development with our collaborative partners. In those instances where we have no continuing involvement in the research or development of these products, sales of royalty rights are recognized as revenue in the period the transaction is consummated or the options are exercised or expire. See Note 2 to our consolidated financial statements for further discussion of our revenue recognition policy with respect to sales of royalty rights.

Sale of royalty rights recognized in 2004 amounted to $31.3 million, net of the deferral of offset rights of $1.4 million and the recognition in 2004 of $0.2 million of option value deferred in previous periods. There were no sales of royalty rights in 2006 and 2005.

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

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

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

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

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

Collaborative Research and Development and Other Revenue

Collaborative research and development and other revenues for 2006 were $4.0 million compared to $10.2 million for 2005 and $11.3 million for 2004. Collaborative research and development and other revenues include reimbursement for ongoing research activities, earned development milestones, and recognition of prior years up-front fees previously deferred in accordance with Staff Accounting Bulletin (SAB) No. 101 *Revenue Recognition*, as amended by SAB 104 (hereinafter referred to as SAB104). Revenue from distribution agreements includes recognition of up-front fees collected upon contract signing and deferred over the life of the distribution arrangement and milestones achieved under such agreements.

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

	Year Ended December 31,		
	2006	**2005**	**2004**
Collaborative research and development	$ 1,678	$ 3,513	$ 7,843
Development milestones and other	2,299	6,704	3,457
	$ 3,977	$ 10,217	$ 11,300

Collaborative Research and Development. The decrease in collaborative research and development revenue for 2006 compared to 2005 is due to the completion of the research phase of our collaborative arrangement with TAP, which concluded in June 2006. The decrease in ongoing research activities reimbursement revenue in 2005 compared to 2004 is due to the termination in November 2004 of our research arrangement with Lilly which contributed $4.0 million to revenue in 2004.

Development Milestones and Other. Development milestones in 2006 reflect a milestone of $2.0 million from GlaxoSmithKline in connection with the commencement of Phase III studies of Promacta (also known as eltrombopag) and a $0.3 million milestone from Wyeth in connection with the filing of an NDA for Viviant (also known as bazedoxifene).

Development milestones revenue in 2005 reflects net development milestones of $3.0 million earned from GlaxoSmithKline in connection with the commencement of Phase II studies of Viviant and Phase I studies of SB-559448 for the treatment of thrombocytopenia; $1.4 million, net for prior milestones received from Wyeth in connection with an agreement in the fourth quarter of 2005 to amend the research, development, and license agreement between Ligand and Wyeth; $1.2 million earned from Lilly in connection with the commencement of

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Phase II trials of LY674 for the treatment of atherosclerosis; and $1.1 million from TAP in connection with TAP s filing of an IND for LGD2941.

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

Gross Margin

Gross margin on product sales was 83.5% in 2006 compared to 79.5% in 2005. The improvement in the gross margin percentage in 2006 reflects the impact of a 7% price increase effective April 1, 2005. Under the sell-through revenue recognition method, changes to prices do not impact net product sales and therefore gross margins until the product sells through the distribution channel. Accordingly, the price increases did not have a full period impact on the margins in 2005. Additionally, as further discussed above under Net Product Sales , net sales and therefore the gross margin percentage in 2006 benefited from: 1) the impact of lower Medicaid rebates; 2) lower net charges related to the impact of price increases on expected returns; and 3) the release of an accrual in the third quarter of 2006 and the refund in the fourth quarter of 2006 of rebates previously paid, related to a court ruling by the U.S. Court of Appeals against the Department of Defense s TriCare Retail Pharmacy refund program. Furthermore, cost of sales in terms of absolute dollars decreased in 2006 compared to 2005 due primarily to a 4% decrease in prescriptions in 2006 compared to 2005.

Gross margin on product sales was 79.5% in 2005 compared to 73.7% in 2004. The improvement in the gross margin percentages in 2005 reflects price increases which became effective July 1, 2004 and April 1, 2005. This improvement was partially offset by a higher proportionate level of rebates and the costs associated with our wholesaler distribution service agreements which were entered into in the third and fourth quarters of 2004.

Research and Development Expenses

Research and development expenses were $41.9 million in 2006 compared to $33.1 million in 2005 and $32.7 million in 2004. The major components of research and development expenses are as follows (in thousands):

	Years Ended December 31,		
	2006	**2005**	**2004**
Research			
Research performed under collaboration agreements	$ 1,968	$ 3,611	$ 7,853
Internal research programs	22,110	20,839	15,517
Total research	24,078	24,450	23,370
Development			
New product development	13,837	1,264	2,568
Existing product support (1)	4,011	7,382	6,782
Total development	17,848	8,646	9,350
Total research and development	$ 41,926	$ 33,096	$ 32,720

(1)

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

Spending for research expenses was $24.1 million for 2006 compared to $24.5 million for 2005. The decrease in research expenses for 2006 compared to 2005 primarily reflects decreased research expenses incurred under our collaboration arrangement with TAP which concluded in June 2006 partially offset by increased research performed under our Selective Androgen Receptor Modulator (SARM) program.

Spending for research expenses amounted to $24.5 million for 2005 compared to $23.4 million for 2004. The overall increase in 2005 is due to an increased level of internal program research in the area of thrombopoietin

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(TPO) agonists. This increase is partially offset by a decrease in research performed under collaboration agreements due primarily to a lower contractual level of research funding under our agreement with TAP and lower research funding under the Lilly collaboration which concluded in November 2004.

Spending for development expenses increased to $17.8 million for 2006 compared to $8.6 million for 2005. These increases reflect a higher level of expense for new product development partially offset by a lower level of expense in existing product support. The increase in spending on new product development was primarily due to the increase in LGD4665 thrombopoietin (TPO), our lead drug candidate in this area which was moved into Phase I clinical trials, and LGD5552 (Glucocorticoid agonist) expenses. LGD5552 was on track to enter clinical trials in 2007; however Good Laboratory Practice studies failed to demonstrate the desired pre-clinical safety characteristics for a drug to treat rheumatoid arthritis. We decided in the first quarter of 2007 not to proceed with the development of LGD5552. The decrease in 2006 for existing product support is due to lower product support for our AVINZA product.

Spending for development expenses decreased to $8.6 million for 2005 compared to $9.4 million for 2004. This decrease primarily reflects a lower level of effort in our glucocorticoid agonist program in 2005 compared to 2004.

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A summary of our significant internal research and development programs as of December 31, 2006 is as follows:

Program	Disease/Indication	Development Phase
AVINZA	Chronic, moderate-to-severe pain	Marketed in U.S. Phase IV
LGD4665 (Thrombopoietin oral mimetic)	Idiopathic Thrombocytopenia Purpura; other thrombocytopenias	Phase I
Selective androgen receptor modulators, (agonists)	Hypogonadism, osteoporosis, sexual dysfunction, frailty, cachexia.	Pre-clinical
Selective glucocorticoid receptor modulators	Inflammation, cancer	Research
Selective androgen receptor modulators, (antagonists)	Prostate cancer	Research

We do not provide forward-looking estimates of costs and time to complete our ongoing research and development projects, as such estimates would involve a high degree of uncertainty. Uncertainties include our ability to predict the outcome of complex research, our ability to predict the results of clinical studies, regulatory requirements placed upon us by regulatory authorities such as the FDA and EMEA, our ability to predict the decisions of our collaborative partners, our ability to fund research and development programs, competition from other entities of which we may become aware in future periods, predictions of market potential from products that may be derived from our research and development efforts, and our ability to recruit and retain personnel or third-party research organizations with the necessary knowledge and skills to perform certain research. We do, however, expect that research and development expenses will be significantly lower in 2007 compared to 2006 due to the reduction of our workforce and related restructuring activities in early 2007 as further discussed under Recent Developments above, and the related refocusing of our research and development activities on fewer, selected programs. Refer to Item 1A. Risks Factors for additional discussion of the uncertainties surrounding our research and development initiatives.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $79.7 million for 2006 compared to $56.2 million for 2005 and $46.4 million for 2004. The increase reflects higher legal costs (incurred in connection with the ongoing SEC investigation, shareholder litigation and our strategic alternatives process) which increased by approximately $8.1 million in 2006 compared to 2005. In June 2006, we announced that we had reached a settlement with the plaintiffs in the Company s shareholder litigation. The amounts paid to the plaintiffs and the plaintiffs attorneys and a portion of our legal expenses incurred in connection with the shareholder litigation were covered by proceeds provided under our Directors and Officers (D&O) Liability insurance.

General and administrative expenses were also higher in 2006 due to higher audit and consultant fees in connection with the completion of the Company s assessment of internal controls as of December 31, 2005 under the Sarbanes-Oxley Act and consultant costs incurred in 2006 in connection with our 2006 SOX compliance program. A significant portion of the Company s 2005 assessment of internal controls was performed in 2006 due to the fact that the restatement of our financial statements was not completed until late 2005.

In addition, AVINZA advertising and promotion expenses increased in 2006 compared to 2005 and 2004 when Ligand and Organon shared equally all AVINZA promotion expenses. As part of the AVINZA termination and return of rights agreement entered into in January 2006, discussed under Overview above, we were responsible for all AVINZA advertising and promotion expenses. This increase was partially offset by lower selling expenses due to a reduction in our AVINZA primary care sales force.

Selling, general and administrative expenses for 2006 also include stock compensation expense of approximately $3.6 million incurred in accordance with SFAS 123(R) which we implemented in 2006 (total company expense of

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$4.8 million) and a charge of approximately $2.3 million related to a reduction in our workforce communicated to employees in the fourth quarter of 2006. Furthermore, general and administrative expenses in 2006 include approximately $1.9 million of expenses in connection with the resignation of the Company s CEO. (Refer to Recent Developments above for further discussion of each of these items.)

The increase for 2005 compared to 2004 reflects a higher level of costs associated with additional Ligand sales representatives hired in the second and third quarter of 2004 to promote AVINZA and higher advertising and promotion expenses for AVINZA. Compared to 2004, 2005 also reflects higher accounting and legal expenses incurred in connection with the Audit Committee s review of the Company s consolidated financial statements, the restatement and re-audits of the Company s consolidated financial statements and ongoing shareholder litigation.

We expect that selling, general and administrative expenses will be significantly lower in 2007 compared to 2006 due primarily to the sales of our AVINZA and oncology product lines, and the reduction in our workforce and related restructuring activities in early 2007, as further discussed under Recent Developments above.

Gain on Sale Leaseback

On October 25, 2006, we, along with our wholly-owned subsidiary Nexus, entered into an agreement with Slough for the sale of our real property located in San Diego, California for a purchase price of approximately $47.6 million. This property, with a net book value of approximately $14.5 million, includes one building totaling approximately 82,500 square feet, the land on which the building is situated, and two adjacent vacant lots. As part of the sale transaction, we agreed to lease back the building for a period of 15 years. The sale transaction subsequently closed on November 9, 2006.

In accordance with SFAS 13, *Accounting for Leases*, we recognized an immediate pre-tax gain on the sale transaction of approximately $3.1 million in the fourth quarter of 2006 and deferred a gain of approximately $29.5 million on the sale of the building. The deferred gain is recognized as an offset to operating expense on a straight-line basis over the 15 year term of the lease at a rate of approximately $2.0 million per year.

Co-promotion Expense and Co-promote Termination Charges

Co-promotion expense amounted to $37.5 million in 2006 compared to $32.5 million for 2005 and $30.1 million for 2004. As discussed under Overview above, in connection with the AVINZA termination and return of co-promote rights agreement with Organon, we agreed to pay Organon 23% of net AVINZA product sales through September 30, 2006 as compensation for promotion of the product during the Transition Period. This compares to co-promote expense in the prior year periods which was based on 30% of net sales, as per the original co-promotion agreement, determined using the sell-in method of revenue recognition.

Co-promotion expense recognized through the nine months ended September 30, 2006 also includes $10.0 million which represents the accrual of a $10.0 million payment we agreed to make to Organon, provided that Organon achieved its required level of sales calls during the Transition Period. We paid Organon the $10.0 million in January 2007. This payment represents an approximation of the fair value of the service element under the agreement during the Transition Period (when the provision to pay 23% of AVINZA net sales is also considered) and, therefore, was recognized as an additional component of the Organon co-promotion expense ratably over the Transition Period.

Co-promotion expense for the fourth quarter of 2006 was $3.8 million determined under the terms of our Sales Call Agreement with King. As further discussed under Recent Developments above, King agreed to perform certain minimum monthly product details (i.e. sales calls), which commenced effective October 1, 2006.

Co-promote termination charges in 2006 were $131.1 million. This expense includes a $37.8 million payment made to Organon in October 2006, and the fair value of subsequent quarterly payments, estimated at approximately $95.2 million as of January 1, 2006, that we agreed to make to Organon based on net product sales of AVINZA, through November 2017. The co-promote termination charge for 2006 also includes expense of approximately $14.2 million recorded throughout the year to reflect the fair value of the liability as of December 31, 2006. The full year expense is net of a credit recorded in the fourth quarter of 2006, resulting from a reduction in the liability of approximately $15.7 million, based on our updated estimate as of December 31, 2006 of future AVINZA sales.

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On February 26, 2007, we closed the AVINZA sale transaction pursuant to which King acquired all of our rights in and to AVINZA. King also assumed our co-promote termination obligation to make payments to Organon based on net sales of AVINZA. As Organon has not consented to the legal assignment of the co-promote termination obligation from us to King, we remain liable to Organon in the event of King s default of this obligation.

Other Expenses, Net

Other expenses, net were $5.5 million for 2006 compared to $9.6 million for 2005 and $7.2 million for 2004.

Interest income increased to $3.8 million for 2006 compared to $1.9 million for 2005 and $1.1 million for 2004. The increase in 2006 is primarily due to higher cash balances during the fourth quarter of 2006 following the sale of our oncology product line to Eisai in October 2006 and the sale and leaseback of our corporate headquarters in November 2006.

Interest expense decreased to $10.6 million for 2006 compared to $12.2 million for 2005 and $12.0 million for 2004. Interest expense in 2006, 2005, and 2004 primarily represents interest on the $155.3 million of 6% convertible subordinated notes that we issued in November 2002. The lower interest expense on the 6% Convertible Subordinated Notes for 2006 is due to the conversion of such notes during 2006 as discussed further under Recent Developments. As all such notes had converted as of December 31, 2006, interest expense for 2007 is expected to be substantially lower than 2006.

Other, net reflects income of $1.3 million in 2006 compared to $0.7 million in 2005 and $3.7 million in 2004. In September 2004, we agreed to vote our shares of X-Ceptor in favor of the acquisition of X-Ceptor by Exelixis Inc. (Exelixis). Exelixis acquisition of X-Ceptor was subsequently completed in October 2004 and in connection therewith, Ligand received shares of Exelixis common stock. Such shares were subject to certain trading restrictions for two years. Additionally, approximately 21% of the shares were placed in escrow for up to one year to satisfy indemnification and other obligations. We recorded a net gain on the transaction in the fourth quarter of 2004 of approximately $3.7 million, based on the fair market value of the consideration received. During 2005, the shares were released from escrow and the Company recognized a gain of $0.9 million. During 2005, the Company sold approximately 247,000 shares for net proceeds of $1.9 million. During 2006, the Company sold the remaining shares for net proceeds of $3.9 million. The Company recognized a gain of $1.2 million in 2006 and a loss of $0.2 million in 2005 on these sales, which are included in other income (expense).

Income Taxes

We had losses from continuing operations and income from discontinued operations for 2006. In accordance with SFAS No. 109, *Accounting for Income Taxes*, the income tax benefit generated by the loss from continuing operations in 2006 was $38.4 million. This income tax benefit captures the deemed use of losses from continuing operations used to offset the income and gain from our Oncology Product Line that was sold in 2006.

Net income tax expense combining both continuing and discontinued operations was $0.7 million for 2006. This expense reflects the net tax due on taxable income for 2006 that was not fully offset by net operating loss and research and development credit carryforwards due to federal and state alternative minimum tax requirements. There was no income tax expense for 2005. Income tax expense was $0.2 million for 2004.

Net operating loss carryforwards for federal and state income tax purposes of $405.5 million and $165.4 million, respectively, are available to be utilized against future taxable income. The net operating losses begin to expire in 2007. We also have $16.4 million of federal research and development credit carryforwards that begin to expire in 2007 and $10.0 million of California research and development credits that have no expiration date. Due to the uncertainty of future taxable income, deferred tax assets resulting from these net operating loss and research and development credit carryforwards have been fully reserved.

Pursuant to Internal Revenue Code Sections 382 and 383, use of net operating loss and credit carryforwards may be limited if there were changes in ownership of more than 50%. We completed a Section 382 study for Ligand, excluding Glycomed and Seragen, and have determined that Ligand had an ownership change in September 2005. As a result of this ownership change, utilization of Ligand s net operating losses and credits are subject to limitations

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under Internal Revenue Code Sections 382 and 383. The information necessary to determine if an ownership change related to Glycomed and Seragen occurred prior to their acquisition by Ligand is not currently available. Accordingly, such tax net operating loss and credit carryforwards are not reflected in our deferred tax assets. If information becomes available in the future to substantiate the amount of these NOLs and credits, we will record the deferred tax assets at such time. Future changes in ownership could result in additional limitations on the utilization of our net operating losses and tax credits under Internal Revenue Code Sections 382 and 383.

Our research and development tax credits pertain to federal and California jurisdictions. These jurisdictions require that we maintain documentation and support. We recently completed a formal study and believe that we maintain sufficient documentation to support the amounts of the research and development tax credits.

Discontinued Operations

On September 7, 2006, we and Eisai entered into the Oncology Purchase Agreement pursuant to which Eisai agreed to acquire all of our worldwide rights in and to our oncology products, including, among other things, all related inventory, equipment, records and intellectual property, and assume certain liabilities (the Oncology Product Line) as set forth in the Oncology Purchase Agreement. The Oncology Product Line included our four marketed oncology drugs: ONTAK, Targretin capsules, Targretin gel and Panretin gel. Pursuant to the Oncology Purchase Agreement, at closing on October 25, 2006, we received approximately $185.0 million in net cash proceeds, which is net of $20.0 million that was funded into an escrow account to support any indemnification claims made by Eisai following the closing of the sale. Eisai also assumed certain liabilities. Of the escrowed amounts not required for claims to Eisai, 50% of the then existing amount will be released on April 25, 2007 with the remaining available balance to be released on October 25, 2007. We also recorded approximately $1.7 million in transaction fees and costs associated with the sale that are not reflected in net cash proceeds. We recorded a pre-tax gain on the sale of $135.8 million in the fourth quarter of 2006.

Income from discontinued operations before income taxes was $7.5 million in 2006 compared to losses from discontinued operations before income taxes of $4.9 million and $22.3 million, respectively, in 2005 and 2004 respectively. The following table summarizes results from discontinued operations for 2006, 2005 and 2004 included in the consolidated statements of operations (in thousands):

	Years Ended December 31,		
	2006	**2005**	**2004**
Product sales	$ 47,512	$ 53,288	$ 50,865
Collaborative research and development and other revenues	208	310	535
Total revenues	47,720	53,598	51,400
Operating costs and expenses:			
Cost of products sold	13,410	16,757	21,540
Research and development	12,895	22,979	32,484
Selling, general and administrative	13,891	18,488	19,367
Total operating costs and expenses	40,196	58,224	73,391
Income (loss) from operations	7,524	(4,626)	(21,991)
Interest expense	(51)	(244)	(332)
Income (loss) before income taxes	$ 7,473	$ (4,870)	$ (22,323)

Product sales were $47.5 million in 2006 compared to $53.3 million and $50.9 million, respectively, for 2005 and 2004. The decrease in product sales in 2006 compared to 2005 is primarily due to the sale of the Oncology Product Line effective October 25, 2006. The increase in product sales in 2005 compared to 2004 is primarily due

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to increases in sales of Targretin capsules from increased demand and the effect of price increases. These increases are partially offset by lower net product sales of ONTAK due to lower demand.

Total operating costs and expenses were $40.2 million in 2006 compared to $58.2 million and $73.4 million, respectively, for 2005 and 2004. The decrease in 2006 compared to 2005 is primarily due to the sale of the Oncology Product Line effective October 25, 2006.

The decrease in cost of products sold in 2005 compared to 2004 is due primarily to lower costs of ONTAK in connection with lower ONTAK demand. Additionally, cost of products sold in 2004 reflects a charge to royalty expense in the amount of $3.0 million for deferred royalties at the end of the contracted royalty period for which we did not have offset rights. Under the sell through revenue recognition method, royalties paid based on unit shipments to wholesalers were deferred and recognized as royalty expense as those units were sold through and recognized as revenue. Royalties paid to technology partners were deferred as we had the right to offset royalties paid for product that were later returned against subsequent royalty obligations. Royalties for which we did have the right to offset, however, (for example, at the end of the contracted royalty period) were expensed in the period the royalty obligation became due.

The decrease in 2005 operating expenses compared to 2004 is primarily due to decreased research expenses across several Oncology research programs, decreased development expenses for existing Oncology product support (primarily a reduced level of spending on Phase III clinical trials for Targretin capsules in non-small cell lung cancer (NSCLC)), and lower promotion expenses for the Oncology products compared to the prior year period.

The net losses from discontinued operations for 2005 and 2004 reflect the significant development costs incurred on the NSCLC trials for Targretin capsules which concluded in 2005.

Liquidity and Capital Resources

We have financed our operations through private and public offerings of our equity securities, collaborative research and development and other revenues, issuance of convertible notes, product sales, capital and operating lease transactions, accounts receivable factoring and equipment financing arrangements and investment income.

Working capital was $64.7 million at December 31, 2006 compared to a deficit of $102.2 million at December 31, 2005. Cash, cash equivalents, short-term investments, and restricted cash and investments totaled $212.5 million at December 31, 2006 compared to $88.8 million at December 31, 2005. We primarily invest our cash in United States government and investment grade corporate debt securities. Restricted cash and investments at December 31, 2006 consist of certificates of deposit held with a financial institution as collateral under asset financing and third-party service provider arrangements, and funds held in an escrow account with a financial institution to be used to repay a loan due to King. We repaid the loan plus interest on January 8, 2007.

Operating Activities

Operating activities used cash of $138.5 million in 2006 and provided cash of $8.4 million in 2005 and $5.8 million in 2004. The use of cash in 2006 reflects a net loss of $31.7 million, adjusted by $24.1 million in items to reconcile the net loss to net cash used in operations. These reconciling items include the gain on the sale of our oncology product line of $135.8 million and the gain on the sale leaseback of our corporate headquarters of $3.1 million, partially offset by non-cash co-promote termination expense of $93.3 million, depreciation and amortization of assets of $16.2 million, and the recognition of $5.3 million of stock-based compensation expense in connection with the adoption of SFAS 123(R), restricted stock grants to employees and option grants to non-employees.

The use of cash for 2006 is further impacted by changes in operating assets and liabilities due primarily to decreases in deferred revenue, net of $72.6 million, and accounts payable and accrued liabilities of $27.6 million partially offset by decreases in accounts receivable, net of $9.4 million; inventories of $1.6 million; and other current assets of $6.6 million. The decreases in deferred revenue and accounts receivable are primarily due to a reduction in shipments of AVINZA starting in September 2006. The AVINZA Purchase Agreement with King provided for a reduction in the purchase price to the extent that product inventories in the wholesale and retail distribution channels were in excess of specified amounts. Accordingly, we reduced shipments of AVINZA starting

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in September 2006. The decrease in accounts payable and accrued liabilities is primarily due to the payment of accrued fees for co-promotion services to Organon during and following the co-promote transition period which terminated effective September 30, 2006, and lower headcount costs and operational expenses following the sale of our Oncology Product Line to Eisai in October 2006.

Cash provided by operating activities in 2005 of $8.4 million reflects a net loss of $36.4 million, non-cash adjustments to operating activities of $18.1 million (primarily the amortization of long-term assets of $18.7 million), and changes in operating assets and liabilities that comprise a net cash inflow of $26.6 million. Changes in operating assets and liabilities provided cash of $26.6 million in 2005 primarily due to increases in accounts payable and accrued liabilities of $13.7 million, deferred revenue of $4.7 million, decreases in accounts receivable, net of $9.9 million, and decreases in other current assets of $2.0 million, partially offset by an increase in inventories of $3.4 million.

Cash provided by operating activities in 2004 of $5.8 million reflects a net loss of $45.1 million, non-cash adjustments to operating activities of $9.7 million, and changes in operating assets and liabilities that comprise a net cash inflow of $41.2 million. The non-cash operating items include the amortization of long-term assets of $15.3 million, partially offset by the gain on sale of an equity investment of $3.7 million and a non-cash development milestone of $2.0 million. Changes in operating assets and liabilities provided cash of $41.2 million in 2004 primarily due to increases in deferred revenue of $47.9 million, and accounts payable and accrued liabilities of $9.8 million, partially offset by increases in accounts receivable and inventories of $11.9 million and $3.3 million, respectively.

Cash used in operating activities of $138.5 million in 2006 includes $38.3 million, net used in discontinued operations. This compares to net cash used in discontinued operations of $6.6 million for 2005 and $10.9 million for 2004.

Investing Activities

Investing activities provided cash of $196.9 million in 2006, used cash of $33.7 million in 2005, and provided cash of $19.6 million in 2004. Cash provided by investing activities in 2006 includes net proceeds from the sale of our Oncology Product Line of $183.3 million, proceeds from the sale leaseback of our corporate headquarters of $46.9 million, and net proceeds from the sale of short-term investments of $7.2 million. These amounts were partially offset by an increase in restricted cash and investments of $38.8 million, primarily from a requirement to fund $38.6 million of the funds received from the sale of our Oncology Product Line into a restricted account to repay a loan to King in January 2007, and purchases of property and equipment of $1.8 million.

The use of cash in 2005 reflects $33.0 million of payments for the buy-down of ONTAK royalty payments in connection with the amended royalty agreement entered into in November 2004 between the Company and Lilly, and $2.6 million of purchases of property and equipment. The use of cash in 2005 was partially offset by net proceeds from the sale of short-term investments of $1.9 million.

Cash provided by investing activities in 2004 reflects net proceeds of $14.1 million from the sale of short-term investments and $9.2 million from the maturing of restricted investments which were used to pay interest on our 6% convertible subordinated notes. The use of cash for investing activities in 2004 reflects $3.6 million for purchases of property and equipment.

Cash provided by investing activities of $196.8 million in 2006 includes $183.3 million provided by discontinued operations from the sale of the Oncology Product Line. Cash used in investing activities of $33.7 million in 2005 includes $33.0 used in discontinued operations for the buy-down of the ONTAK royalty payments. None of the cash provided by investing activities of $19.6 million in 2004 relates to discontinued operations.

Financing Activities

Financing activities provided cash of $33.3 million in 2006, used cash of $0.2 million in 2005, and provided cash of $7.9 million in 2004. Cash provided by financing activities in 2006 includes proceeds of $37.8 million from a note issued to King in connection with the AVINZA Purchase Agreement and proceeds from the exercise of

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employee stock options and stock purchases of $9.1 million, partially offset by the repayment of the mortgage note payable due on our corporate headquarters of $11.8 million in connection with the sale of that building in November 2006, and net payments under equipment financing arrangements of $1.5 million.

Cash used in financing activities in 2005 reflects repayment of long-term debt and net payments under equipment financing arrangements of $0.3 million and $0.8 million, respectively, partially offset by net proceeds from the exercise of employee stock options and stock purchases under our employee stock purchase plan of $0.9 million.

Cash provided by financing activities in 2004 includes net proceeds of $6.6 million from the exercise of employee stock options and stock purchases under our employee stock purchase plan and $1.8 million of net proceeds received under equipment financing arrangements.

Cash provided by financing activities of $33.3 million in 2006 includes $0.2 million used in discontinued operations. This compares to cash used in discontinued operations for financing activities of $0.04 million for 2005 and cash provided by financing activities of discontinued operations of $0.2 million for 2004.

Certain of our property and equipment is pledged as collateral under various equipment financing arrangements. As of December 31, 2006, $4.3 million was outstanding under such arrangements with $2.2 million classified as current. Our equipment financing arrangements have terms of three to five years with interest ranging from 7.35% to 10.11%.

The noteholders of our 6% convertible subordinated notes, in the aggregate principal amount of $155.3 million, converted all of the notes into approximately 25.1 million shares of our common stock in 2006. Accrued interest and unamortized debt issue costs related to the converted notes of $0.5 million and $1.4 million, respectively, were recorded as additional paid-in capital.

Other Liquidity and Capital Resource Matters

In December 2006, following the sale of our Oncology Product Line to Eisai, we entered into a plan to eliminate 63 employee positions. The affected employees were informed of the plan in December 2006 with an effective termination date of January 2, 2007. In connection with the termination plan, we expect to pay severance of approximately $2.4 million and other costs of $0.3 million in the first quarter of 2007.

On January 31, 2007, we announced an additional restructuring plan calling for the further elimination of approximately 204 positions across all functional areas. This reduction was made in connection with our efforts to refocus the Company, following the sale of our commercial assets, as a smaller, highly focused research and development and royalty-driven biotech company. In connection with the restructuring, we expect to pay severance of approximately $7.5 million and other costs of approximately $1.1 million in 2007.

Pursuant to the AVINZA Purchase Agreement, at closing in 2007, we received net cash proceeds of approximately $280.4 million, which is a net of $15.0 million that was funded into an escrow account to support any indemnification claims made by King. See further discussion above under Recent Developments Sale of AVINZA Product .

On March 1, 2007, we entered into an indemnity fund agreement, which established in a trust account with Dorsey & Whitney LLP, counsel to the Company s independent directors and to the Audit Committee of our Board of Directors, a $10.0 million indemnity fund to support our existing indemnification obligations to continuing and departing directors in connection with the ongoing SEC investigation and related matters.

We believe our available cash, cash equivalents, short-term investments and existing sources of funding will be sufficient to satisfy our anticipated operating and capital requirements through at least the next 12 months. Our future operating and capital requirements will depend on many factors including: the pace of scientific progress in our research and development programs; the magnitude of these programs; the scope and results of preclinical testing and clinical trials; the time and costs involved in obtaining regulatory approvals; the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims; competing technological and market

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developments; and the efforts of our collaborators. We will also consider additional equipment financing arrangements similar to arrangements currently in place.

We have never declared or paid any cash dividends on our capital stock. We have previously announced that the Board is considering a special cash dividend in connection with our recent asset sales, but no decision has yet been made regarding such dividend. Aside from the consideration of this special one-time dividend, we do not intend to pay any cash dividends in the foreseeable future. We currently intend to retain future earnings, if any, to finance future growth.

Leases and Off-Balance Sheet Arrangements

We lease certain of our office and research facilities under operating lease arrangements with varying terms through November 2021. The agreements provide for increases in annual rents based on changes in the Consumer Price Index or fixed percentage increases ranging from 3% to 7%.

Contractual Obligations

As of December 31, 2006, future minimum payments due under our contractual obligations are as follows (in thousands):

		Payments Due by Period			
	Total	**Less than 1 year**	**1-3 years**	**3-5 years**	**After 5 years**
Capital lease obligations (1)	$ 4,773	$ 2,459	$ 2,220	$ 94	$
Operating lease obligations	72,548	5,227	10,061	10,569	46,691
Loan payable to King Pharmaceuticals (2)	38,633	38,633			
Co-promote termination liability (3)	194,980	13,307	29,157	36,472	116,044
Retention bonus obligation	2,654	2,654			
Severance obligation	2,061	2,061			
Distribution service agreements	4,818	4,818			
Consulting agreements	1,270	1,270			
Manufacturing agreements (4)	12,600	5,400	4,800	2,400	
Total contractual obligations	$ 334,337	$ 75,829	$ 46,238	$ 49,535	$ 162,735
(1) Includes interest payments as follows:	$ 449	$ 291			