

LIGAND PHARMACEUTICALS INC

Form PREM14A

November 06, 2006

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

**SCHEDULE 14A  
INFORMATION**

**PROXY STATEMENT PURSUANT TO SECTION 14(a) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

Filed by the Registrant

Filed by a party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

**LIGAND PHARMACEUTICALS INCORPORATED**  
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
  - 1) Title of each class of securities to which transaction applies:
  - 2) Aggregate number of securities to which transaction applies:
  - 3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

The purchase price payable under the asset purchase agreement consists of an aggregate upfront cash consideration of \$265 million, assumption by King of payment obligations of Ligand of \$47.75 million (or reimbursement to Ligand at closing of the asset sale to the extent any such amounts have been paid) and specified existing royalty obligations to third parties, and receipt of certain royalty payments based on King's annual net sales of AVINZA<sup>®</sup> through AVINZA<sup>®</sup>'s patent expiration in November 2017.

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Solely for purposes of calculating the amount of the filing fee, the registrant estimates a purchase price of approximately \$480.8 million.

- 4) Proposed maximum aggregate value of transaction: \$480.8 million
  
  - 5) Total fee paid: \$51,445.60
    - o Fee paid previously with preliminary materials.
    - o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.
      - (1) Amount Previously Paid: \$
  
      - (2) Form, Schedule or Registration Statement No.:
  
      - (3) Filing Party:
  
      - (4) Date Filed:
-

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**PRELIMINARY COPY SUBJECT TO COMPLETION  
DATED           , 2006**

**Ligand Pharmaceuticals Incorporated  
10275 Science Center Drive  
San Diego, California 92121**

, 2006

To our stockholders:

You are cordially invited to attend a special meeting of stockholders of Ligand Pharmaceuticals Incorporated to be held at the La Jolla Marriott located at 4240 La Jolla Village Drive, La Jolla, California 92037 on           , 2006 at 9:00 a.m., local time.

We have agreed to sell all of our rights in and to AVINZA<sup>®</sup> (morphine sulfate extended-release capsules), in the United States, its territories and Canada to King Pharmaceuticals, Inc. ( King ), and its wholly-owned subsidiary King Pharmaceuticals Research and Development, Inc. ( King R&D ), pursuant to an asset purchase agreement, dated as of September 6, 2006. In exchange for our rights in and to AVINZA<sup>®</sup>, King and King R&D have agreed to pay us \$265 million in cash, subject to specific inventory adjustments, assume a payment obligation of Ligand of approximately \$48 million (or reimburse Ligand at closing of the asset sale to the extent any such amounts have been paid ) and specified existing royalty obligations to third parties, and pay Ligand certain royalty payments based on King s annual net sales of AVINZ<sup>®</sup> through AVINZA<sup>®</sup> s patent expiration in November 2017. The full text of the asset purchase agreement is included as Annex A to the proxy statement that accompanies this letter.

The proposed asset sale will not become effective until such time as we receive not less than the minimum number of votes necessary to approve the sale of all or substantially all of our assets, under Delaware law. We have scheduled a special meeting of our stockholders for this vote on           , 2006. **YOUR VOTE IS VERY IMPORTANT.**

After careful consideration, our board of directors has unanimously determined that the proposed sale of assets is in the best interest of Ligand Pharmaceuticals Incorporated and our stockholders. **THE BOARD OF DIRECTORS UNANIMOUSLY APPROVED THE PROPOSED SALE AND THE ASSET PURCHASE AGREEMENT AND RECOMMENDS THAT YOU VOTE FOR THE APPROVAL AND ADOPTION OF THE PROPOSED SALE.**

We are also asking for your approval of a proposal to amend Ligand s 2002 Stock Incentive Plan (the 2002 Plan ) to allow equitable adjustments to be made to options outstanding under the 2002 Plan in the event of a payment of a special cash dividend to our stockholders.

Our board of directors has approved the amendment to the 2002 Plan. **THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE FOR THE APPROVAL AND ADOPTION OF THE AMENDMENTS TO OUR 2002 PLAN.**

Please review in detail the attached proxy statement for a more complete statement regarding the proposal to approve the asset sale (proposal 1 in this proxy statement), which includes a description of the asset purchase agreement, the background of the decision to enter into the asset purchase agreement, and the reasons that our board of directors has decided to recommend that you approve the asset sale; and the amendment to the 2002 Plan (proposal 2 in this proxy statement).

Your vote is very important to us regardless of the number of shares you own. Whether or not you are able to attend the special meeting in person, please complete, sign and date the enclosed proxy card and return it in the envelope provided as soon as possible. If you hold shares of our common stock directly in your name, you may also grant a proxy using the Internet or by telephone by following the instructions printed on your proxy card. Granting a

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proxy by mail, telephone or the Internet will not limit your right to vote in person if you wish to attend the special meeting and vote in person.

On behalf of our board of directors, I thank you for your support and urge you to vote **FOR** each of the proposals described in this proxy statement.

By Order of the Board of Directors,

Henry F. Blissenbach  
*Chairman and Interim Chief Executive Officer*

San Diego, California  
, 2006

The notice and proxy statement are first being mailed to our stockholders on or about \_\_\_\_\_, 2006.

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**Ligand Pharmaceuticals Incorporated  
10275 Science Center Drive  
San Diego, California 92121**

**NOTICE OF SPECIAL MEETING OF STOCKHOLDERS  
To Be Held On \_\_\_\_\_, 2006**

To our stockholders:

A special meeting of stockholders of Ligand Pharmaceuticals Incorporated will be held at the La Jolla Marriott located at 4240 La Jolla Village Drive, La Jolla, California 92037 on \_\_\_\_\_, 2006 at 9:00 a.m., local time. At this meeting you will be asked:

1. To consider and to vote on a proposal to approve the sale of all or substantially all of our assets under Delaware law through the sale of our rights in and to AVINZA® (morphine sulfate extended-release capsules), in the United States, its territories and Canada, pursuant to the asset purchase agreement attached as Annex A to this proxy statement;
2. To consider and to vote on a proposal to amend Ligand's 2002 Stock Incentive Plan to allow equitable adjustments to be made to options outstanding under the plan in the event of the payment of a large non-recurring cash dividend;
3. To approve adjournment of the special meeting, if necessary, to facilitate the approval of the preceding proposals, including to permit the solicitation of additional proxies if there are not sufficient votes at the time of the special meeting to establish a quorum or to approve the preceding proposals; and
4. To transact such other business as may properly be brought before the special meeting or any adjournment or postponement thereof.

After careful consideration, our board of directors has unanimously determined that the proposed sale of assets is in the best interest of Ligand Pharmaceuticals Incorporated and our stockholders. **THE BOARD OF DIRECTORS UNANIMOUSLY APPROVED THE PROPOSED SALE AND THE ASSET PURCHASE AGREEMENT AND RECOMMENDS THAT YOU VOTE FOR THE APPROVAL AND ADOPTION OF THE PROPOSED SALE.**

Our board of directors has approved the amendment to our 2002 Stock Incentive Plan. **THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE FOR THE APPROVAL AND ADOPTION OF THE AMENDMENT TO THE 2002 STOCK INCENTIVE PLAN.**

Only holders of record of our common stock at the close of business on \_\_\_\_\_, 2006, will be entitled to notice of and to vote at the special meeting or any adjournment thereof. Each share of our common stock is entitled to one vote on each matter to be voted upon at the special meeting.

Your vote is important, regardless of the number of shares you own. The proposed sale of AVINZA® will not be completed unless it is authorized by the affirmative vote of the holders of a majority of the outstanding shares of our common stock entitled to vote at the special meeting. Even if you plan to attend the meeting in person, we request that you complete, sign, date and return the enclosed proxy or grant a proxy by the telephone or using the Internet to ensure that your shares will be represented at the meeting if you are unable to attend. Your prompt cooperation will be greatly appreciated.

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You are urged to review carefully the information contained in the enclosed proxy statement prior to deciding how to vote your shares at the special meeting.

The notice and proxy statement are first being mailed to stockholders on or about \_\_\_\_\_, 2006.

Please follow the voting instructions on the enclosed proxy card to vote either by mail, telephone or electronically by the Internet.

By Order of the Board of Directors,

Warner R. Broaddus  
*Secretary*

San Diego, California  
\_\_\_\_\_, 2006

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**SUMMARY TERM SHEET**

The following summary highlights selected information from this proxy statement and may not contain all of the information that may be important to you. Accordingly, we encourage you to read carefully this entire proxy statement, its annexes and the documents referred to in this proxy statement. Each item in this summary includes a page reference directing you to a more complete description of that item. In this proxy statement, the terms Ligand, company, we, our, ours, and us refer to Ligand Pharmaceuticals Incorporated, a Delaware corporation, and its subsidiaries.

**Parties to the Asset Sale**

*Ligand Pharmaceuticals Incorporated*  
10275 Science Center Drive  
San Diego, California 92121  
Telephone No.: (858) 550-7500

Ligand discovers, develops and markets new drugs that address critical unmet medical needs of patients in the areas of cancer, pain, skin diseases, men's and women's hormone-related diseases, osteoporosis, metabolic disorders, and cardiovascular and inflammatory diseases. Ligand's proprietary drug discovery and development programs are based on its leadership position in gene transcription technology, primarily related to intracellular receptors.

*King Pharmaceuticals, Inc.*  
501 Fifth Street  
Bristol, Tennessee 37620  
Telephone No.: (423) 989-8000

King Pharmaceuticals, Inc., or King, is a vertically integrated branded pharmaceutical company. King seeks to capitalize on opportunities in the pharmaceutical industry through the development, including through in-licensing arrangements and acquisitions, of novel branded prescription pharmaceutical products in attractive markets and the strategic acquisition of branded products that can benefit from focused promotion and marketing and product life-cycle management.

*King Pharmaceuticals Research and Development, Inc.*  
4000 CentreGreen Way, Suite 300  
Cary, North Carolina 27513  
Telephone No.: (919) 653-7099

King Pharmaceuticals Research and Development, Inc., or King R&D, is a Delaware corporation and a wholly-owned subsidiary of King.

**The Special Meeting**

***Date, Time, Place and Purpose (Page 11)***

The special meeting will be held on \_\_\_\_\_, 2006, starting at 9:00 a.m., local time, at the La Jolla Marriott located at 4240 La Jolla Village Drive, La Jolla, California 92037.

You will be asked to consider and vote upon approval of: (i) the asset sale and adoption of the asset purchase agreement; and (ii) the amendment of our 2002 Stock Incentive Plan, referred to in this proxy statement as the 2002 Plan, to allow equitable adjustments to be made to options subject to the 2002 Plan in the event of the payment of a special cash dividend. In addition, you will be asked to approve the adjournment of the special meeting, if necessary, in order to permit the solicitation of additional proxies if there are not sufficient votes at the time of the special meeting to establish a quorum or to approve the forgoing proposals.

The persons named in the accompanying proxy card will also have discretionary authority to vote upon other business, if any, that properly comes before the special meeting and any adjournment of the special meeting.

***Record Date, Voting and Quorum (Page 11)***

You are entitled to vote at the special meeting if you owned shares of our common stock at the close of business on \_\_\_\_\_, 2006, the record date for the special meeting. You will have one vote for each share of our common stock that you owned on the record date. As of the record date, there were \_\_\_\_\_ shares of our common stock outstanding and entitled to be voted.

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A quorum of the holders of the outstanding shares of our common stock must be present for the special meeting to be held. A quorum is present if the holders of a majority of the outstanding shares of our common stock entitled to vote are present at the special meeting, either in person or represented by proxy. Abstentions and broker non-votes are counted as present for the purpose of determining whether a quorum is present. A broker non-vote occurs on an item when a broker is not permitted to vote on that item without instructions from the beneficial owner of the shares and no instructions are given.

### ***Required Vote (Page 12)***

For the first proposal, the affirmative vote of the holders of a majority of our common stock outstanding at the close of business on the record date will be required for approval. A failure to vote your shares, an abstention or a broker non-vote will have the same effect as a vote against the asset sale.

For the second and third proposals, the affirmative vote of the holders of a majority of our common stock represented in person or by proxy at the special meeting and entitled to vote will be required to approve each proposal. Abstentions and broker non-votes will not be counted in determining the number of votes present in person or represented by proxy, and therefore will not have an effect on the approval of the amendment to the 2002 Plan or whether to adjourn the meeting. The approval of the amendment to the 2002 Plan is not a condition to the approval of the asset sale.

### ***Security Ownership of Certain Beneficial Owners, Directors and Management (Page 88)***

As of the record date, the directors and current executive officers of Ligand beneficially owned in the aggregate shares, representing approximately % of the shares of our common stock entitled to vote at the special meeting.

### ***Revocability of Proxies (Page 12)***

Any Ligand registered stockholder (meaning a stockholder that holds stock in its own name) entitled to vote may submit a proxy by telephone or the Internet or by returning the enclosed proxy card by mail, or may vote in person by appearing at the special meeting. If your shares are held in street name by your broker, you should instruct your broker on how to vote your shares using the instructions provided by your broker. If you do not provide your broker with instructions, your shares will not be voted and that will have the same effect as a vote against the asset sale.

Any Ligand registered stockholder who executes and returns a proxy card (or submits a proxy via telephone or the Internet) may revoke the proxy at any time before it is voted in any one of the following ways:

delivering to the Secretary of Ligand a written instrument that revokes the proxy;

submitting another properly completed proxy with a later date; or

attending the special meeting and voting in person.

Simply attending the special meeting will not constitute revocation of a proxy. If you have instructed your broker to vote your shares, the above-described options for revoking your proxy do not apply and instead you must follow the directions provided by your broker to change your instructions.

## **The Asset Sale**

*The Asset Sale (Page 14)*

On September 6, 2006, our board of directors, at a meeting duly called and held, approved the asset sale by and between Ligand, King and King R&D, pursuant to an asset purchase agreement, dated as of September 6, 2006, a copy of which is included as Annex A to this proxy statement. Please read it carefully. Ligand, King and King R&D may sometimes be referred to in this proxy statement as a party, or collectively as the parties. Pursuant to the terms of the asset purchase agreement:

we intend to sell all of our rights in and to AVINZA<sup>®</sup> (morphine sulfate extended-release capsules), in the United States, its territories and Canada, which would constitute a sale of all or substantially all of our assets under Delaware law; and

in exchange for our rights in and to AVINZA<sup>®</sup>, King and King R&D have agreed to pay us \$265 million in cash, subject to specific inventory adjustments, assume a payment obligation of Ligand to Organon of approximately \$48 million (or reimburse Ligand at closing of the asset sale to the extent any such amounts have been paid), assume the Company's existing co-promote termination obligation to make payments to

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Organon based on net sales of AVINZA<sup>®</sup>, and assume specified existing royalty obligations to other third parties. The Company will also receive certain royalty payments based on King's annual net sales of AVINZA<sup>®</sup> through AVINZA<sup>®</sup>'s patent expiration in November 2017. At closing of the asset sale \$15 million of the cash payment will be funded into an escrow to support any indemnification claims made by King within the first year of closing.

### ***Reasons for the Asset Sale (Page 21)***

In evaluating the asset sale, our board of directors considered the recommendations of the strategic alternatives committee, its consultations with our management and financial and legal advisors and various factors. For the material factors considered by our board of directors in reaching its decision to approve the asset sale and adopt the asset purchase agreement, see "The Asset Sale" Reasons for the Asset Sale, beginning on page 21.

### ***Recommendation of Our Board of Directors (Page 23)***

After careful consideration, our board of directors has unanimously:

determined that the asset sale, the asset purchase agreement and the transactions contemplated thereby are advisable and fair to and in the best interests of Ligand and our stockholders;

approved the asset sale and adopted the asset purchase agreement; and

recommended that Ligand's stockholders vote FOR the approval of the asset sale and adoption of the asset purchase agreement.

### ***Opinion of Our Financial Advisor (Page 23 and Annex B)***

In connection with the asset sale, Ligand's board of directors received a written opinion, dated September 6, 2006, from Ligand's financial advisor, UBS Securities LLC, or UBS, as to the fairness, from a financial point of view and as of the date of such opinion, to Ligand of the aggregate consideration to be received by Ligand in the asset sale. The full text of UBS' written opinion, dated September 6, 2006, is attached to this proxy statement as Annex B. We encourage you to read this opinion carefully and in its entirety for a description of the assumptions made, procedures followed, matters considered and limitations on the review undertaken. **UBS' opinion, which was provided to Ligand's board in connection with its evaluation of the aggregate consideration from a financial point of view, does not address any other aspect of the asset sale and does not constitute a recommendation to any stockholder as to how to vote or act with respect to the transaction.**

### ***Proceeds from the Asset Sale (Page 27)***

While we are evaluating a distribution of a substantial portion of the net cash proceeds from the asset sale to our stockholders in the form of a special dividend, we cannot predict the timing or amount of such distribution, if any, to be made to our stockholders. The amount, if any, available to our stockholders will be determined by our board of directors, after weighing the company's remaining liabilities and operational needs.

### ***Effects of the Asset Sale (Page 27)***

If the asset sale is approved and the asset purchase agreement is adopted by our stockholders and the other conditions to closing of the asset sale are satisfied, we expect to become a highly-specialized research and development and royalty company.



***Other Agreements and Transactions Related to the Asset Sale (Page 29)***

In addition to the asset purchase agreement, we also entered into the following related agreements and transactions in connection with the asset sale:

a contract sales force agreement with King, pursuant to which King agreed to conduct a detailing program to promote the sale of AVINZA®;

a loan arrangement with King, pursuant to which King loaned to us, \$37.75 million; and

as a condition to closing the asset sale, we are also required to mail a notice of redemption to each of the holders of our 6% Convertible Subordinated Notes, due 2007, which we mailed on October 30, 2006.

***Other Agreements and Transactions Related to our Strategic Review Process (Page 29)***

In connection with our overall strategic review process we also entered into the following agreements:

an asset purchase agreement with Eisai Inc. and Eisai Co., Ltd., pursuant to which we sold to Eisai Inc. and Eisai Co., Ltd. all of our rights to our marketed oncology products; and

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a sale and leaseback transaction for our corporate headquarters with Slough Estates USA Inc.

***Interests of Ligand's Directors and Executive Officers in the Asset Sale (Page 29)***

After the closing of the asset sale, King and King R&D have agreed to indemnify and hold our executive officers and directors harmless from any loss arising out of any breach of representations and warranties by King, or a failure by King to perform covenants applicable to them under the asset purchase agreement. All of our directors and executive officers own shares of our common stock and/or options to purchase shares of our common stock, and to that extent, their interests in the asset sale are the same as that of other holders of our common stock. See Security Ownership of Certain Beneficial Owners, Directors and Management, beginning on page 88.

***Dissenters Rights (Page 30)***

You will not experience any change in your rights as a stockholder as a result of the asset sale. None of Delaware law, our certificate of incorporation or our bylaws provides for appraisal or other similar rights for dissenting stockholders in connection with the asset sale. Accordingly, you will have no right to dissent and obtain payment for your shares.

***Material U.S. Federal and State Income Tax Consequences (Page 30)***

The asset sale will not result in any U.S. federal income tax consequences to our stockholders. The transaction will be a taxable event to Ligand for U.S. federal income tax purposes, but Ligand anticipates that a substantial portion or all of the taxable gain resulting from the asset sale will be offset by net operating losses. For a complete description of the material tax consequences of the asset sale to Ligand, please see Material U.S. Federal and State Income Tax Consequences, beginning on page 30.

***Regulatory Matters (Page 30)***

On October 5, 2006, we were notified that we had been granted early termination of the waiting period under the HSR Act.

***Asset Purchase Agreement (Page 31)***

***No Negotiation (Page 34)***

The asset purchase agreement restricts our ability to solicit or engage in discussions or negotiations with third parties regarding specified transactions involving Ligand. Notwithstanding these restrictions, under certain limited circumstances, our board of directors may respond to an alternative acquisition proposal, change its recommendation with respect to the asset sale and/or terminate the asset purchase agreement and enter into an alternative agreement if it constitutes a superior proposal under the asset purchase agreement after paying the termination fee specified in the asset purchase agreement.

***Conditions to Completion of the Asset Sale (Page 35)***

Before we can complete the asset sale, a number of conditions must be satisfied. These include, among other things:

the absence of any governmental or court order that enjoins, restrains, prohibits, or makes illegal the asset sale;

the expiration or termination of the applicable waiting period under the HSR Act, which condition was satisfied on October 5, 2006, when we were notified that we had been granted early termination of the waiting period under the HSR Act;

the receipt of our stockholder approval;

the accuracy of the parties' representations and warranties, subject to specified materiality qualifications;

the performance by each party of its obligations under the asset purchase agreement in all material respects;

the delivery of specified third-party consents;

the execution and delivery of specified agreements; and

the redemption or conversion of all outstanding Ligand 6% Convertible Subordinated Notes due 2007.

Other than the conditions pertaining to our stockholder approval and the absence of governmental or court orders, either Ligand on the one hand, or King on the other hand, may elect to waive conditions to their respective performance and consummate the asset sale.

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***Termination (Page 36)***

The asset purchase agreement may be terminated and the asset sale may be abandoned at any time prior to consummation of the asset sale by:

the mutual written consent of both parties;

either King or us, if the asset sale has not been completed by December 31, 2006 and, in either case, the failure to complete the asset sale by such date is not the result of the failure of the party seeking to terminate the asset purchase agreement of its obligations under the asset purchase agreement;

either King or us, if our stockholders do not adopt the asset purchase agreement at the special meeting;

either King or us, if the other party is in material breach of the asset purchase agreement, which breach is not cured within 10 days of the breaching party being notified of such breach;

us, if our board of directors has determined that an acquisition proposal is a superior proposal;

King, if, prior to the adoption of the asset purchase agreement by our stockholders, our board of directors:

fails to include in this proxy statement its recommendation of the asset purchase agreement; or

approves or recommends an acquisition proposal to our stockholders or approves or recommends that our stockholders tender their shares of common stock in any tender offer or exchange offer that is an acquisition proposal;

King, if it receives written notice from us that our board of directors has determined that an acquisition proposal is a superior proposal.

***Termination Fee (Page 37)***

We are obligated to pay King a termination fee of \$12 million if we or King terminates the asset purchase agreement under certain circumstances.

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**QUESTIONS AND ANSWERS ABOUT THE SPECIAL MEETING, PROPOSED ASSET SALE AND THE PROPOSED AMENDMENT TO THE 2002 PLAN**

**The Special Meeting**

**Q: Why am I receiving this proxy statement and proxy card?**

A: You are receiving a proxy statement and proxy card because you owned shares of our common stock as of the record date. This proxy statement and proxy card relate to Ligand's special meeting of stockholders (and any adjournment thereof) and describes the matters on which we would like you, as a stockholder, to vote.

**Q: Where and when is the special meeting?**

A: The special meeting will take place at the La Jolla Marriott located at 4240 La Jolla Village Drive, La Jolla, California 92037 on [redacted], 2006 at 9:00 a.m., local time.

**Q: Who is soliciting my proxy?**

A: Our board of directors is soliciting your proxy for use at the special meeting.

**Q: What proposals will be voted on at the special meeting?**

A: You will be asked to consider and vote on the following proposals:

to approve the sale of all or substantially all of our assets under Delaware law through the sale of our rights in and to AVINZA<sup>®</sup> (morphine sulfate extended-release capsules), in the United States, its territories and Canada, pursuant to the asset purchase agreement attached as Annex A to this proxy statement;

to approve the amendment of our 2002 Plan, to allow equitable adjustments to be made to options subject to the 2002 Plan in the event of the payment of a large non-recurring cash dividend;

to approve adjournment of the special meeting, if necessary, to facilitate the approval of the foregoing, including to permit the solicitation of additional proxies if there are not sufficient votes at the time of the special meeting to establish a quorum or to approve the foregoing; and

to transact such other business as may properly be brought before the special meeting or any adjournment or postponement thereof.

**Q: Why are we asking for a stockholder vote?**

A: Delaware law requires that a Delaware corporation obtain approval from its stockholders for the sale of all or substantially all of its property and assets. Obtaining stockholder approval is also a condition to closing of the asset sale under the terms of the asset purchase agreement we negotiated with King. In addition, Nasdaq rules require that stockholder approval be obtained for any material amendment to an equity compensation plan such as the 2002 Plan.

**Q: Who is entitled to vote?**

A: Record holders of our outstanding shares of common stock as of \_\_\_\_\_, 2006 are entitled to vote.

**Q: How many votes do I have?**

A: Each record holder of common stock is entitled to one vote per share of common stock.

**Q: How many shares may vote at the special meeting?**

A: As of the record date of \_\_\_\_\_, 2006, we had outstanding shares of common stock, which are all eligible to vote at the special meeting.

**Q: How does our Board of Directors recommend that I vote?**

A: The board of directors unanimously recommends that you vote:

FOR the proposal to approve the asset sale and adopt the asset purchase agreement;

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FOR the proposal to approve the amendment to the 2002 Plan; and

FOR the adjournment of the special meeting, if necessary, to solicit additional proxies if there are not sufficient votes at the time of the special meeting to establish a quorum or to approve the asset sale.

**Q: What vote of our stockholders is required to approve the asset sale and adopt the asset purchase agreement?**

A: For us to complete the asset sale, stockholders holding at least a majority of the shares of our outstanding common stock at the close of business on the record date must vote FOR the resolution approving the asset sale and adopting the asset purchase agreement.

**Q: What vote of our stockholders is required to approve the amendment to the 2002 Plan?**

A: For us to amend the 2002 Plan, stockholders holding at least a majority of the shares of our outstanding common stock represented in person or by proxy and entitled to vote at the special meeting must vote FOR the proposal.

**Q: What vote of our stockholders is required to approve the proposal to adjourn the special meeting, if necessary, to solicit additional proxies?**

A: The affirmative vote of a majority of the outstanding shares of our common stock present or represented by proxy at the special meeting and entitled to vote on the matter.

**Q: What is the share ownership of our directors and executive officers?**

A: As of the close of business on the record date, , 2006, our directors and executive officers collectively owned of the outstanding shares of our common stock, representing % of the shares entitled to vote at the special meeting. For more information on the share ownership of our directors and executive officers see Security Ownership of Certain Beneficial Owners, Directors and Management, (beginning on page 87).

**Q: Am I entitled to appraisal or dissenters rights in connection with the asset sale?**

A: No. Holders of shares of our outstanding common stock will not have appraisal or dissenters rights in connection with either the asset sale or amendments to the 2002 Plan.

**Q: What do I need to do now?**

A: After carefully reading and considering the information contained in this proxy statement, please vote your shares by completing, signing, dating and returning the enclosed proxy card in the enclosed return envelope, by granting a proxy using the telephone number printed on your proxy card; or by granting a proxy using the Internet instructions printed on your proxy card. You can also attend the special meeting and vote in person. The special meeting will take place on , 2006. Our board of directors unanimously recommends that you vote FOR of the asset sale and amendments to the 2002 Plan.

**Q: Can I change my vote after I have mailed in my signed proxy card?**

A: Yes. You can change your vote at any time before we vote your proxy at the special meeting. You can do so in three ways. First, you can send written notice stating that you would like to revoke your proxy to our Secretary at

the address given below. Second, you can request a new proxy card and complete and send it to our Secretary at the address given below. Third, you can attend the special meeting and vote in person. You should send any written notice or request for a new proxy card to the attention of the Secretary, 10275 Science Center Drive, San Diego, California 92121.

**Q: If my shares are held in street name by my broker, will my broker vote my shares for me?**

A: Your broker or other nominee will vote your shares only if you provide instructions on how to vote to such broker or other nominee. Following the directions provided by your broker or other nominee, you should instruct your broker or other nominee to vote your shares. Without your instructions, your shares will not be voted, which will have the same effect as a vote against the asset sale.

**Q: How will we solicit proxies?**



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A: Proxies may be solicited in person, by telephone, facsimile, mail or e-mail by our directors, officers and employees without additional compensation. Brokers, nominees, fiduciaries, and other custodians have been requested to forward soliciting material to the beneficial owners of shares of our common stock held of record by them, and we will reimburse such custodians for their reasonable expenses.

### **Q: Who can help answer further questions about the asset sale?**

A: If you have more questions about the asset sale, the amendment to the 2002 Plan, the special meeting or this proxy statement, you should contact Ligand's Secretary at 10275 Science Center Drive, San Diego, California 92121.

## **The Asset Sale**

### **Q: What is the proposed asset sale?**

A: The proposed asset sale is the sale of all of our rights in and to AVINZA<sup>®</sup> (morphine sulfate extended-release capsules), in the United States, its territories and Canada to King, and its wholly-owned subsidiary King R&D, pursuant to an asset purchase agreement, dated as of September 6, 2006. In exchange for our rights, King and King R&D have agreed to pay us \$265 million in cash, subject to specific inventory adjustments, and assume a payment obligation of Ligand to Organon of approximately \$48 million (or reimburse Ligand at closing of the asset sale to the extent any such amounts have been paid), assume the Company's existing co-promote termination obligation to make payments to Organon based on net sales of AVINZA<sup>®</sup> and assume specified existing royalty obligations to other third parties. The Company will also receive certain royalty payments based on King's annual net sales of AVINZA<sup>®</sup> through AVINZA<sup>®</sup>'s patent expiration in November 2017. At closing of the asset sale \$15 million of the cash payment will be funded into an escrow to support any indemnification claims made by King within the first year of closing. The full text of the asset purchase agreement is included as Annex A to this proxy statement.

### **Q: Why is the Ligand board of directors recommending the approval of the asset sale and adoption of the asset purchase agreement?**

A: The board of directors has unanimously approved the asset sale and adopted the purchase agreement. In evaluating the asset sale, our board of directors considered the recommendations of the strategic alternatives committee, its consultations with our management and financial and legal advisors and various factors. For the material factors considered by our board of directors in reaching its decision to approve and adopt the asset purchase agreement, see "The Asset Sale - Reasons for the Asset Sale", beginning on page 21.

### **Q: What do you expect to do with the proceeds from the asset sale?**

A: While we are evaluating a distribution of a substantial portion of the net cash proceeds from the asset sale to our stockholders in the form of a special dividend, we cannot predict the timing or amount of such distribution, if any, to be made to our stockholders. The amount, if any, available to our stockholders will be determined by our board of directors, after weighing the company's remaining liabilities and operational needs.

### **Q: When do you expect the asset sale to be completed?**

A: We are working to complete the asset sale as quickly as practicable. If all necessary approvals have been obtained, including stockholder and regulatory approvals, and any third party consents, we hope to complete the asset sale shortly after this special meeting scheduled for \_\_\_\_\_, 2006.

**Q: What will happen if the asset sale is approved? What will happen if it is not approved?**

A: If the asset sale is approved, King and King R&D will acquire all of our rights in and to AVINZA® in the United States, its territories and Canada. This will constitute the sale of substantially all of our assets under Delaware law. If approved, we expect to become a highly-specialized research and development and royalty company following the consummation of the asset sale. If the asset sale is not approved by the holders of a majority of our outstanding shares, then either we or King may terminate the asset purchase agreement and our board of directors, along with management, will reassess our options in light of our long-term strategic goals.

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**Q: Is the asset sale subject to conditions?**

A: Yes. In addition to the approval of the asset sale and adoption of the asset purchase agreement by our stockholders, the asset sale is subject to satisfaction of various conditions, including, among other things, the expiration or termination of the applicable waiting periods under the HSR Act, and the redemption or conversion of all outstanding Ligand 6% Convertible Subordinated Notes due 2007. For a description of these conditions, please see *The Asset Purchase Agreement Conditions to the Completion of the Asset Sale*, beginning on page 35.

**Q: Will the asset sale be a taxable transaction to me?**

A: The asset sale will not result in any U.S. federal income tax consequences to our stockholders. The transaction will be a taxable event to Ligand for U.S. federal income tax purposes, but Ligand anticipates that a substantial portion or all of the taxable gain resulting from the asset sale will be offset by net operating losses. For a complete description of the material tax consequences of the asset sale to Ligand, please see *Material U.S. Federal and State Income Tax Consequences*, beginning on page 30.

**The 2002 Plan**

**Q: Why is Ligand proposing to amend the 2002 Plan?**

A: Ligand is proposing the amendment to the 2002 Plan to enable it to maintain the retention benefits derived from the outstanding options held by our directors, officers and employees by preserving the potential rewards of those options in the event of a large cash dividend to our stockholders.

**Q: What will happen if the proposed amendment to the 2002 Plan is approved? What will happen if it is not approved?**

A: If the proposed amendment is approved, Ligand will be able to adjust the outstanding options to reflect any special cash dividend that may be paid to our stockholders after the consummation of the asset sale. Such adjustments may take the form of either an adjustment to each outstanding option's strike price and/or the number of shares granted under such option in order to equitably reflect the amount of cash distributed to our stockholders as a cash dividend. As a result of the plan modification, any such adjustments to the terms of outstanding options would be considered a modification for accounting purposes and result in the recognition of compensation expense in the Company's consolidated statement of operations under the requirements of Statement of Financial Accounting Standard No 123(R) *Share-Based Payment*. Any such expense could be material. If the proposed amendment to the 2002 Plan is not approved by the holders of a majority of our outstanding shares present at the meeting and we make a large cash dividend to our stockholders, a large percentage of the outstanding options may lose much, if not all, of their value and will no longer help us retain the talent we believe we need to operate the company on an ongoing basis. The amendments to the stock option plan have been approved by our board of directors.

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**CAUTIONARY STATEMENT CONCERNING  
FORWARD-LOOKING INFORMATION**

This proxy statement, and the documents to which we refer you in this proxy statement, contain forward-looking statements about our plans, objectives, expectations and intentions. Forward-looking statements include information concerning possible or assumed future results of operations of Ligand, the expected completion and timing of the asset sale and other information relating to the asset sale. There are forward-looking statements throughout this proxy statement, including, among others, under the headings Summary, Effects of the Asset Sale, and in statements containing the words believes, expects, estimates, forecasts, seeks, may, will, and continues or other similar expressions. You should read statements that contain these words carefully. They discuss our future expectations or state other forward-looking information, and may involve known and unknown risks over which we have no control, including, without limitation:

the inability to complete the asset sale due to the failure to satisfy the conditions to consummation of the asset sale, including the failure to obtain stockholder approval;

the occurrence of any event, change or other circumstances that could give rise to the termination of the asset purchase agreement;

the failure of the asset sale to close for any other reason;

the ability to recognize the benefits of the asset sale;

the outcome of legal proceedings that may be instituted against us and others in connection with the asset purchase agreement;

the amount of the costs, fees, expenses and charges related to the asset sale;

the effect of the announcement of the asset sale on our client relationships, operating results and business generally, including the ability to retain key employees; and

risks, uncertainties and factors set forth in our reports and documents filed with the Securities and Exchange Commission, or the SEC (which reports and documents should be read in conjunction with this proxy statement).

See **Where You Can Find Additional Information** on page 92. You should not place undue reliance on forward-looking statements. We cannot guarantee any future results, levels of activity, performance or achievements. All forward-looking statements contained or incorporated by reference in the proxy statement speak only as of the date of this proxy statement or as of such earlier date that those statements were made and are based on current expectations or expectations as of such earlier date and involve a number of assumptions, risks and uncertainties that could cause the actual result to differ materially from such forward-looking statements. Except as required by law, we undertake no obligation to update or publicly release any revisions to these forward-looking statements or reflect events or circumstances after the date of this proxy statement.

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**THE SPECIAL MEETING**

We are furnishing this proxy statement to you, as a stockholder of Ligand, as part of the solicitation of proxies by our board of directors for use at the special meeting of stockholders. In this proxy statement, the terms "Ligand," "company," "we," "our," "ours," and "us" refer to Ligand Pharmaceuticals Incorporated, a Delaware corporation, and its subsidiaries. The term "asset purchase agreement" refers to the Purchase Agreement, dated as of September 6, 2006, by and between Ligand Pharmaceuticals Incorporated, King Pharmaceuticals, Inc., and King Pharmaceuticals Research and Development, Inc. The term "asset sale" refers to the proposed sale of all of our rights in and to AVINZA<sup>®</sup> to King and King R&D pursuant to the asset purchase agreement. The term "King" refers to King Pharmaceuticals, Inc., and the term "King R&D" refers to King Pharmaceuticals Research and Development, Inc.

**Date, Time, Place and Purpose of the Special Meeting**

This proxy statement is being furnished to our stockholders in connection with the solicitation of proxies by our board of directors for use at that special meeting to be held at the La Jolla Marriott located at 4240 La Jolla Village Drive, La Jolla, California 92037 on \_\_\_\_\_, 2006 at 9:00 a.m., local time. The purpose of the special meeting is:

to consider and to vote on a proposal to approve the asset sale, which will constitute the sale of substantially all of the assets of Ligand to King and King R&D and approve the asset purchase agreement;

to consider and to vote on a proposal to amend Ligand's 2002 Stock Incentive Plan, referred to herein as the 2002 Plan, to allow equitable adjustments to be made to options outstanding under the 2002 Plan in the event of the payment of a large non-recurring cash dividend;

to approve adjournment of the special meeting, if necessary, to permit the solicitation of additional proxies if there are not sufficient votes at the time of the special meeting to establish a quorum or to approve the asset sale and adopt the asset purchase agreement; and

to transact such other business as may properly be brought before the special meeting or any adjournment or postponement thereof.

Our board of directors has unanimously determined that the approval of the asset sale is advisable and that the asset sale is fair and in the best interest of our stockholders. Accordingly, our board of directors unanimously recommends that our stockholders vote **FOR** the approval of the asset sale.

In addition, our board of directors has approved the amendment of the amendment of the 2002 Plan that would allow equitable adjustments to be made to options outstanding under the 2002 Plan in the event a special cash dividend is paid to our stockholders. Accordingly, our board of directors recommends that our stockholders vote **FOR** the approval of the amendment of the 2002 Plan.

**Record Date, Voting and Quorum**

Our board of directors fixed the close of business on \_\_\_\_\_, 2006, as the record date for the determination of holders of our outstanding shares entitled to notice of and to vote on all matters presented at the special meeting. Such stockholders will be entitled to one vote for each share held on each matter submitted to a vote at the special meeting. As of the record date, there were \_\_\_\_\_ shares of our common stock, \$0.001 par value per share, issued and outstanding, each of which is entitled to one vote on each matter to be voted upon. You may vote in person or by

proxy.

The required quorum for the transaction of business at the special meeting is a majority of the votes eligible to be cast by holders of shares of our common stock issued and outstanding on the record date. Shares that are voted FOR, or AGAINST a proposal or marked ABSTAIN are treated as being present at the special meeting for purposes of establishing a quorum and are also treated as shares entitled to vote at the special meeting with respect to such proposal. Broker non-votes and the shares of common stock as to which a stockholder abstains are included for purposes of determining whether a quorum of shares of common stock is present at a meeting. A broker non-vote occurs when a nominee holding shares of common stock for the beneficial owner does not vote on a

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particular proposal because the nominee does not have discretionary voting power with respect to that item and has not received instructions from the beneficial owner.

### **Required Vote**

Approval of the asset sale requires the affirmative vote of the holders of a majority of the outstanding shares of our common stock entitled to vote at the special meeting. The proposals to amend the 2002 Plan and to adjourn the meeting, if necessary, to solicit additional proxies, each require the affirmative vote of the holders of a majority of the outstanding shares of our common stock present or represented by proxy at the special meeting and entitled to vote on the matter.

Each holder of a share of our common stock is entitled to one vote per share. Failure to vote by proxy (by returning a properly executed proxy card or by following the instructions printed on the proxy card for telephone and Internet voting) or to vote in person will not count as votes cast or shares voting on the proposals. Since the first proposal requires the approval of the holders of a majority of our shares outstanding, both broker non-votes and abstentions would have the same effect as votes against such proposal. With respect to the second, third and fourth proposals, to approve the adjournment of the special meeting, if necessary, neither broker non-votes nor abstentions are included in the tabulation of the voting results and, therefore, they do not have the effect of votes against such proposals.

### **Voting**

Stockholders may vote their shares:

by attending the special meeting and voting their shares of our common stock in person;

by completing the enclosed proxy card, signing and dating it and mailing it in the enclosed post-prepaid envelope;

by using the telephone number printed on your proxy card; or

by using the Internet by going to <http://www.proxyvoting.com/lgnd> and following the instructions printed on your proxy card.

Our board of directors is asking for your proxy. Giving the board of directors your proxy means you authorize it to vote your shares at the special meeting in the manner you direct. You may vote for or against the proposals or abstain from voting. All valid proxies received prior to the special meeting will be voted. All shares represented by a proxy will be voted, and where a stockholder specifies by means of the proxy a choice with respect to any matter to be acted upon, the shares will be voted in accordance with the specification so made. If no choice is indicated on the proxy, the shares will be voted FOR the approval of the asset sale and adoption of the asset purchase agreement, the amendment to the 2002 Plan and as the proxy holders may determine in their discretion with respect to any other matters that properly come before the special meeting.

Stockholders who have questions or requests for assistance in completing or submitting proxy cards should contact us at 1-800-356-2017.

Stockholders who have their shares in street name, meaning the name of a broker or other nominee who is the record holder, must either direct the record holder of their shares to vote their shares or obtain a proxy from the record holder to vote their shares at the special meeting.

**Revocability of Proxies**

A stockholder giving a proxy has the power to revoke his or her proxy, at any time prior to the time it is voted, by:

delivering to the Secretary of Ligand a written instrument that revokes the proxy;

submitting another properly completed proxy with a later date; or

attending the special meeting and voting in person.



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Simply attending the special meeting will not constitute revocation of your proxy. If your shares are held in the name of a broker or other nominee who is the record holder, you must follow the instruction of your broker or other nominee to revoke a previously given proxy.

The form of proxy accompanying this proxy statement confers discretionary authority upon the named proxyholders with respect to amendments or variations to the matters identified in the accompanying Notice of Special Meeting and with respect to any other matters which may properly come before the special meeting. As of the date of this proxy statement, management knows of no such amendment or variation or of any matters expected to come before the special meeting which are not referred to in the accompanying Notice of Special Meeting.

**Attendance at the Special Meeting**

Only holders of common stock, their proxy holders and guests we may invite may attend the special meeting. If you wish to attend the special meeting in person but you hold your shares through someone else, such as a stockbroker, you must bring proof of your ownership and identification with a photo at the special meeting. For example, you could bring an account statement showing that you beneficially owned shares of common stock of Ligand as of the record date as acceptable proof of ownership.

**Solicitation of Proxies**

In addition to solicitation by mail, our directors, officers and employees may solicit proxies by telephone, other electronic means or in person. These people will not receive compensation for their services, but we will reimburse them for their out-of-pocket expenses. We will bear the cost of printing and mailing proxy materials, including the reasonable expenses of brokerage firms and others for forwarding the proxy materials to beneficial owners of common stock.

**Other Business**

We are not currently aware of any business to be acted upon at the special meeting other than the matters discussed in this proxy statement. Under our bylaws, business transacted at the special meeting is limited to the purposes stated in the notice of special meeting, which is provided at the beginning of this proxy statement. If other matters do properly come before the special meeting, or at any adjournment or postponement of the special meeting, we intend that shares of our common stock represented by properly submitted proxies will be voted in accordance with the recommendations of our board of directors.

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**PROPOSAL ONE:  
THE ASSET SALE**

The following is a description of the material aspects of the asset sale, including background information relating to the proposed terms of the asset purchase agreement. While we believe that the following description covers the material terms of the asset sale, the asset purchase agreement and other arrangements between King and King R&D and us, the description may not contain all of the information that is important to you. In particular, the following summary of the asset purchase agreement is not complete and is qualified in its entirety by reference to the copy of the asset purchase agreement attached to this proxy statement as Annex A and incorporated by reference herein. You should carefully read this proxy statement and the other documents to which we refer, including the asset purchase agreement, for a complete understanding of the terms of the asset sale.

**Background of the Asset Sale**

Ligand's board of directors and management have from time to time evaluated and considered a variety of strategic alternatives as part of our long-term strategy to maximize stockholder value.

In September 2005, as we neared the end of our financial restatement process (in 2005 we restated our consolidated financial statements for the years 2002 and 2003, the quarters of 2003, and the first three quarters of 2004, to correct errors related to revenue recognition and other matters), we considered retaining an investment banker to help us in evaluating strategic alternatives, including the sale of the company as a whole. UBS Securities LLC, or UBS, was subsequently engaged as our financial advisor to assist us in our review of near-term and long-term business and financial objectives and financial and strategic alternatives. In addition, in late September 2005, one of our largest shareholders began urging our board of directors and management to take a number of actions, including the evaluation of strategic options.

On October 31, 2005, our board of directors held a special meeting, at which management presented to and discussed with our board of directors, its proposed business plan and various business and strategic alternatives. Our board of directors also met with our financial advisor to discuss possible business and strategic alternatives as part of our effort to maximize stockholder value.

On November 18, 2005, we announced that we would be exploring strategic alternatives to enhance shareholder value and that we had engaged UBS as our financial advisor to assist our board of directors and management in this process.

At regularly scheduled meetings held on December 8<sup>th</sup> and 9<sup>th</sup> of 2005, our board of directors met and discussed Ligand's strategic review process with management and our financial and legal advisors. Management presented to and discussed with our board of directors its current strategic plan, including financial projections and product trends, and other strategic alternatives. Our board of directors also discussed with our financial advisor the process proposed for evaluating possible strategic alternatives, including the sale of the entire company, the sale or divestiture of our separate assets, including our rights in AVINZA<sup>®</sup>, which we refer to herein as the AVINZA<sup>®</sup> assets, the establishment of a royalty trust, and a combination of a sale of the company as a whole or selected commercial assets with the establishment of a royalty trust. In addition, a representative of our outside legal advisor, Latham & Watkins LLP, discussed with our board of directors its fiduciary duties under Delaware law in connection with this process. After extended discussion, our board of directors directed management and our financial advisor to conduct further work to evaluate the strategic alternatives that had been discussed at the meeting and to contact third parties regarding their interest in pursuing a possible transaction with us.

Between December 2005 and February 2006, in accordance with our board of directors' directives, our financial advisor contacted 78 interested parties, including 64 strategic parties and 14 financial parties, regarding their interest in pursuing a possible transaction with us. Confidentiality agreements were executed with 38 interested parties, 24 other strategic parties and 13 financial parties, each of which were provided with a confidential information memorandum regarding Ligand. During this period an electronic and a physical data room were assembled that contained, among other things, financial, legal and operational due diligence materials related to Ligand and the AVINZA<sup>®</sup> assets.

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On December 28, 2005, we executed a confidentiality agreement with King and a copy of the confidential information memorandum regarding Ligand was provided.

On January 17, 2006, we entered into a termination and return of rights agreement with Organon USA, Inc., or Organon, that terminated the AVINZA® co-promotion agreement between Ligand and Organon. Pursuant to the termination and return of rights agreement Organon agreed to continue to promote AVINZA® through September 30, 2006. The termination and return of rights agreement also obligates Ligand to pay Organon an approximately \$48 million termination payment, with approximately \$38 million due on or before October 15, 2006, and an additional \$10 million due on or before January 15, 2007. Under certain circumstances, including the sale of the AVINZA® assets, these cash payments will accelerate.

On or about January 19, 2006, at our board of director's direction, our financial advisor contacted representatives of King and the other interested parties to inform them that Ligand had established February 10, 2006, as the deadline for submission by interested parties of preliminary, non-binding indications of interest with respect to an acquisition of Ligand as a whole or the acquisition of one or more of our assets, including the AVINZA® assets.

On or about February 10, 2006, we received preliminary, non-binding indications of interest from King, and two other strategic parties referred to herein as Company A and Company B, for an acquisition of either the company as a whole or an acquisition of the AVINZA® assets.

On February 16, 2006, our board of directors held a special meeting, together with management and our financial and legal advisors, to review and discuss the indications of interest received to date. At the meeting, our financial advisor updated our board of directors regarding the overall strategic review process and reviewed with our board of directors the terms of the indications of interest that had been received and certain publicly available information relating to each of the companies that had submitted bids. Following a discussion of the bids received, our board of directors authorized management and our financial advisor to continue discussions with the parties that had submitted indications of interest, including inviting these companies to conduct comprehensive due diligence and participate in management presentations. Our board of directors also instructed management and our financial advisor to continue to evaluate our transaction options, including those discussed at the board meetings held on December 8th and 9th of 2005, and invite other companies into the process.

From February 16 to mid-April 2006, our management made presentations to three interested parties, including King on March 6, 2006. The management presentations included a general overview of our business, including the AVINZA® assets and our historical and projected financial performance. In addition, during this time, our representatives conducted due diligence calls with representatives of interested parties and responded to requests for additional due diligence materials.

During the week of February 20, 2006, Company A and Company B indicated that they would not be submitting a second round of non-binding indications of interest.

During the week of March 6, 2006, in accordance with our board of directors' directives, our financial advisor contacted an additional financial party, referred to herein as Company C. On March 16, 2006, we executed a confidentiality agreement with Company C, which submitted a preliminary non-binding indication of interest on April 7, 2006.

On or about April 6, 2006, at our board of director's direction, our financial advisor informed the interested parties that Ligand had established April 24, 2006 as the deadline for submission by interested parties of a second round of non-binding indications of interest with respect to an acquisition of the AVINZA® assets.

On April 11, 2006, King and Company C were provided a draft asset purchase agreement for their review and comment.

On April 24, 2006, we received a second round non-binding indication of interest from King for an acquisition of the AVINZA<sup>®</sup> assets, along with a mark-up of the draft asset purchase agreement previously provided by Ligand. Company C declined to submit a second indication of interest, citing issues with its financing.

On April 28, 2006, our board of directors held a special meeting, together with management and our financial and legal advisors, to review and discuss the strategic review process, including King's indication of interest. At the

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meeting, our financial advisor updated our board of directors regarding the overall strategic review process and reviewed with our board the financial terms of King's indication of interest, which reflected a significant decrease in the purchase price from the price reflected in King's initial indication of interest. Our board was informed by our financial advisor that King had indicated that this reduction in King's proposed purchase price was a result of the due diligence King had conducted to date. In addition, our legal advisors reviewed with our board of directors the principal legal matters reflected in the mark-up of the draft asset purchase agreement submitted by King. Management provided our board of directors with an update on general business matters, including our preliminary financial results for the first quarter of 2006, and discussed with the board financial reporting requirements for 2006. After extended discussion, our board of directors directed management and our financial advisor to continue to evaluate Ligand's strategic alternatives, including pursuing a potential transaction with King.

During May 2006, representatives of King conducted additional due diligence.

On May 25, 2006, our board of directors held a regular meeting, together with management and our financial advisor, at which our financial advisor updated our board with respect to the strategic review process, including efforts to provide King with the additional due diligence materials. Also at the meeting, management and our financial advisor discussed with our board of directors the other strategic alternatives, initially discussed at the board meetings held on December 8<sup>th</sup> and 9<sup>th</sup> of 2005.

On June 6, 2006, King submitted a revised indication of interest which contained a proposed purchase price for the acquisition of the AVINZA<sup>®</sup> assets significantly lower than the purchase price set forth in its April 24, 2006 indication of interest.

On June 8, 2006, our board of directors held a special meeting, together with management and our financial and legal advisors, at which management and our financial advisor reviewed with our board of directors King's June 6, 2006 indication of interest. After extended conversation, our board of directors decided to suspend negotiations with King at that time. Following this determination, management led a discussion of the status of the strategic review process in general and its proposed business plan.

During June 2006, at our board of directors' direction, our financial advisor contacted parties which previously had expressed an interest in the AVINZA<sup>®</sup> assets but had declined to submit either a preliminary or second round indication of interest, including Company A and Company B, and an additional four potential parties which had not been contacted previously.

On June 13, 2006, our board of directors held a special meeting at which the board of directors and management discussed the formation of a strategic alternatives committee of our board of directors to oversee the strategic review process. A representative of our outside legal advisor, Latham & Watkins LLP, also discussed with our board of directors its fiduciary duties under Delaware law with respect to the formation of a strategic alternatives committee to oversee the strategic review process. Following a discussion of these matters and the responsibilities to be delegated to the strategic alternatives committee, our board of directors established the strategic alternatives committee, comprised of independent directors of our board of directors John Groom and Michael A. Rocca and board member Brigette Roberts, to assist our board of directors and management with its review and supervision of the strategic review process and any resulting transactions.

On June 15, 2006, the strategic alternatives committee held a regular meeting, together with management and our financial advisor, to review and discuss the strategic review process. At the meeting, our financial advisor updated the committee regarding the overall strategic review process, including efforts to divest the AVINZA<sup>®</sup> assets. In addition, management presented and discussed with the committee several contingency options should Ligand be unable to divest the AVINZA<sup>®</sup> assets prior to the Organon termination date. These topics were also discussed on June 21, 2006,

our board of directors held a regular meeting also attended by management and our financial advisor.

Between early and mid-July 2006, our management made presentations similar to those previously provided to the other interested parties to each of Company A and Company B. During this time, our representatives also conducted diligence calls with representatives of each of Company A and Company B and responded to requests for additional due diligence materials. In addition, on July 13, 2006 Company A and Company B were provided with a draft asset purchase agreement for their review and comment.

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On or about July 13, 2006, at the strategic alternative committee's direction, our financial advisor informed Company A and Company B that Ligand had established July 31, 2006 as the deadline for submission by interested parties of a second round of non-binding indications of interest with respect to an acquisition of the AVINZA® assets.

On or about July 25, 2006, Jason Aryeh, the general partner of JALAA Equities, LP, one of our stockholders, had a telephonic conversation with Adriann W. Sax, Executive Vice President, Business Development and Strategic Planning of King, during which Ms. Sax indicated that King was still interested in a possible transaction with Ligand for the AVINZA® assets. Dating back to early 2005, Mr. Aryeh had been independently contacting potential purchasers of Ligand to gauge their interest in purchasing either Ligand as a whole or its individual assets. It was in this context that Mr. Aryeh began to develop a relationship with representatives of King, including Ms. Sax and Neil Morton, Associate Director of Business Development and Strategic Planning of King. From their first telephone conversation on November 18, 2005, Mr. Aryeh, Ms. Sax and Mr. Morton spoke on a regular basis regarding a possible transaction with Ligand for the AVINZA® assets. In addition, Mr. Aryeh provided King with diligence materials that he had independently developed to aid King in its due diligence process.

On July 26, 2006, our board of directors held a special meeting at which management updated our board of directors regarding the overall strategic review process and presented and discussed with our board of directors management's current operational initiatives to support Ligand's ongoing business. Following management's presentation, the non-management members of the board of directors discussed the strategic review process in an executive session.

On July 27, 2006, our board of directors reconvened at a regular meeting, together with management and our financial advisor. Following a discussion with management and our financial advisor regarding the strategic review process, the non-management members of our board of directors met in executive session. Following this executive session David E. Robinson, a director and our President, Chief Executive Officer and Chairman of the Board, offered his resignation from his positions as director, President, Chief Executive Officer, and Chairman of the Board, to be effective as of July 31, 2006.

On July 28, 2006, Mr. Aryeh contacted Dr. Roberts and Jeffrey R. Perry, one of our directors, regarding his conversations with King and relayed Ms. Sax's statement that King remained interested in a possible transaction with Ligand for the AVINZA® assets.

On or about July 29, 2006, Dr. Roberts had conversations with her fellow strategic alternative committee members, Messrs. Groom and Rocca, regarding Mr. Aryeh's discussion with Ms. Sax.

On July 31, 2006, our board of directors held a special meeting at which Henry F. Blissenbach, one of our directors, was appointed as Chairman of the Board and Interim Chief Executive Officer. Mr. Groom updated the board of directors regarding the overall strategic review process and summarized for the board King's expression of interest in reengaging in the process. In addition, our board of directors discussed the possibility of utilizing Mr. Aryeh to help facilitate a possible transaction with King regarding the sale of the AVINZA® assets. Following an extended discussion, our board of directors authorized the strategic alternatives committee to ask Mr. Aryeh to help facilitate a possible transaction with King regarding the sale of the AVINZA® assets. On August 1, 2006, Mr. Aryeh entered into a confidentiality agreement with Ligand.

On July 31 and August 1, 2006, we received a second round non-binding indication of interest from Company A and Company B, respectively. In addition, Company A provided Ligand and our outside counsel with a mark-up of the draft asset purchase agreement. Pursuant to its written proposal, Company A proposed to purchase the AVINZA® assets for a purchase price of \$325 million in cash, but did not offer to assume Ligand's payment obligations under the Organon termination and return of rights agreement. Pursuant to its written proposal, Company B proposed to purchase the AVINZA® assets for a purchase price of \$300 million in cash and assume Ligand's payment obligations



of approximately \$48 million under the Organon termination and return of rights agreement.

On August 1, 2006, Dr. Roberts and Mr. Aryeh met with Brian A. Markison, President and Chief Executive Officer of King, Ms. Sax, Steve Andrzejewski, Chief Commercial Officer of King, and Mr. Morton at King's offices in Bridgewater, New Jersey, to discuss a possible transaction with Ligand regarding the AVINZA<sup>®</sup> assets. At this

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meeting the parties discussed financial terms of King's bid for the AVINZA® assets and process matters such as the status of King's due diligence.

On August 2, 2006, the strategic alternatives committee held a meeting, together with management and our financial and legal advisors, to review and discuss Company A's and Company B's respective indications of interest. At the meeting, our financial advisor updated the committee regarding the overall strategic review process and reviewed with the committee the terms of Company A's and Company B's indications of interest, respectively, and certain publicly available information relating to each of the companies. The committee was informed by our financial advisor that each of Company A and Company B had indicated that its proposed acquisition was not fully funded, but that it was either working with a current financing source or its existing equity sponsors to develop a fully financed bid. Following an extensive discussion of the bids received, the committee authorized management and our financial advisor to continue discussions with Company A and Company B, including inviting these companies to conduct comprehensive due diligence and participate in management presentations.

On August 4, 2006, the strategic alternatives committee held a meeting with management and our financial and legal advisors, to review and discuss the strategic review process. At the meeting the committee was updated regarding the status of discussions with Company A and Company B. The committee was also updated with respect to the status of discussions with King, including King's request for an onsite due diligence visit and concerns raised by King regarding Ligand's current inventory levels. After a discussion, the committee directed management and Messrs. Perry and Aryeh to arrange a due diligence visit at Ligand's offices in San Diego, California for August 7 through August 9, 2006.

From August 7 through August 9, 2006, representatives of King, including Ms. Sax, Mr. Morton and representatives of King's financial advisor, Citigroup Global Markets Inc., met with representatives of Ligand, including Dr. Roberts, Mr. Aryeh, Andres Negro-Vilar, M.D., Ph.D., Executive Vice President, Research and Development, and Chief Scientific Officer of Ligand, James L. Italien, Ph.D., Senior Vice President, Regulatory Affairs and Compliance of Ligand, and Tod G. Mertes, CPA, Vice President, Controller and Treasurer of Ligand, at Ligand's offices in San Diego, California to discuss King's open diligence issues.

On August 10, 2006, the strategic alternatives committee held a meeting, together with management and our financial and legal advisors, to receive an update on the status of discussions with Company A, Company B and King. The committee was updated regarding the discussions with Company A and Company B, and with respect to the status of discussions with King, including King's recent diligence visit to Ligand's offices and ongoing concerns raised by King regarding Ligand's current inventory levels. Mr. Aryeh discussed with the committee several potential solutions to resolve these concerns as well as fill the promotion gap to be vacated by Organon beginning on October 1, 2006. After a discussion, the committee authorized management and Mr. Aryeh to continue discussions with King and to propose the potential solutions discussed with the committee, including a possible contract sales agreement with King, pursuant to which King's sales force would promote the AVINZA® product between October 1, 2006 and the closing of the proposed sale of the AVINZA® assets.

On August 14, 2006, representatives of Ligand and Company A telephonically discussed Company A's mark-up of the draft asset purchase agreement. At the culmination of the telephonic discussion, and at the strategic alternative committee's direction, Company A was informed that Ligand had established August 24, 2006 as the deadline for submission by interested parties of a final best offer and asked that Company A submit a revised mark-up of the asset purchase agreement with its bid. Following these discussions and in accordance with the strategic alternative committee's directives, our financial advisor also informed Company B that Ligand had established August 24, 2006 as the deadline for submission by interested parties of a final best offer and asked that Company B submit a mark-up of the draft asset purchase agreement with its bid.

On August 15, 2006, we received a written indication of interest from King pursuant to which King proposed to purchase the AVINZA® assets for a purchase price of \$250 million in cash, assume Ligand's payment obligations of approximately \$48 million under the Organon termination and return of rights agreement, and pay a royalty based on King's annual net sales of AVINZA® through AVINZA®'s patent expiration in November 2017.

On August 15, 2006, the strategic alternatives committee held a meeting with management and our financial and legal advisors, to receive an update on the discussions with the interested parties.

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On August 15, 2006, King provided Ligand and our legal advisor with a draft non-binding term sheet for an asset purchase agreement to be entered into in connection with the sale of the AVINZA<sup>®</sup> assets and a draft non-binding term sheet for a contract sales force agreement. During the period from August 15, 2006 through August 22, 2006, representatives of Ligand and King negotiated the terms of the two term sheets during several telephonic meetings. In connection with these negotiations, on August 18, 2006, Mr. Aryeh, Mr. Perry and a representative of our outside legal counsel had a telephonic meeting with Joseph Squicciarino, Chief Financial Officer of King, Ms. Sax, James W. Elrod, General Counsel of King to negotiate the terms of non-binding term sheets for the asset purchase agreement and the contract sales force agreement. On August 22, 2006, Dr. Blissenbach, Mr. Perry, Mr. Aryeh and a representative of our outside legal counsel met with Mr. Markison, Mr. Squicciarino, Ms. Sax, Mr. Andrzejewski and Mr. Elrod, at Ligand's offices in San Diego, California, to finalize the terms of the non-binding term sheets, including the structure of the royalty payment. Pursuant to the non-binding term sheet, King agreed to pay Ligand a 15% royalty during the first 20 months after the closing of the asset sale on its net sales of the AVINZA<sup>®</sup> product. With respect to subsequent royalty payments King agreed to pay Ligand a 5% royalty if its net sales were less than \$200 million, and if King's calendar year net sales were greater than \$200 million, then the royalty payment would be 10% of all of King's net sales less than \$250 million, plus 15% of all of King's net sales greater than \$250 million.

On August 21, 2006, our board of directors held a special meeting at which management updated our board of directors regarding the status of discussions with the three remaining interested parties.

On August 23, 2006, King provided Ligand and our legal advisors a draft contract sales force agreement.

On August 24, 2006, Company A submitted a final best offer pursuant to which Company A increased its offer price from \$325 million to \$350 million in cash and added 1% royalty on Company A's net sales for a period of five years. Company B informed our financial advisor that it would not be submitting a final best offer at that time, although it remained interested in a possible transaction with Ligand.

On August 25, 2006, the strategic alternatives committee held a special meeting with management and our financial and legal advisors, to review and discuss King's and Company A's respective bids. Our financial advisor reviewed with the committee the terms of Company A's bid and informed the committee that Company B had indicated that it would not be submitting a final best offer at that time, although it remained interested in a possible transaction with Ligand. Our legal advisor reviewed the principal legal aspects of Company A's mark-up of the draft asset purchase agreement. The committee was also updated with respect to the status of discussions with King and discussed with Messrs. Perry and Aryeh the financial terms of the non-binding term sheets for an asset purchase agreement to be entered into in connection with the sale of the AVINZA<sup>®</sup> assets and the contract sales force agreement. Our legal advisor reviewed the principal legal aspects of the terms sheets agreed upon with King. After an extended discussion, the committee directed management and our financial and legal advisors to continue discussions with both King and Company A with respect to a possible sale of the AVINZA<sup>®</sup> assets.

On August 25, 2006, King provided Ligand and our legal advisors with a mark-up of the draft asset purchase agreement. Thereafter, management, Mr. Aryeh and our outside legal advisor negotiated the terms of the asset purchase agreement and contract sales force agreement with King's representatives.

On August 30, 2006 and August 31, 2006, representatives of Company A discussed with our financial advisor the value of Company A's bid and pending due diligence requirements, which Company A estimated would require approximately two weeks to complete. Company A was informed that a two week due diligence period could place Company A at a substantial timing disadvantage. As a result of these discussions, Company A increased the cash component of its offer price from \$350 million to \$385 million and restructured its proposed royalty payment to provide for a 1% royalty for sales up to \$100 million, which would increase incrementally for each additional \$100 million in sales up to \$500 million at which point the royalty would remain at 11%, as well as its duration.

On August 31, 2006, the strategic alternatives committee held a meeting, together with management and our financial and legal advisors, to review and discuss the status of negotiations with King and Company A. At the meeting, our financial advisor discussed with the committee financial aspects of King's and Company A's proposals to purchase the AVINZA® assets. Our legal advisors also summarized and discussed with the committee the material terms of the proposed asset purchase agreements. After an extended discussion, the committee directed

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management and our financial and legal advisors to continue discussions with both King and Company A with respect to a possible sale of the AVINZA® assets and inform them that Ligand had established September 5, 2006 as the deadline for submission of final best offers coupled with a fully negotiated asset purchase agreement.

Following the strategic alternatives committee meeting, our financial advisor informed Company A, in accordance with the committee's directives, of the September 5, 2006 deadline for submission of final best offers and discussed with Company A its remaining diligence requirements. Company A expressed an interest in completing its remaining due diligence on an accelerated basis and negotiating the asset purchase agreement. Over the next several days, management and our advisors worked with Company A and its advisors to address its due diligence requests and negotiate the asset purchase agreement. Following the strategic alternatives committee meeting, Mr. Aryeh informed King, in accordance with the committee's directives, of the deadline for submission of a final best offer and a fully negotiated asset purchase agreement. Over the next several days, Messrs. Perry and Aryeh and our legal advisor worked with King to negotiate and finalize the asset purchase agreement and contract sales force agreement.

On September 4, 2006, Mr. Aryeh and King's financial advisor had a telephonic conversation to discuss possible changes to King's proposal. During this discussion, Mr. Aryeh suggested that King offer to loan Ligand, at Ligand's option, an amount equal to the initial termination payment Ligand will be required to make under the termination and return of rights agreement with Organon, at a favorable interest to Ligand, but which would be forgiven at closing of the proposed asset sale, if the parties closed the transaction prior to January 1, 2007. Later that day, Mr. Perry had a telephonic conversation with King's financial advisor during which he urged King to raise the cash component of its bid.

On September 5, 2006, Dr. Blissenbach and Mr. Markison had a telephonic discussion to clarify King's proposal. As a result of these discussions, King increased the cash component of its offer price from \$250 million to \$265 million and offered to loan Ligand, at Ligand's option, up to \$37.75 million at an interest rate of 9.50%, which accrued interest amounts, if any, would be forgiven at closing of the proposed asset sale, if the parties closed the transaction prior to January 1, 2007. Mr. Markison stated that this was King's best and final offer.

On September 5, 2006, the strategic alternatives committee held a meeting, together with management and our financial and legal advisors to review and discuss King's and Company A's final best offers and asset purchase agreements, respectively. Mr. Aryeh reviewed and discussed with the committee the financial terms of King's final best offer, including the increase of upfront cash and the no-interest loan. Our legal advisors reviewed and discussed with the committee its fiduciary obligations under Delaware law in connection with the proposed asset sale. Our legal advisors also summarized and discussed with the committee the material terms of the asset purchase agreements, including provisions permitting the board of directors to change its recommendation to stockholders or terminate the asset purchase agreement to accept a superior proposal, subject to payment of a termination fee equal to approximately 2.5% of the aggregate purchase price plus reimbursement of King's out-of-pocket expenses. Our financial advisor then reviewed with the committee the events leading up to the asset sale. The committee, with the assistance of management and our financial advisor, compared financial terms of King's and Company A's final best offers, including the different royalty payment structures, management's view of the respective abilities of each bidder to market AVINZA® going forward, the impact such abilities could have on the relative attractiveness of the offers and the implications of our existing net operating losses on the potential after-tax value to be received by Ligand in the proposed transactions. After an extended discussion regarding King's proposal relative to Company A's, the committee concluded to recommend that our board of directors approve the asset purchase agreement to be entered into with King and recommend that our stockholders approve the sale of the AVINZA® assets to King, based on the expected relative values of the offers, the implications of our existing net operating losses on the potential after-tax value to be received by Ligand in the proposed transactions and the increased assurance of closing a transaction with King.

On September 6, 2006, our board of directors held a special meeting with management and our financial and legal advisors to review and discuss King's and Company A's final best offers and asset purchase agreements, respectively, and consider the recommendation of the strategic alternatives committee to approve the sale of the AVINZA® assets to King. Dr. Blissenbach reviewed and discussed with the board the financial terms of the asset purchase agreement with King and the events leading up to the asset sale. The board discussed, with the assistance

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of management and our financial advisor, financial terms of King's and Company A's final best offers, including the different royalty payment structures, management's view of the respective abilities of each bidder to market AVINZA® going forward, the impact such abilities could have on the relative attractiveness of the offers and the implications of our existing net operating losses on the potential after-tax value to be received by Ligand in the proposed transactions. Mr. Groom discussed with our board of directors the strategic alternatives committee's process and relayed the committee's recommendation that the board of directors approve the asset purchase agreement to be entered into with King and recommend that our stockholders approve the sale of the AVINZA® assets to King. UBS then reviewed with our board of directors its financial analysis of the aggregate consideration to be paid by King for the AVINZA® assets, and delivered to our board of directors an oral opinion, which opinion was confirmed by delivery of a written opinion dated September 6, 2006, to the effect that, as of that date and based on and subject to various assumptions, matters considered and limitations described in its opinion, the aggregate consideration to be received by Ligand in the transaction was fair, from a financial point of view, to Ligand. Our legal advisors reviewed and discussed with our board of directors its fiduciary obligations under Delaware law in connection with the asset sale. Our legal advisors also summarized and discussed with our board the material terms of the asset purchase agreement with King, including provisions permitting the board of directors to change its recommendation to stockholders or terminate the asset purchase agreement to accept a superior proposal, subject to payment of a termination fee equal to approximately 2.5% of the aggregate purchase price plus reimbursement of King's out-of-pocket expenses. After an extended discussion regarding the financial and legal advantages of King's proposal relative to Company A's proposal, our board unanimously approved the sale of the AVINZA® assets to King and resolved to recommend that our stockholders approve the sale of the AVINZA® assets to King.

The parties executed the asset purchase agreement and contract sales agreement on September 6, 2006. On September 7, 2006, Ligand and King issued a press release announcing the transaction.

## **Reasons for the Asset Sale**

In evaluating the asset sale, the board of directors considered the recommendations of the strategic alternatives committee, consulted with our management and financial and legal advisors, reviewed a significant amount of information and considered a number of factors. The material factors considered by the board of directors were:

the value and the consideration to be received by the company pursuant to the asset purchase agreement, including the fact that the company would receive an up-front cash payment, and King would agree to assume certain payment obligations of Ligand, plus Ligand would receive a certain royalty payment based on King's annual net sales of AVINZA® through AVINZA®'s patent expiration in November 2017, which will, among other things, provide funds to operate the company following the completion of the asset sale;

the implications of our existing net operating losses on the potential after-tax value of the consideration to be received by Ligand in the asset sale;

the solicitation and bid process undertaken on behalf of the company which resulted in King's offer to acquire the AVINZA® assets;

the recommendation of the strategic alternatives committee (a committee formed to consider strategic alternatives available to the company and make recommendations to the board of directors regarding the company's strategic alternatives) to approve the asset purchase agreement and recommend that our stockholders vote for the approval of the asset sale and adoption of the asset purchase agreement;

historical, current and projected information concerning the AVINZA® business, financial performance and condition, operations, technology, management and competitive position, and current industry, economic and



market conditions, including the possibility that we continue to operate the AVINZA® business, shut down certain operations or sell other business assets;

the financial presentation of our financial advisor, UBS, including its opinion (the full text of which is attached as Annex B to this proxy statement), dated September 6, 2006, to the board of directors as to the fairness, from a financial point of view and as of the date of the opinion, to Ligand of the aggregate consideration to be received by Ligand in the asset sale, as more fully described below under the caption THE ASSET SALE Opinion of Our Financial Advisor beginning on page 23;

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the potential impact of the asset sale on our reputation, customers, strategic partners and employees;

King's agreement to hire our sales representatives whose primary responsibility is the promotion of AVINZA®;

King's premier sales force and its ability to promote AVINZA®, and the impact of such promotion will have on the royalty payments we will be entitled to under the asset purchase agreement;

the Contract Sales Force Agreement, referred to herein as the "contract 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, subject to the terms and conditions of the contract sales agreement, which commenced on October 1, 2006 and is scheduled to continue for a period of six months or until the closing of the asset sale or earlier termination of the asset purchase agreement. Previously, Organon Pharmaceuticals USA, Inc., conducted a detailing program to promote the sale of AVINZA®, however, Organon's ceased on September 30, 2006, pursuant to and in accordance with the terms of Termination and Return of Rights Agreement, dated as of January 1, 2006, by and between Ligand and Organon Pharmaceuticals USA, Inc., which would have resulted in the under promotion of AVINZA® if not for the contract sales agreement;

the fact that the asset purchase agreement affords our board of directors flexibility to consider, evaluate and accept superior proposals in the period after signing and prior to the consummation of the asset purchase agreement as follows:

- subject to compliance with the asset purchase agreement, we can participate in any discussions or negotiations with, and provide any non-public information (other than any confidential information of King or any non-public financial or other material terms of the asset purchase agreement) to, any person in response to an acquisition proposal by any such person, if our board of directors determines that there is a reasonable likelihood that such acquisition proposal could lead to a superior proposal, as defined in the asset purchase agreement;
- subject to compliance with the asset purchase agreement, our board of directors is permitted to change its recommendation to stockholders with respect to or enter into an alternative transaction that is a superior proposal, conditioned upon the payment to King of a \$12 million termination fee;
- subject to compliance with the asset purchase agreement, our board of directors is permitted to change its recommendation to stockholders, if it determines that doing so is consistent with its fiduciary duties to our stockholders under applicable law; and
- subject to compliance with the asset purchase agreement, our board of directors is permitted to take and disclose to our stockholders a position with respect to any tender offer or exchange offer by a third party or amend or withdraw such a position in accordance with applicable law;

our efforts, with the assistance of our advisors, to negotiate and execute an asset purchase agreement favorable to us.

In the course of its deliberations, the board of directors also considered a variety of risks and other countervailing factors concerning the asset purchase agreement and asset sale. The material factors considered by the board of directors were:

the risk that the asset sale might not be completed in a timely manner or at all;

the fact that our participation in any future earnings or growth of AVINZA® will be limited to royalty payments;

the restrictions on the conduct of our business prior to completion of the asset sale, requiring us to conduct our business only in the ordinary course, subject to specific limitations or King's consent, which may delay or prevent us from undertaking business opportunities that may arise pending completion of the asset sale;

the restrictions on our board of directors' ability to solicit or engage in discussions or negotiations with a third party regarding alternative transactions involving AVINZA® or Ligand as a whole, and the requirement

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that we pay King a \$12 million termination fee in certain cases in the event of a termination of the asset purchase agreement;

the risk that the inventory adjustments required under the King proposal could be substantial, thus reducing the up-front cash consideration;

the fact that we selected the King proposal over an alternative proposal which offered consideration consisting of a larger up-front cash payment coupled with a smaller royalty payment;

the risk of diverting management focus and resources from other strategic opportunities and from operational matters while working to implement the asset sale; and

the possibility of management and employee disruption associated with the asset sale.

The foregoing discussion of the material information and factors considered by our board of directors. The board of directors collectively reached a unanimous conclusion to recommend the approval of the asset sale and adoption of the asset purchase agreement in light of the various factors and other factors that each member of the board of directors believed were appropriate. In of the variety of factors considered by the board of directors in connection with its evaluation of the asset sale and the complexity of these matters, the board of directors did not consider it practicable, and did not attempt, to quantify, rank or otherwise assign relative or specific weight or values to any of these factors. Rather, the board of directors made its recommendation based on the totality of information presented to it and the investigation conducted by it. In considering the factors discussed above, individual directors may have given different weight to different factors.

## **Recommendation of Our Board of Directors**

After careful consideration, our board of directors unanimously determined that the asset sale is fair to, and in the best interests of, the company and our stockholders and that the asset purchase agreement and the asset sale are advisable. Accordingly, our board of directors approved the asset purchase agreement and recommended that our stockholders approve the asset sale.

**THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR THE APPROVAL OF THE ASSET SALE.**

## **Opinion of Our Financial Advisor**

On September 6, 2006, at a meeting of our board of directors held to evaluate the asset sale, UBS delivered to our board of directors an oral opinion, confirmed by delivery of a written opinion dated September 6, 2006, to the effect that, as of that date and based on and subject to various assumptions, matters considered and limitations described in its opinion, the aggregate consideration to be received by Ligand in the transaction was fair, from a financial point of view, to Ligand.

The full text of UBS' opinion describes the assumptions made, procedures followed, matters considered and limitations on the review undertaken by UBS. This opinion is attached as Annex B and is incorporated into this proxy statement by reference. **UBS' opinion is directed only to the fairness, from a financial point of view, of the aggregate consideration to be received by Ligand in the transaction and does not address any other aspect of the transaction. The opinion does not address the relative merits of the transaction as compared to other business strategies or transactions that might be available with respect to Ligand's rights in AVINZA® and assets to be sold in the asset sale, collectively referred to in this section as the AVINZA® assets, or Ligand's underlying**

**business decision to effect the transaction. The opinion does not constitute a recommendation to any stockholder as to how such stockholder should vote or act with respect to the transaction. Holders of our common stock are encouraged to read this opinion carefully in its entirety.** The summary of UBS' opinion described below is qualified in its entirety by reference to the full text of its opinion.

In arriving at its opinion, UBS:

reviewed publicly available business and financial information relating to the AVINZA® assets and King;

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reviewed internal financial information and other data relating to the AVINZA® assets that were provided to UBS by Ligand's management and not publicly available, including financial forecasts and estimates (including forecasts and estimates as to net sales anticipated by Ligand's management to be achieved by King) prepared by Ligand's management;

conducted discussions with members of Ligand's senior management concerning the AVINZA® assets;

reviewed publicly available financial and stock market data with respect to companies UBS believed to be generally relevant;

compared the financial terms of the transaction with the publicly available financial terms of other transactions which UBS believed to be generally relevant;

reviewed the purchase agreement and certain related documents; and

conducted other financial studies, analyses and investigations, and considered other information, as UBS deemed necessary or appropriate.

In connection with its review, with Ligand's consent, UBS did not assume any responsibility for independent verification of any of the information provided to or reviewed by UBS for the purpose of its opinion and, with Ligand's consent, UBS relied on that information being complete and accurate in all material respects. In addition, with Ligand's consent, UBS did not make any independent evaluation or appraisal of any assets, including the AVINZA® assets, or liabilities, contingent or otherwise, of Ligand, and UBS was not furnished with any evaluation or appraisal. With respect to the financial forecasts and estimates (including forecasts and estimates as to net sales) prepared by Ligand's management, UBS assumed, at Ligand's direction, that they were reasonably prepared on a basis reflecting the best currently available estimates and judgments of Ligand's management as to the future performance of the AVINZA® assets and as to net sales. In addition, UBS assumed, with your approval, that the forecasts and estimates as to net sales anticipated by Ligand's management to be achieved by King will be achieved at the times and in the amounts projected. UBS also relied, at Ligand's direction, without independent verification or investigation, upon the assessments of Ligand's management as to the AVINZA® assets and the risks associated with the AVINZA® assets (including the potential impact of drug competition). UBS' opinion was necessarily based on economic, monetary, market and other conditions as in effect on, and the information available to UBS as of, the date of its opinion.

At Ligand's direction, UBS contacted third parties to solicit indications of interest in a possible transaction with Ligand and held discussions with certain of these parties prior to the date of UBS' opinion. At Ligand's direction, UBS was not asked to, and it did not, offer any opinion as to the terms of the transaction agreement or any related documents, other than the aggregate consideration to be received by Ligand in the transaction to the extent expressly specified in the opinion, or the form of the transaction. In rendering its opinion, UBS assumed, with Ligand's consent, that Ligand, King and King R&D would comply with all material terms of the purchase agreement and related documents and that the transaction would be consummated in accordance with the terms of the purchase agreement and related documents without any adverse waiver or amendment of any material term or condition of the purchase agreement or related documents. UBS also assumed that all governmental, regulatory or other consents and approvals necessary for the consummation of the transaction would be obtained without any material adverse effect on the AVINZA® assets, Ligand, King or the transaction. Except as described above, Ligand imposed no other instructions or limitations on UBS with respect to the investigations made or the procedures followed by UBS in rendering its opinion.

In connection with rendering its opinion to our board of directors, UBS performed a variety of financial and comparative analyses which are summarized below. The following summary is not a complete description of all

analyses performed and factors considered by UBS in connection with its opinion. The preparation of a financial opinion is a complex process involving subjective judgments and is not necessarily susceptible to partial analysis or summary description. With respect to the selected companies analysis and the selected transactions analysis summarized below, no company or transaction used as a comparison is identical or directly comparable to the AVINZA® assets or the transaction. These analyses necessarily involve complex considerations and judgments concerning financial and operating characteristics and other factors that could affect the public trading or acquisition values of the companies or businesses concerned.

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UBS believes that its analyses and the summary below must be considered as a whole and that selecting portions of its analyses and factors or focusing on information presented in tabular format, without considering all analyses and factors or the narrative description of the analyses, could create a misleading or incomplete view of the processes underlying UBS' analyses and opinion. None of the analyses performed by UBS was assigned greater significance or reliance by UBS than any other. UBS arrived at its ultimate opinion based on the results of all analyses undertaken by it and assessed as a whole. UBS did not draw, in isolation, conclusions from or with regard to any one factor or method of analysis for purposes of its opinion.

The estimates of the future performance of the AVINZA® assets and estimates of net sales provided by Ligand's management in or underlying UBS' analyses are not necessarily indicative of future results or values, which may be significantly more or less favorable than those estimates. In performing its analyses, UBS considered industry performance, general business and economic conditions and other matters, many of which are beyond the control of Ligand. Estimates of the financial value of companies, businesses or product lines do not necessarily purport to be appraisals or reflect the prices at which such companies, businesses or product lines actually may be sold.

The aggregate consideration was determined through negotiation between Ligand and King and the decision to enter into the transaction was solely that of Ligand's board of directors. UBS' opinion and financial analyses were only one of many factors considered by Ligand's board in its evaluation of the transaction and should not be viewed as determinative of the views of Ligand's board of directors or management with respect to the transaction or the aggregate consideration.

The following is a brief summary of the material financial analyses performed by UBS and reviewed with Ligand's board of directors in connection with its opinion relating to the asset sale. **The financial analyses summarized below include information presented in tabular format. In order to fully understand UBS' financial analyses, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses. Considering the data below without considering the full narrative description of the financial analyses, including the methodologies and assumptions underlying the analyses, could create a misleading or incomplete view of UBS' financial analyses.** For purposes of the analyses described below, the term "implied value of the aggregate consideration" refers to the implied value of the aggregate consideration to be received by Ligand in the transaction based on the initial consideration of \$312.75 million, consisting of \$265.0 million in cash and the assumption of Ligand's payment obligation of \$47.75 million to Organon Pharmaceuticals USA Inc. (or reimbursement to Ligand of such amount to the extent paid by Ligand prior to the closing of the asset sale) plus the estimated net present value of future royalty payments payable to Ligand derived utilizing internal estimates of Ligand's management as to net sales of AVINZA® that will be achieved by King and a discount rate of 13.5%.

### ***Selected Companies Analysis***

UBS compared selected standalone financial data for the AVINZA® assets with corresponding data for the following six publicly traded specialty pharmaceuticals companies:

Axcan Pharma Inc.

Bradley Pharmaceuticals, Inc.

Connetics Corporation

Pharmion Corporation



Salix Pharmaceuticals, Ltd.

Sciele Pharma, Inc.

UBS reviewed, among other things, enterprise values of the selected companies, calculated as equity market value based on closing stock prices on September 1, 2006, plus book value of debt and minority interests, plus preferred stock, less cash, as a multiple of latest 12 months revenue and calendar years 2006 and 2007 estimated revenue. UBS then compared the latest 12 months revenue and calendar years 2006 and 2007 estimated revenue

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multiples derived from the selected companies with corresponding multiples implied for the AVINZA® assets based on the implied value of the aggregate consideration. Financial data of the selected companies were based on publicly available research analysts' estimates, public filings and other publicly available information. Financial data relating to the AVINZA® assets were based on public filings and internal estimates of Ligand's management. This analysis indicated the following implied high, mean, median and low multiples for the selected companies, as compared to corresponding multiples implied for the AVINZA® assets based on the implied value of the aggregate consideration:

Enterprise Value as Multiple of:	Implied Multiples for Selected Companies				Implied Multiples for AVINZA® Assets Based on Implied Value of Aggregate Consideration
	High	Mean	Median	Low	
Revenue					
Latest 12 Months	3.1x	2.3x	2.2x	1.8x	3.7x
Calendar year 2006	2.8x	2.3x	2.2x	1.9x	3.3x
Calendar year 2007	2.3x	2.1x	2.0x	1.9x	3.2x

**Selected Transactions Analysis**

UBS reviewed transaction values in the following 10 selected transactions in the pharmaceuticals industry announced since August 2000 involving the sale of one or more products:

Acquiror	Seller (Product)
Valeant Pharmaceuticals International	InterMune, Inc. (Infergen)
Pfizer Inc.	Sanofi-Synthelabo (Campto)
Connetics Corporation	Hoffmann-La Roche Inc. (Soriatane)
Galen Holdings PLC	Eli Lilly and Company (Sarafem)
Enzon, Inc.	Elan Corporation, plc (Abelcet)
Schering AG	Immunex Corporation (Leukine)
King	Johnson & Johnson (Ortho-Prefest)
King	Bristol-Myers Squibb Company (Corgard, Corzide, Delestrogen and Florinef)
Biovail Corporation	Aventis Pharmaceuticals Inc. (Cardizem)
Hoffman-La Roche Inc.	SmithKline Beecham plc (Kytrel)

UBS reviewed transaction values in the selected transactions as a multiple of latest 12 months revenue. UBS then compared the latest 12 months revenue multiples derived from the selected transactions with the corresponding multiple implied for the AVINZA® assets based on the implied value of the aggregate consideration. Multiples for the selected transactions were based on publicly available information at the time of announcement of the relevant transaction. Financial data relating to the AVINZA® assets were based on public filings. This analysis indicated the following implied high, mean, median and low multiples for the selected transactions, as compared to the corresponding multiple implied for the AVINZA® assets based on the implied value of the aggregate consideration:

<b>Transaction Value as Multiple of:</b>	<b>Implied Multiples for Selected Companies</b>				<b>Implied Multiple for AVINZA® Assets Based on Implied Value of Aggregate Consideration</b>
	<b>High</b>	<b>Mean</b>	<b>Median</b>	<b>Low</b>	
Latest 12 Months Revenue	4.3x	3.2x	3.4x	1.7x	3.7x

***Discounted Cash Flow Analysis***

UBS performed a discounted cash flow analysis to calculate the estimated present value of the standalone unlevered, after-tax free cash flows that could be generated from the AVINZA® assets over the period beginning September 6, 2006 through fiscal year 2020 based on internal estimates of Ligand's management. The cash flows were then discounted to present value using discount rates ranging from 11.5% to 15.5%. This analysis indicated the

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following implied reference range for the AVINZA® assets, as compared to the implied value of the aggregate consideration:

<b>Implied Reference Range for AVINZA® Assets</b>	<b>Implied Value of Aggregate Consideration</b>
\$307.6 million - \$357.4 million	\$ 480.8 million

**Miscellaneous**

Under the terms of UBS' engagement, Ligand has agreed to pay UBS for its financial advisory services in connection with the transaction an aggregate fee of approximately \$4.5 million, a portion of which was payable in connection with UBS' opinion and a significant portion of which is contingent upon completion of the transaction. In addition, Ligand has agreed to reimburse UBS for its reasonable expenses, including fees, disbursements and other charges of legal counsel, and to indemnify UBS and related parties against liabilities, including liabilities under federal securities laws, relating to, or arising out of, its engagement. UBS in the past has provided, and currently is providing, investment banking services to Ligand unrelated to the asset sale, including acting as financial advisor to Ligand in connection with Ligand's sale of its oncology product lines to Eisai Co., Ltd., for which UBS received an aggregate fee of approximately \$2.1 million. In the past, UBS has provided investment banking services to King unrelated to the asset sale, for which UBS received compensation. In the ordinary course of business, UBS, its successors and affiliates may hold or trade, for their own accounts and the accounts of their customers, securities of Ligand and King and, accordingly, may at any time hold a long or short position in such securities.

Ligand selected UBS as its financial advisor in connection with the transaction because UBS is an internationally recognized investment banking firm with substantial experience in similar transactions and is familiar with Ligand and its business. UBS is continually engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, leveraged buyouts, negotiated underwritings, competitive bids, secondary distributions of listed and unlisted securities and private placements.

**Required Vote**

Approval of the asset sale requires the affirmative vote of the holders of a majority of the outstanding shares of our common stock entitled to vote at the special meeting. Each holder of a share of our common stock is entitled to one vote per share. Failure to vote by proxy (by returning a properly executed proxy card or by following the instructions printed on the proxy card for telephone and Internet voting) or to vote in person will not count as votes cast or shares voting on the proposals. Abstentions, however, will count for the purpose of determining whether a quorum is present. Since the approval of the asset sale requires the approval of the holders of a majority of our shares outstanding, abstentions will have the same effect as votes against the proposal. Broker non-votes and the shares of common stock as to which a stockholder abstains are included for purposes of determining whether a quorum of shares of common stock is present at a meeting. A broker non-vote occurs when a nominee holding shares of common stock for the beneficial owner does not vote on a particular proposal because the nominee does not have discretionary voting power with respect to that item and has not received instructions from the beneficial owner. Since the approval of the asset sale requires the approval of the holders of a majority of our shares outstanding, broker non-votes will have the same effect as votes against such proposal.

**Proceeds from the Asset Sale**

While we are evaluating a distribution of a substantial portion of the net cash proceeds from the asset sale to our stockholders in the form of a special dividend, we cannot predict the timing or amount of such distribution, if any, to be made to our stockholders. The amount, if any, available to our stockholders will be determined by our board of directors, after weighing the company's remaining liabilities and operational needs.

**Effects of the Asset Sale**

If the asset sale is approved and the purchase agreement is adopted by our stockholders and the other conditions to closing are satisfied, we expect to become a research and development focused company with no

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marketed products and we will consider all available alternatives. Such alternatives may include, without limitation, the acquisition of a new business or alternatively, the sale of the company, the sale of additional assets, restructuring, the distribution of assets to our stockholders or the possible dissolution of us and liquidation of our assets, the discharge of any remaining liabilities, and the eventual distribution of the remaining assets to our stockholders in the event we are liquidated. Furthermore, although we are evaluating a distribution of a substantial portion of the net cash proceeds from the asset sale to our stockholders in the form of a special dividend, we have not determined the timing or amount of distribution, if any, to be made to our stockholders. The amount, if any, available to our stockholders will be determined by our board of directors, after weighing the company's remaining liabilities and operational needs.

Most of our products in development will also 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. 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.

The AVINZA® assets constitute approximately 67% of our revenues and 81% of our operating loss in the first two quarters of fiscal 2006. Following the asset sale, our immediate ability to produce revenues and income will therefore be substantially reduced. As such, the proceeds from the asset sale, along with other capital that we have access to, may not be adequate to bring our developing product lines to market, nor can we be certain that our future products, even if brought to market, will be sufficiently profitable to justify the sale of AVINZA®.

In addition, under the asset purchase agreement, 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. That indemnification obligation could cause us to be liable to King under certain circumstances, which would decrease the remaining cash available for eventual distribution to stockholders or for our use in connection with any future corporate purposes. Additionally, the asset purchase agreement requires that King assume specified liabilities related to the AVINZA® drug product. If King fails to perform and discharge the assumed liabilities specified in the asset purchase agreement, then we may be liable for the assumed liabilities which would also decrease the remaining cash available for eventual distribution to stockholders or for our use in connection with any future corporate purposes.

Finally, we will continue to have an obligation to comply with the applicable reporting requirements of the Securities Exchange Act of 1934, as amended, even though compliance with such reporting requirements is economically burdensome.

## **Purpose of the Asset Sale**

The purpose of the asset sale for Ligand is to enable it to immediately realize the value of its remaining business. In this respect, the board of directors believes that the asset sale is more favorable to Ligand's stockholders than any other alternative reasonably available because of the uncertain returns to such stockholders in light of Ligand's business, operations, financial condition, strategy and prospects, as well as the risks involved in achieving those prospects, and general industry, economic and market conditions, both on a historical and on a prospective basis.

In particular, the board of directors believes that we face several challenges in our efforts to increase stockholder value, including competition from companies with substantially greater scale. For these reasons, and the other reasons discussed under "The Asset Sale" Reasons for the Asset Sale beginning on page 21, the board of directors has determined that the asset purchase agreement, the asset sale and related transactions are advisable and are fair to and in the best interests of Ligand and its stockholders.



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**Other Agreements and Transactions Related to the Asset Sale**

***Contract Sales Force Agreement***

On September 6, 2006, we entered into a Contract Sales Force Agreement, referred to herein as the contract 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, subject to the terms and conditions of the contract sales agreement. Pursuant to the contract sales agreement, King has agreed to perform certain minimum monthly product details, which commenced on October 1, 2006 and continue for a period of six months or until the closing of the asset sale or earlier termination is scheduled to the asset purchase agreement. We estimate that, assuming the closing of the asset sale were to occur at the end of December 2006, the amount due to King under the contract sales agreement would be approximately \$4 million.

***Loan Arrangement***

In connection with the asset sale, King agreed to loan to us, at our option, up to \$37.75 million. On October 13, 2006 we entered into a loan agreement with King pursuant to which King loaned to us \$37.75 million at a 9.50% interest rate. Pursuant to the loan agreement King took a security interest in the AVINZA® assets as well as cash proceeds from the sale of our oncology products equal to the loan amount. Upon closing of the asset sale, accrued interest, if any, on the amount loaned by King to us will be forgiven and the amount of the closing payment King owes us under the asset purchase agreement will be increased by the amount of the loan, including interest thereon, if any, and an equal amount will be credited against that payment for repayment of the loan. If the closing of the asset sale does not occur, then the principal of the loan plus accrued interest will become due on January 1, 2007.

***Redemption of 6% Notes***

As a condition to the consummation of the asset purchase agreement we are required, and on October 30, 2006, mailed a notice of redemption to each of the holders of our 6% Convertible Subordinated Notes, due 2007, referred to herein as the 6% Notes, the outstanding aggregate principal amount of which, as of October 31, 2006, was approximately \$128 million. Pursuant to the notice of redemption each outstanding 6% Note will be redeemed or converted on or prior to November 29, 2006. For those notes that are not converted into shares prior to the redemption date, we will pay the holders of those notes a redemption price equal to 101.2% of the outstanding principal amount plus accrued and unpaid interest.

**Other Agreements and Transactions Related to our Strategic Review Process**

***Sale of Oncology Product Line to Eisai Inc. and Eisai Co., Ltd.***

On September 7, 2006, we entered into an asset purchase agreement with Eisai Inc. and Eisai Co., Ltd., pursuant to which we agreed to sell to Eisai Inc. and Eisai Co., Ltd. all of our rights to our four marketed oncology products: ONTAK®, Targretin® capsules, Targretin® gel and Panretin® gel. In exchange for our interests in and to the oncology products, Eisai Inc. and Eisai Co., Ltd. agreed to pay us an aggregate up-front cash payment of \$205 million, \$20 million of which will be funded into an escrow account to support any indemnification claims made by Eisai following the Closing, and Eisai will assume certain liabilities. On October 25, 2006, we consummated the transactions described above.

***Sale and Leaseback Transaction***



On October 25, 2006, we entered into an asset purchase agreement with Slough Estates USA Inc., for the sale of our corporate headquarters building, the land it is on and two adjacent undeveloped parcels for an aggregate consideration of \$47.6 million. Under the terms of the asset purchase agreement, we will receive an up-front cash payment, net of fees, expenses and payment of existing indebtedness of approximately \$35 million. In addition, we agreed to lease back the building for a period of fifteen years, at a rate of approximately \$3 million per year, subject to a fixed annual percentage increase as stated in the asset purchase agreement. In addition, Ligand will have the right to extend the term of the lease for two five year periods under the same terms and conditions as the initial term. We currently expect these transactions to close in November of 2006.

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**Interests of Our Directors and Executive Officers in the Asset Sale**

After the closing of the asset sale, King and King R&D have agreed to indemnify and hold our executive officers and directors from any loss arising out of any breach of representations and warranties by King or King R&D, or a failure by King or King R&D to perform covenants applicable to them under the asset purchase agreement. All of our directors and executive officers own shares of our common stock and/or options to purchase shares of our common stock, and to that extent, their interests in the asset sale is the same as that of other holders of our common stock. See Security Ownership of Certain Beneficial Owners, Directors and Management beginning on page 87.

**Dissenters Rights**

Holders of our common stock will not have appraisal or dissenters rights in connection with the asset sale. Neither the Delaware General Corporation Law nor our certificate of incorporation provides our stockholders with appraisal or dissenters rights in connection with the asset sale. Our shares of common stock will remain publicly traded on the Nasdaq Global Market following the consummation of the asset sale.

**Accounting Treatment of the Asset Sale**

Under accounting principles generally accepted in the United States of America, upon stockholder approval of the asset purchase agreement, we expect to reflect the results of operations of the AVINZA® assets sold as discontinued operations, including the related gain on the sale, net of any applicable taxes commencing with the quarter during which the asset sale is probable of occurring and is approved by the shareholders. For further information, see the unaudited pro forma condensed financial information included in this proxy statement.

**Financing; Source and Amount of Funds**

The asset sale is not conditioned upon King obtaining financing. The total amount of funds necessary to pay the initial asset sale consideration will be approximately \$312.75 million. King expects to fund the transaction from its working capital.

**MATERIAL U.S. FEDERAL AND STATE INCOME TAX CONSEQUENCES**

The asset sale will not result in any U.S. federal income tax consequences to our stockholders. The transaction will be a taxable event to Ligand for U.S. federal income tax purposes, but Ligand anticipates that a substantial portion or all of the taxable gain resulting from the asset sale will be offset by net operating losses. However, the asset sale is expected to result in some federal alternative minimum tax being imposed on Ligand in the year of the sale and may, depending upon several factors, result in the imposition of federal income taxes in subsequent years that may or may not be offset by available tax credits. In addition, assuming net operating losses are used to offset gain recognized on Ligand's other asset dispositions, Ligand expects that all or substantially all of the taxable gain resulting from the asset sale will be subject to state income tax, which may be substantially reduced if Ligand is able to substantiate and claim certain tax credits. The asset sale also may result in Ligand being subject to state or local sales, use or other taxes in jurisdictions in which Ligand files tax returns or has assets.

**REGULATORY MATTERS**

The asset sale is subject to the HSR Act, which provides that certain acquisition transactions may not be consummated unless certain acquisition transactions may not be consummated unless certain information has been furnished to the

Antitrust Division of the Department of Justice, which we refer to as the DOJ, and the Federal Trade Commission, which we refer to as the FTC, and certain waiting period requirements have been satisfied. Pursuant to the HSR Act, on September 13, 2006, each of Ligand and King filed a Notification and Report Form for Certain Mergers and Acquisitions in connection with the asset sale with the DOJ and FTC. On October 5, 2006, we were notified that we had been granted early termination of the waiting period under the HSR Act.

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**ASSET PURCHASE AGREEMENT**

The following is a summary of the material terms of the asset purchase agreement. This summary does not purport to describe all the terms of the asset purchase agreement and is qualified by reference to the complete asset purchase agreement, which is attached as Annex A to this proxy statement. We urge you to read the asset purchase agreement carefully and in its entirety because it, and not this proxy statement, is the legal document that governs the asset sale.

The text of the asset purchase agreement has been included to provide you with information regarding its terms. The terms of the asset purchase agreement (such as the representations and warranties) are intended to govern the contractual rights and relationships, and allocate risks, between the parties in relation to the asset sale. The asset purchase agreement contains representations and warranties that Ligand, on the one hand, and King and King R&D on the other hand, made to each other as of specific dates. The representations and warranties were negotiated between the parties with the principal purpose of setting forth their respective rights with respect to their obligations to consummate the asset sale and may be subject to important limitations and qualifications as set forth therein, including a contractual standard of materiality different from that generally applicable under federal securities laws.

In addition, such representations and warranties are qualified by information in confidential disclosure schedules that Ligand and King have exchanged in connection with signing the asset purchase agreement. While Ligand does not believe that the disclosure schedules contain information that the securities laws require to be publicly disclosed, the disclosure schedules do contain information that modifies, qualifies and creates exceptions to the representations and warranties set forth in the attached asset purchase agreement. Accordingly, you should not rely on the representations and warranties as characterizations of the actual state of facts, since they are modified by the underlying disclosure schedules. These disclosure schedules contain information that has been included in our prior public disclosures, as well as potential additional non-public information. Moreover, information concerning the subject matter of the representations and warranties may have changed since the date of the asset purchase agreement, which subsequent information may or may not be fully reflected in our public disclosures.

**General**

Under the terms of the asset purchase agreement, King and King R&D have agreed to purchase all of our United States, and its territories and Canadian rights in and to AVINZA<sup>®</sup>, including, among other things, all AVINZA<sup>®</sup> inventory, equipment, records and related intellectual property.

Pursuant to the terms of the asset purchase agreement, King and King R&D will make a \$265 million cash payment to Ligand, \$15 million of which will be funded into an escrow account to support any indemnifications claims made by King, to acquire our rights in and to AVINZA<sup>®</sup>. In addition, King will assume a product-related liability totaling approximately \$48 million and future royalty payments owed to Organon Pharmaceuticals USA Inc. and all other existing product royalty obligations. In addition to existing royalty obligations assumed by King, King will pay Ligand a 15% royalty during the first 20 months after the closing of the asset sale. Subsequent royalty payments will be based upon calendar year net sales. If King's calendar year net sales are less than \$200 million, the royalty payment will be 5% of all of King's net sales for that year. If King's calendar year net sales are greater than \$200 million, then the royalty payment will be 10% of all of King's net sales less than \$250 million, plus 15% of all of King's net sales greater than \$250 million.

Additionally, the \$265 million cash payment from King and King R&D may be offset by an inventory value adjustment. On the closing date of the asset sale, we will provide King and King R&D with a report based on our inventory data, which will set forth (i) certain inventory calculations, (ii) whether we have met certain specified

reduction of levels of inventory held by retailers and wholesalers, and (iii) our out-of-pocket costs paid with respect to certain of our contracts related to AVINZA<sup>®</sup>. If, as of the closing of the asset sale, we have not reduced the amount of inventory held by wholesalers and retailers, to the agreed upon levels, King will have the right to the distribution of such amounts from a special inventory escrow amount which shall be funded at closing from the \$265 million cash proceeds.

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**Closing**

Closing of the asset sale under the asset purchase agreement will occur on a date following the satisfaction or waiver of all conditions to the obligations of the parties to consummate the transactions contemplated thereby, including the approval of the asset sale and adoption of the asset purchase agreement by the holders of a majority of our common stock outstanding on the record date.

**Representations and Warranties**

The asset purchase agreement contains a number of customary representations and warranties applicable to Ligand, subject in some cases to customary qualifications, relating to, among other things, the following:

due organization, valid existence and good standing, and other corporate matters of Ligand;

authorization, execution, delivery and enforceability of the asset purchase agreement;

conflicts or violations under charter documents, contracts and instruments or law;

title to, or interest in, encumbrances upon and the sufficiency of the properties and assets that are used to conduct our AVINZA<sup>®</sup> business;

intellectual property matters;

pending or threatened material litigation;

required consents and approvals;

taxes;

matters related to employee benefits applicable to us;

governmental registrations;

material compliance with all applicable laws;

regulatory matters;

government contracts

financial statements;

matters related to product recalls, product returns, product warranties and product liabilities;

brokerage or finders fees, and other fees with respect to the asset sale;

inventory and equipment;

contracts;

product liability

exporting and manufacturing;

customers, suppliers and third-party service providers; and

adverse event reports.

The asset purchase agreement also contains a number of customary representations and warranties applicable to King and King R&D, subject in some cases to customary qualifications, relating to, among other things, the following:

due organization, valid existence and good standing, and other corporate matters of King and King R&D;

authorization, execution, delivery and enforceability of the asset purchase agreement;

conflicts or violations under charter documents, contracts and instruments or law;

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pending or threatened material litigation;

required consents and approvals;

financing; and

brokerage or finders fees, and other fees with respect to the asset sale.

The representations and warranties of each of the parties to the asset purchase agreement will expire upon completion of the asset sale.

### **Indemnification; Survival of Indemnification Obligations**

After closing of the asset sale, we have agreed to indemnify and hold King and its affiliates and their respective officers, directors, employees, stockholders, agents, and representatives harmless from any loss arising out of (i) any breach of representations and warranties by us, (ii) our activities before closing of the asset sale, (iii) a failure by us to perform covenants applicable to us under the asset purchase agreement, (iv) any liability not undertaken by King and King R&D pursuant to the asset purchase agreement, or (v) fees owed by us to any broker, financial advisor, or others retained by us in connection with the asset sale. In general, we may be required to indemnify King and King R&D for any indemnifiable losses incurred by them in connection with the asset sale for a period of 16 months following the closing date of the asset sale, except that King may bring a claim relating to a breach of representations and warranties relating to the authorization, execution and delivery of the asset purchase agreement, title to and sufficiency of assets, and employee benefits for a period of 30 months following the closing date of the asset sale. In general, we are not obligated to make King whole for any losses until King suffers losses in excess of \$1.5 million and then only to the extent such losses exceed \$1.5 million. In addition, our liability for any claim for indemnification brought by King or King R&D is limited to \$40 million. Pursuant to the asset purchase agreement, \$15 million of the cash payment to be made by King to us at the closing of the asset sale will be funded into an escrow account to support any indemnification claims made by King. If no claims are made by King as of the one year anniversary of the closing of the asset sale, the escrow amount will be released to Ligand.

After closing of the asset sale, King and King R&D have agreed to indemnify and hold us and our affiliates, and our respective officers, directors, employees, stockholders, agents, and representatives harmless from any loss arising out of (i) any breach of representations and warranties by King or King R&D, (ii) or a failure by King or King R&D to perform covenants applicable to them under the asset purchase agreement, (iii) any liability assumed by King and King R&D under the asset purchase agreement, or (iv) fees owed by King or King R&D to any broker, financial advisor, or others retained by them in connection with the asset sale.

### **Covenants and Agreements**

Under the asset purchase agreement, we have agreed to abide by certain customary covenants prior to the closing of the asset sale. Among others, these covenants include the following:

permitting representatives of King to have reasonable access to all premises, personnel, personnel records, other records and contracts of Ligand with respect to AVINZA®;

providing certain reports to King regarding inventory;



operating the AVINZA® business in the ordinary course, preserving the AVINZA® business substantially intact, and preserving the goodwill of those third parties having business relationships with us;

using our best efforts to reduce inventory to achieve specified levels in the wholesale and retail channels;

paying all taxes and payables;

making all filings required to consummate the asset sale;

preparing and filing this proxy statement, soliciting proxies from our stockholders in favor of the approval of the asset sale and adoption of the asset purchase agreement, and holding the special meeting to which this proxy statement relates;

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mailing to each of the holders of our convertible notes a notice of redemption;

using commercially reasonable efforts to facilitate an efficient transfer of AVINZA® to Buyer.

We have agreed to promptly notify King following any material developments or changes with respect to AVINZA® or upon becoming aware of any event arising after the date of the asset purchase agreement that would result in any material breach of our representations, warranties or covenants or that would have the effect of making any representation or warranty untrue or incorrect in any material respect so as to cause the failure of any closing conditions. In addition, we have also agreed that until the consummation of the asset sale, subject to certain exceptions for actions taken in the ordinary course of business or actions contemplated by the asset purchase agreement, consistent with past practice, we will comply with specific restrictions relating to, among others:

taking any willful action likely to result in any material representation or warranty becoming untrue;

creating any encumbrance on our properties;

entering into any contracts relating primarily or exclusively to AVINZA®;

terminating any of the contracts to be assigned to King pursuant to the asset purchase agreement;

transferring or granting any rights related to AVINZA®, including any intellectual property rights;

failing to renew specified contracts;

initiating any litigation or arbitration actions, or make any claims or demands for breach with respect to specified contracts;

entering into or modifying employment agreements with certain employees, or modifying the job descriptions of such employees; or

agreeing to take any of the actions specified in the previous bullet points.

**Regulatory Matters**

The asset purchase agreement provides that we and King will file as soon as practicable after the date of the asset purchase agreement any required filings and applications with governmental authorities in connection with the asset sale, including filings under the HSR Act.

**No Negotiation**

The asset purchase agreement provides that Ligand shall not, nor shall it cause any of its affiliates or representatives to, directly or indirectly, take any action to:

solicit, initiate or facilitate any acquisition proposal (as described below);

participate in any discussions or negotiations with, or furnish any non-public information to, any third party that has made an acquisition proposal; or

enter into any agreement with respect to any acquisition proposal.

So long as we provide notice to King, at any time prior to the closing of the asset sale, we are permitted to:

participate in any discussions or negotiations with, and with certain exceptions, provide any non-public information to, any third party in response to an acquisition proposal by such third party, if our board of directors determines that there is a reasonable likelihood that such acquisition proposal could lead to a superior proposal (as described below);

enter into an agreement with respect to an acquisition proposal if our board of directors determines that such acquisition proposal constitutes a superior proposal; and

effect a change in the recommendation of our board of directors regarding the asset purchase agreement and asset sale, if our board of directors determines that (i) such acquisition proposal constitutes a superior

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proposal or (ii) failure to take such action would be inconsistent with the board's fiduciary duties under Delaware law; and

The prohibition on solicitation does not prevent Ligand or our board of directors from complying with SEC rules with regard to an acquisition proposal by means of a tender offer or recommending or exploring an acquisition proposal if the board determines in good faith that an unsolicited acquisition proposal is reasonably likely to lead to a superior proposal and that, after consultation with its legal advisor, failure to take such action would be inconsistent with its fiduciary duties under Delaware law.

As described in this proxy statement, the term "acquisition proposal" means an unsolicited proposal from a third party relating to any transaction involving, in whole or in part, directly or indirectly, AVINZA<sup>®</sup>, including an acquisition of more than 25% of our common stock.

The term "superior proposal" means an acquisition proposal which (a) as determined in good faith by our board of directors (after consultation with Ligand's financial advisor and outside legal counsel) would, if consummated, (i) result in a transaction more favorable to us than the asset sale, if such transaction is for the acquisition of AVINZA<sup>®</sup>, or (ii) result in a transaction more favorable to our stockholders than the asset sale if such transaction is for the acquisition of equity interests in Ligand or substantially all of our assets, or (b) does not require the termination of the asset purchase agreement as a condition to the consummation of such acquisition proposal. If we enter into an agreement with any third party with respect to a superior proposal, we will be required to pay the termination fee of \$12 million. See "The Asset Purchase Agreement - Termination Fee" beginning on page.

**Conditions to Completion of the Asset Sale**

The obligations of Ligand and King and King R&D to complete the asset sale are subject to the satisfaction or waiver of the following conditions:

no preliminary or permanent injunction or other order has been issued by any court or by any government authority enjoining, restraining, prohibiting or making illegal the asset sale;

any waiting period (and any extension) under the HSR Act has expired or been terminated; and

the Ligand stockholders have adopted resolutions approving the asset sale and adopting the asset purchase agreement.

In addition, the obligations of King and King R&D to complete the asset sale are subject to the satisfaction by Ligand or waiver by King or King R&D of conditions, including the following:

Ligand's representations and warranties shall be true and correct in all material respects as of the date of the asset purchase agreement and the date of the closing of the asset sale, except those representations and warranties which address matters only as of a particular date need only be true and correct as of such date;

Ligand shall have performed and complied in all material respects with each of the covenants, agreements and obligations Ligand is required to perform under the asset purchase agreement;

all specified consents shall have been duly executed and delivered to King or King R&D;

King or King R&D shall have received a certificate from us certifying the accuracy of our representations and warranties and performance of our obligations as of the date of the asset purchase agreement and the closing

date of the asset sale;

Ligand shall have executed and delivered to King or King R&D each of the following agreements: the Assignment of Product Intellectual Property, the Bill of Sale and Assignment and Assumption Agreement, the Product License and Supply Agreement Assignment, the Second Source Supply Agreement Assignment, the Termination and Return of Rights Agreement Assignment, the Technical Agreement AVINZA<sup>®</sup> Assignment, the Quality Agreement for AVINZA<sup>®</sup> Assignment, the Transition Services Agreement and the Escrow Agreement; and

Ligand shall have redeemed or converted all outstanding 6% Convertible Subordinated Notes due 2007.

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In addition, the obligations of Ligand to complete the asset sale are subject to the satisfaction by King and King R&D or waiver by Ligand of conditions, including the following:

King's and King R&D's representations and warranties shall be true and correct in all material respects as of the date of the asset purchase agreement and the date of the closing of the asset sale, except those representations and warranties which address matters only as of a particular date need only be true and correct as of such date;

King and King R&D shall have performed and complied in all material respects with each of the covenants, agreements and obligations King and King R&D are required to perform under the asset purchase agreement;

Ligand shall have received a certificate from King and King R&D certifying the accuracy of their representations and warranties and performance of their obligations as of the date of the asset purchase agreement and the closing date of the asset sale; and

King and King R&D shall have executed and delivered to Ligand each of the following agreements: the Assignment of Product Intellectual Property, the Bill of Sale and Assignment and Assumption Agreement, the Product License and Supply Agreement Assignment, the Second Source Supply Agreement Assignment, the Termination and Return of Rights Agreement Assignment, the Technical Agreement AVINZA® Assignment, the Quality Agreement for AVINZA® Assignment, the Transition Services Agreement and the Escrow Agreement.

## **Termination**

We and King may by mutual written consent terminate the asset purchase agreement at any time prior to the completion of the asset sale.

In addition, either we or King may, in writing, terminate the asset purchase agreement at any time prior to the effective time of the asset sale:

if the asset sale has not been consummated on or before December 31, 2006 so long as the failure to complete the asset sale by such date is not the result of the failure of the party seeking to terminate to comply with the terms of the asset purchase agreement;

if the adoption of the asset purchase agreement by our stockholders has not been obtained at the special meeting or any adjournment thereof by reason of the failure to obtain the required vote; or

if a material breach of any provision of the asset purchase agreement has been committed by the other party, and such breach has not been waived or cured within 60 days after written notice.

We may terminate, in writing, the asset purchase agreement at any time prior to the completion of the asset sale:

if any representation or warranty of King shall have become untrue in any material respect or King has materially breached any covenant under the asset purchase agreement, and such breach or misrepresentation is not capable of being cured prior to December 31, 2006;

if a material breach of any provision of the asset purchase agreement has been committed by King, and such breach is not cured by King within 10 days after receipt of written notice, or in the reasonable determination of Ligand, is incapable of being cured by King; or

if our board of directors has determined that an acquisition proposal is a superior proposal provided that we give King written notice within two days of such determination and pay to King the termination fee of \$12 million.

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King may terminate, in writing, the asset purchase agreement at any time prior to the completion of the asset sale:

if any representation or warranty of ours shall have become untrue in any material respect or we have materially breached any covenant under the asset purchase agreement, and such breach or misrepresentation is not capable of being cured prior to December 31, 2006;

if a material breach of any provision of the asset purchase agreement has been committed by us, and such breach is not cured by us within 10 days after receipt of written notice, or in the reasonable determination of King, is incapable of being cured by us;

if, prior to the adoption of the asset purchase agreement by our stockholders, our board of directors (i) fails to include in this proxy statement its recommendation of the asset purchase agreement or (ii) approves or recommends an acquisition proposal to our stockholders or approves or recommends that our stockholders tender their shares of our common stock in any tender offer or exchange offer that is an acquisition proposal; or

if King has received written notice from us that our board of directors has determined that an acquisition proposal is a superior proposal.

## **Termination Fee**

We will be obligated to pay King a fee of \$12 million in connection with the termination of the asset purchase agreement in the event that:

if, prior to the receipt of requisite stockholder approval, King terminates the asset purchase agreement as a result of our board of directors:

approving or recommending an acquisition proposal to Ligand stockholders or approving or recommending that Ligand stockholders tender their shares of common stock in any tender offer or exchange offer that is an acquisition proposal; or

failing to include in this proxy statement its recommendation that our stockholders should approve the asset sale;

if King terminates the asset purchase agreement after receiving written notice from us that our board of directors has determined that an alternative acquisition proposal is a superior proposal; or

if we terminate the asset purchase agreement as a result of our board of directors determining that an alternative acquisition proposal is a superior proposal.

## **Expenses**

The asset purchase agreement provides that other than any antitrust filing fees, which shall be shared equally by Ligand and King, all costs and expenses incurred in connection with the asset purchase agreement and the transactions contemplated by the asset purchase agreement will be paid by the party incurring the expenses.

## **Amendment**



The asset purchase agreement may be amended, supplemented, or otherwise modified by the parties in writing at any time before or after any approval of the asset purchase agreement by the Ligand stockholders, but after the stockholder approval, no amendment may be made for which the law requires stockholder approval without such stockholder approval.

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**UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

As described further in this Proxy Statement, on September 6, 2006, the Company, King Pharmaceuticals, Inc., a Tennessee corporation, and King Pharmaceuticals Research and Development, Inc., a Delaware corporation and wholly-owned subsidiary of King Pharmaceuticals (together with King Pharmaceuticals, "King") entered into a purchase agreement (the "AVINZA Purchase Agreement"), pursuant to which King agreed to acquire all of the Company's rights in and to AVINZA® (morphine sulfate extended-release capsules) in the United States, its territories and Canada, including, among other things, all Avinza® inventory, equipment, records and related intellectual property, and assume certain liabilities (together, "AVINZA" or the "AVINZA Product Line") as set forth in the AVINZA Purchase Agreement. Additionally, a condition of the AVINZA Purchase Agreement requires that the Company redeem, prior to the close of the sale of AVINZA to King, the outstanding 6% convertible subordinated notes, previously issued by the Company (the "Debt Redemption"). Also, King will assume certain liabilities, including certain product-related liabilities owed by the Company to Organon Pharmaceuticals USA Inc. Pursuant to the AVINZA Purchase Agreement, at closing, the Company will be paid a \$265.0 million cash payment, \$15.0 million of which will be funded into an escrow account to support any indemnification claims. The Company expects to account for the disposition of the AVINZA Product Line as a discontinued operation in its consolidated financial statements.

On September 7, 2006, the Company, 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 has agreed to acquire all of the Company's worldwide rights in and to the Company's oncology product line, including, among other things, all related inventory, equipment, records and intellectual property, and assume certain liabilities (together "Oncology" or the "Oncology Product Line") as set forth in the Oncology Purchase Agreement. The Oncology Product Line includes the Company's four marketed oncology drugs: ONTAK, Targretin capsules, Targretin gel and Panretin gel. Pursuant to the Oncology Purchase Agreement, at closing, the Company will be paid a \$205.0 million cash payment, \$20.0 million of which will be funded into an escrow account to support any indemnification claims. On October 25, 2006, the Company consummated the sale of Oncology. The Company expects to account for the disposition of the Oncology Product Line as a discontinued operation in its consolidated financial statements.

On October 25, 2006, the Company entered into an agreement with Slough Estates USA, Inc. (the "Buyer") to sell the real properties at its corporate headquarters located in San Diego, California (the "Sale Leaseback"). Under the terms of the agreement, the Buyer has agreed to purchase all real properties (land, building and improvements) known as 10275 Science Center Drive, 10265 Science Center Drive and 10285 Science Center Drive in San Diego, California for a purchase price of approximately \$47.6 million. In addition, the Company is leasing back the building at 10275 Science Center Drive from the Buyer as its corporate headquarters office, with a lease term of fifteen years through 2021. Under the terms of the lease, the Company will pay a basic annual rent, which is subject to an annual fixed percentage increase, and management fees, property taxes and other necessary expenses associated with the lease. As a condition of the sale, the Company will pay off its outstanding mortgage for the property. The transaction is expected to close on or before November 27, 2006.

The following unaudited pro forma condensed consolidated financial statements illustrate the effects of the Company's proposed sale of AVINZA and consummated sale of Oncology, the Debt Redemption, which is a requirement of the proposed sale of AVINZA, and the Sale Leaseback (together, the "Transactions"). The Transactions have not yet been fully reflected in the Company's historical financial statements.

The unaudited pro forma condensed consolidated balance sheet as of June 30, 2006 gives effect to the Transactions as if they occurred as of that date. The unaudited pro forma condensed consolidated statements of operations give effect

to the Sale Leaseback as if it occurred on January 1, 2005 and give effect to the sales of AVINZA and Oncology as if they occurred on January 1, 2003, as they are expected to be reported as discontinued operations in the Company's consolidated financial statements. The Sale Leaseback has not been reflected in the unaudited pro forma condensed consolidated statements of operations for the years ended December 31, 2004 and 2003, as it will not be reported as a discontinued operation in the Company's consolidated financial statements. The unaudited pro forma condensed consolidated financial statements have been derived from, and should be read in conjunction with the Company's historical consolidated financial statements, including the notes thereto, in the

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Company's Annual Report filed on Form 10-K for the year ended December 31, 2005 and Quarterly Report filed on Form 10-Q for the quarter ended June 30, 2006. The unaudited pro forma condensed consolidated financial statements are not necessarily indicative of the financial position or results of operations that would have been achieved had the Transactions described above occurred on the dates indicated or that may be expected to occur in the future as a result of such transactions.

The unaudited pro forma condensed consolidated balance sheet reflects significant assets and liabilities associated with the AVINZA and Oncology product lines that will remain for a period of time with the Company subsequent to the proposed dispositions. Accordingly, the unaudited pro forma condensed consolidated balance sheet may not reflect the ongoing financial position of the Company. The unaudited pro forma condensed consolidated statements of operations exclude revenues and expenses directly attributable to AVINZA and Oncology, the Debt Redemption and the Sale Leaseback. As such, the unaudited pro forma condensed consolidated statements of operations do not reflect a reduction of general corporate allocations or other non-direct costs which may be expected to occur as a result of the Transactions.

The board of directors of the Company is evaluating the distribution of a substantial portion of the net cash proceeds from the asset sales to the Company's shareholders in the form of a special dividend following the consummation of the Transactions. Additionally, the Company is seeking shareholder approval to modify its 2002 Stock Incentive Plan (the 2002 Plan) to allow equitable adjustments to be made to options outstanding under the 2002 Plan in the event of a special cash dividend. Assuming our stockholders approve the amendment to the 2002 Plan, any such adjustments to outstanding options would be considered a modification and result in the recognition of compensation expense in the Company's consolidated statement of operations under the requirements of Statement of Financial Accounting Standard No 123(R) *Share-Based Payment* (SFAS 123(R)). Any such expense could be material. The accompanying unaudited pro forma condensed consolidated financial statements do not reflect adjustments related to the potential special cash dividend or modifications to the terms of outstanding stock options that may occur in connection with such a dividend.

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**Unaudited Pro Forma Condensed Consolidated Balance Sheet**  
**As of June 30, 2006**  
(In thousands, except share data)

	<b>As</b>	<b>AVINZA</b>	<b>Pro Forma After AVINZA</b>	<b>Oncology</b>	<b>Sale Leaseback</b>	<b>Pro Forma as Adjusted</b>
	<b>Reported</b>	<b>Adjustments</b>	<b>Adjustments</b>	<b>Adjustments</b>	<b>Adjustments</b>	
<b>ASSETS</b>						
Current assets:						
Cash and cash equivalents	\$ 41,615	\$ 54,926 <b>C</b>	\$ 96,541	\$ 182,268 <b>C</b>	\$ 47,642) <b>J</b> (719) <b>J</b> (11,669) <b>J</b> (400) <b>J</b>	\$ 313,663
Short-term investments	19,168		19,168			19,168
Accounts receivable, net	18,667		18,667			18,667
Current portion of inventories, net	8,467	(2,922) <b>A</b>	5,545	(5,545) <b>B</b>		
Other current assets	25,986	(8,464) <b>D</b>	17,522	(1,620) <b>D</b>		15,902
Total current assets	113,903	43,540	157,443	175,103	34,854	367,400
Restricted investments	1,826		1,826			1,826
Long-term portion of inventories, net	5,211		5,211	(5,211) <b>B</b>		
Property and equipment, net	21,561	(707) <b>A</b>	20,854	(12) <b>B</b>	(14,666) <b>J</b>	6,176
Acquired technology, product rights and royalty buy-down, net	139,766	(86,897) <b>A</b>	52,869	(52,869) <b>B</b>		
Other assets	3,665	(1,358) <b>E</b>	2,307	(2,176) <b>B</b>		131
Total Assets	\$ 285,932	\$ (45,422)	\$ 240,510	\$ 114,835	\$ 20,188	\$ 375,533
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>						
Current liabilities:						
Accounts payable	\$ 19,460		\$ 19,460			\$ 19,460
Accrued liabilities	58,302	9,315 <b>F</b> 34,603 <b>G</b> (961) <b>C</b> 15,849 <b>K</b>	117,108	3,526 <b>F</b> 21,194 <b>G</b> 7,105 <b>K</b>	1,964 <b>J</b> 2,309 <b>K</b>	153,206

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Current portion of deferred revenue	143,102	(107,537) <b>D</b>	35,565	(35,565) <b>D</b>		
Current portion of co-promote termination liability	45,046	(45,046) <b>A</b>				
Current portion of equipment financing obligations	2,146	(251) <b>H</b>	1,895	(8) <b>H</b>		1,887
Current portion of long-term debt	356		356		(356) <b>J</b>	
Total current liabilities	268,412	(94,028)	174,384	(3,748)	3,917	174,553
Long-term debt	139,463	(128,150) <b>I</b>	11,313		(11,313) <b>J</b>	
Long-term portion of co-promote termination liability	94,261	(94,261) <b>A</b>				
Long-term portion of equipment financing obligations	2,851	(251) <b>H</b>	2,600	(14) <b>H</b>		2,586
Long-term portion of deferred revenue	4,100		4,100	(1,553) <b>D</b>		2,547
Other long-term liabilities	3,002		3,002	(584) <b>B</b>	27,498 <b>J</b>	29,916
Total liabilities	512,089	(316,690)	195,399	(5,899)	20,102	209,602
Commitments and contingencies						
Common stock subject to conditional redemption; 997,568 shares issued and outstanding at June 30, 2006	12,345		12,345			12,345
Stockholders' equity (deficit):						
Common stock, \$0.001 par value; 200,000,000 shares authorized; 77,730,044 shares issued at June 30, 2006	78		78			78
Additional paid-in capital	751,547		751,547			751,547
Accumulated other comprehensive income	30		30			30
Accumulated deficit	(989,246)	271,268 <b>L</b>	(717,978)	120,734 <b>L</b>	86 <b>L</b>	(597,158)
Treasury stock at cost, 73,842 shares	(237,591)	271,268	33,677	120,734	86	154,497
	(911)		(911)			(911)

Total stockholders equity (deficit)	(238,502)	271,268	32,766	120,734	86	153,586
	\$ 285,932	\$ (45,422)	\$ 240,510	\$ 114,835	\$ 20,188	\$ 375,533

See accompanying notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements.

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**Unaudited Pro Forma Condensed Consolidated Statement of Operations**  
**For the Six Months Ended June 30, 2006**  
(In thousands except share data)

	<b>As Reported</b>	<b>AVINZA Adjustments</b>	<b>Pro Forma After AVINZA Adjustments</b>	<b>Oncology Adjustments</b>	<b>Other Adjustments</b>	<b>Pro Forma as Adjusted</b>
Revenues:						
Product sales	\$ 95,311	\$ (66,146)M	\$ 29,165	\$ (29,165)N	\$	\$
Collaborative research and development and other revenues	4,092		4,092	(113)N		3,979
Total revenues	99,403	(66,146)	33,257	(29,278)		3,979
Operating costs and expenses:						
Cost of products sold	20,006	(10,968)M	9,038	(9,038)N		
Research and development	26,113	(40)M	26,073	(7,568)N	(323)P 1,470Q	19,652
Selling, general and administrative	46,988	(20,148)M	26,840	(8,966)N	(149)P 602Q	18,327
Accretion of deferred gain on sale leaseback					(982)R	(982)
Co-promotion	21,880	(21,880)M				
Co-promote termination charges	132,507	(132,507)M				
Total operating costs and expenses	247,494	(185,543)	61,951	(25,572)	618	36,997
Loss from operations	(148,091)	119,397	(28,694)	(3,706)	(618)	(33,018)
Other income (expense):						



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Interest income	1,160		1,160			1,160
Interest expense	(12,223)	7,113M 4,494O	(616)	50N	425P	(141)
Other, net	1,002		1,002			1,002
Total other income (expense), net	(10,061)	11,607	1,546	50	425	2,021
Loss before income taxes	(158,152)	131,004	(27,148)	(3,656)	(193)	(30,997)
Income tax expense	(35)		(35)	35N 1,464N	(1,464)N	
Net loss	\$ (158,187)	\$ 131,004	\$ (27,183)	\$ (2,157)	\$ (1,657)	\$ (30,997)
Basic and diluted per share amounts:						
Net loss	\$ (2.03)		\$ (0.35)			\$ (0.40)
Weighted average number of common shares	78,021,236		78,021,236			78,021,236

See accompanying notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements.

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**Unaudited Pro Forma Condensed Consolidated Statement of Operations**  
**For the Year Ended December 31, 2005**  
(In thousands except share data)

	<b>As Reported</b>	<b>AVINZA Adjustments</b>	<b>Other AVINZA Adjustments</b>	<b>Pro Forma After AVINZA Adjustments</b>	<b>Oncology Adjustments</b>	<b>Other Adjustments</b>	<b>Pro Forma as Adjusted</b>
Revenues:							
Product sales	\$ 166,081	\$ (112,793)M	\$	\$ 53,288	\$ (53,288)N	\$	\$
Collaborative research and development and other revenues	10,527			10,527	(310)N		10,217
Total revenues	176,608	(112,793)		63,815	(53,598)		10,217
Operating costs and expenses:							
Cost of products sold	39,847	(23,090)M		16,757	(16,757)N		
Research and development	56,075	(2,386)M		53,689	(22,979)N	(675)P 3,095Q	33,130
Selling, general and administrative	74,656	(33,034)M		41,622	(18,488)N	(261)P 1,052Q	23,925
Accretion of deferred gain on sale leaseback						(1,964)R	(1,964)
Co-promotion	32,501	(32,501)M					
Total operating costs and expenses	203,079	(91,011)		112,068	(58,224)	1,247	55,091
Loss from operations	(26,471)	(21,782)		(48,253)	4,626	(1,247)	(44,874)
Other income (expense):							
Interest income	1,890			1,890			1,890
Interest expense	(12,458)	551M 10,357O		(1,550)	244N	871P	(435)

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Other, net	699			699				699
Total other income (expense), net	(9,869)	10,908		1,039	244	871		2,154
Loss before income taxes	(36,340)	(10,874)		(47,214)	4,870	(376)		(42,720)
Income tax expense	(59)	4,354	(4,354)M	(59)	59N			
Net loss	\$ (36,399)	\$ (6,520)	\$ (4,354)	\$ (47,273)	\$ 4,929	\$ (376)		\$ (42,720)
Basic and diluted per share amounts:								
Net loss	\$ (0.49)			\$ (0.64)				\$ (0.58)
Weighted average number of common shares	74,019,501			74,019,501				74,019,501

See accompanying notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements.

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**Unaudited Pro Forma Condensed Consolidated Statement of Operations**  
**For the Year Ended December 31, 2004**  
(In thousands except share data)

	<b>As Reported</b>	<b>AVINZA Adjustments</b>	<b>Pro Forma After AVINZA Adjustments</b>	<b>Oncology Adjustments</b>	<b>Pro Forma as Adjusted</b>
Revenues:					
Product sales	\$ 120,335	\$ (69,470)M	\$ 50,865	\$ (50,865)N	\$
Sale of royalty rights, net	31,342		31,342		31,342
Collaborative research and development and other revenues	11,835		11,835	(535)N	11,300
Total revenues	163,512	(69,470)	94,042	(51,400)	42,642
Operating costs and expenses:					
Cost of products sold	39,804	(18,264)M	21,540	(21,540)N	
Research and development	65,204	(1,978)M	63,226	(32,484)N	30,742
Selling, general and administrative	65,798	(33,851)M	31,947	(19,367)N	12,580
Co-promotion	30,077	(30,077)M			
Total operating costs and expenses	200,883	(84,170)	116,713	(73,391)	43,322
Loss from operations	(37,371)	14,700	(22,671)	21,991	(680)
Other income (expense):					
Interest income	1,096		1,096		1,096
Interest expense	(12,338)	459M 10,289O	(1,590)	332N	(1,258)
Other, net	3,705		3,705		3,705
Total other income (expense), net	(7,537)	10,748	3,211	332	3,543
Income (loss) before income taxes	(44,908)	25,448	(19,460)	22,323N	2,863
Income tax expense	(233)		(233)	54N	(179)
Net Income (loss)	\$ (45,141)	\$ 25,448	\$ (19,693)	\$ 22,377	\$ 2,684

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Basic per share amounts:			
Net income (loss)	\$ (0.61)	\$ (0.27)	\$ 0.04
Diluted per share amounts:			
Net income (loss)	\$ (0.61)	\$ (0.27)	\$ 0.04
Weighted average number of common shares used in basic calculation			
	73,692,987	73,692,987	73,692,987
Weighted average number of common shares used in diluted calculation			
	73,692,987	73,692,987	75,253,038

See accompanying notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements.

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**Unaudited Pro Forma Condensed Consolidated Statement of Operations**  
**For the Year Ended December 31, 2003**  
(In thousands, except share data)

	<b>As Reported</b>	<b>AVINZA Adjustments</b>	<b>Pro Forma After AVINZA Adjustments</b>	<b>Oncology Adjustments</b>	<b>Pro Forma as Adjusted</b>
Revenues:					
Product sales	\$ 55,324	\$ (16,482)M	\$ 38,842	\$ (38,842)N	\$
Sale of royalty rights, net	11,786		11,786		11,786
Collaborative research and development and other revenues	14,008		14,008	(310)N	13,698
Total revenues	81,118	(16,482)	64,636	(39,152)	25,484
Operating costs and expenses:					
Cost of products sold	26,557	(12,383)M	14,174	(14,174)N	
Research and development	66,678	(1,347)M	65,331	(37,029)N	28,302
Selling, general and administrative	52,540	(22,717)M	29,823	(17,764)N	12,059
Co-promotion	9,360	(9,360)M			
Total operating costs and expenses	155,135	(45,807)	109,328	(68,967)	40,361
Loss from operations	(74,017)	29,325	(44,692)	29,815	(14,877)
Other income (expense):					
Interest income	783		783		783
Interest expense	(11,142)	358M 10,225O	(559)	121N	(438)
Other, net	(10,034)		(10,034)		(10,034)
Total other income (expense), net	(20,393)	10,583	(9,810)	121	(9,689)
Loss before income taxes and cumulative effect of a change in accounting principle	(94,410)	39,908	(54,502)	29,936	(24,566)
Income tax expense	(56)		(56)	56N	

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Loss from continuing operations	\$ (94,466)	\$ 39,908	\$ (54,558)	\$ 29,992	\$ (24,566)
Basic and diluted per share amounts:					
Net loss from continuing operations	\$ (1.34)		\$ (0.77)		\$ (0.35)
Weighted average number of common shares	70,685,234		70,685,234		70,685,234

See accompanying notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements.

**Table of Contents****Basis of Pro Forma Presentation**

On September 6, 2006, the Company, King Pharmaceuticals, Inc., a Tennessee corporation, and King Pharmaceuticals Research and Development, Inc., a Delaware corporation and wholly-owned subsidiary of King Pharmaceuticals (together with King Pharmaceuticals, King) entered into a purchase agreement (the AVINZA Purchase Agreement), pursuant to which King agreed to acquire all of the Company's rights in and to AVINZA® (morphine sulfate extended-release capsules) in the United States, its territories and Canada, including, among other things, all Avinza® inventory, equipment, records and related intellectual property, and assume certain liabilities (together, AVINZA or the AVINZA Product Line) as set forth in the AVINZA Purchase Agreement. Additionally, a condition of the AVINZA Purchase Agreement requires that the Company redeem, prior to the close of the sale of AVINZA to King, the outstanding 6% convertible subordinated notes, previously issued by the Company (the Debt Redemption). Also, King will assume certain liabilities, including certain product-related liabilities owed by the Company to Organon Pharmaceuticals USA Inc. Pursuant to the AVINZA Purchase Agreement, at closing, the Company will be paid a \$265.0 million cash payment, \$15.0 million of which will be funded into an escrow account to support any indemnification claims. The Company expects to account for the disposition of the AVINZA Product Line as a discontinued operation in its consolidated financial statements.

Also on September 7, 2006, the Company, 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 has agreed to acquire all of the Company's worldwide rights in and to the Company's oncology product line, including, among other things, all related inventory, equipment, records and intellectual property, and assume certain liabilities (together Oncology or the Oncology Product Line) as set forth in the Oncology Purchase Agreement. The Oncology Product Line includes the Company's four marketed oncology drugs: ONTAK, Targretin capsules, Targretin gel and Panretin gel. Pursuant to the Oncology Purchase Agreement, at closing, the Company will be paid a \$205.0 million cash payment, \$20.0 million of which will be funded into an escrow account to support any indemnification claims. The Company expects to account for the disposition of the Oncology Product Line as a discontinued operation in its consolidated financial statements.

On October 25, 2006, the Company entered into an agreement with Slough Estates USA, Inc. (the Buyer) to sell the real properties at its corporate headquarters located in San Diego, California (the Sale Leaseback). Under the terms of the agreement, Slough Estates USA, Inc. has agreed to purchase all real properties (land, building and improvements) known as 10275 Science Center Drive, 10265 Science Center Drive and 10285 Science Center Drive in San Diego, California for a purchase price of approximately \$47.6 million. In addition, the Company is leasing back the building at 10275 Science Center Drive from the Buyer as its corporate headquarters office, with a lease term of fifteen years through 2021. Under the terms of the lease, the Company will pay a basic annual rent of approximately \$3.0 million, which is subject to an annual fixed percentage increase, and management fees, property taxes and other necessary expenses associated with the lease. Concurrent with the sale, the Company will pay off its outstanding mortgage for the property. The transaction is expected to close on or before November 27, 2006.

Together, the sale of AVINZA, the sale of Oncology, the Debt Redemption and the Sale Leaseback are referred to as the Transactions. The unaudited pro forma condensed consolidated balance sheet as of June 30, 2006 gives effect to the Transactions as if they occurred as of that date. The unaudited pro forma condensed consolidated statements of operations give effect to the Sale Leaseback as if it occurred on January 1, 2005 and give effect to the sales of AVINZA and Oncology as if they occurred on January 1, 2003, as they are expected to be reported as discontinued operations in the Company's consolidated financial statements. The Sale Leaseback has not been reflected in the unaudited pro forma condensed consolidated statements of operations for the years ended December 31, 2004 and 2003, as it is not expected to be reported as a discontinued operation in the Company's consolidated financial statements. The unaudited pro forma condensed consolidated financial statements have been derived from, and should be read, in conjunction with the historical consolidated financial statements, including the notes thereto, in the



Company's Annual Report filed on Form 10-K for the year ended December 31, 2005 and the Company's Quarterly Report filed on Form 10-Q for the quarter ended June 30, 2006. The unaudited pro forma condensed consolidated financial statements are not necessarily indicative of the financial position or results of operations of the Company that would have been achieved had the Transactions described above occurred on the dates indicated or that may be expected to occur as a result of such Transactions.

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The unaudited pro forma condensed consolidated balance sheet reflects significant assets and liabilities associated with the AVINZA and Oncology Product Lines that will remain for a period of time with the Company subsequent to the proposed dispositions. Accordingly, the unaudited pro forma condensed consolidated balance sheet may not reflect the ongoing financial position of the Company. The unaudited pro forma condensed consolidated statements of operations exclude revenues and expenses directly attributable to AVINZA and Oncology, the Debt Redemption and the Sale Leaseback. As such, the unaudited pro forma condensed consolidated statements of operations do not reflect a reduction of general corporate allocations or other non-direct costs which may be expected to occur as a result of the Transactions.

The Board of Directors of the Company is evaluating the distribution of a substantial portion of the net cash proceeds from the asset sales to the Company's shareholders in the form of a special dividend following the consummation of the Transactions. Additionally, the Company is seeking shareholder approval to modify its 2002 Stock Incentive Plan (the 2002 Plan) to allow equitable adjustments to be made to options outstanding under the 2002 Plan in the event of a special cash dividend. Assuming shareholder approval of the change to the 2002 Plan, any such adjustments to outstanding options would be considered a modification and result in the recognition of compensation expense in the Company's consolidated statement of operations under the requirements of Statement of Financial Accounting Standard No 123(R) *Share-Based Payment* (SFAS 123(R)). Any such expense could be material. The accompanying unaudited pro forma condensed consolidated financial statements do not reflect adjustments related to the potential special cash dividend or modifications to the terms of outstanding stock options that may occur in connection with such a dividend.

**Notes to Unaudited Pro Forma Condensed Consolidated Financial Statements**

- A. Reflects the adjustments to the Company's historical consolidated balance sheet for the specific assets and liabilities to be transferred to King under the AVINZA Purchase Agreement.
- B. Reflects the adjustments to the Company's historical consolidated balance sheet for the specific assets and liabilities to be transferred to Eisai under the Oncology Purchase Agreement.
- C. Reflects the adjustments to cash and cash equivalents related to the sales of the AVINZA and Oncology product lines and the Debt Redemption as follows:

*The amounts in thousands:*

	<b>AVINZA</b>	<b>Oncology</b>
Cash consideration	\$ 265,000	\$ 205,000
Additional consideration to settle product-line liabilities	10,000	
Less: Cash held in escrow	(15,000)	(20,000)
Inventory value contingency	(65,341)	
Estimated transaction costs	(7,044)	(2,710)
Repayment of equipment financing obligations for equipment transferred to King and Eisai	(502)	(22)
Redemption of 6% convertible subordinated notes, including a contractual redemption premium of \$3,076	(131,226)	
Payment of accrued interest on 6% convertible subordinated notes	(961)	
	<b>\$ 54,926</b>	<b>\$ 182,268</b>

As part of the Company's co-promotion termination agreement with Organon, the Company agreed to pay Organon \$10.0 million in January 2007. In accordance with the AVINZA Purchase Agreement, King is expected to reimburse Ligand for this obligation. The AVINZA and Oncology Purchase Agreements require a total of \$35.0 million be held in escrow pending the resolution of certain contingencies. Such amounts have been excluded from the net sales consideration in the table above. If these contingencies are resolved in favor of Ligand and additional consideration is distributable, the additional consideration received will serve to increase the Company's gain on the disposal of the AVINZA and Oncology product lines.

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Additionally, under the AVINZA Purchase Agreement, cash consideration may be affected by an inventory value contingency for product held in the distribution channel. Under this arrangement, if the AVINZA inventory at closing is above an agreed-upon level, the AVINZA purchase price will be adjusted down. For purposes of the unaudited pro forma condensed consolidated financial statements, the Company estimated the potential reduction in cash consideration related to the inventory value contingency based on inventory levels as of June 30, 2006, and excluded such amounts from the net sales consideration to be received. In the event that the inventory value contingency resolves in an amount different than the adjustment assumed in the unaudited pro forma condensed consolidated financial statements, the purchase price will be adjusted accordingly. Although the Company expects that the adjustment may be significantly lower than that assumed in the accompanying unaudited pro forma condensed consolidated balance sheet due to lower current inventory levels, there can be no assurance that the lower inventory levels will be sustained.

As of the closing date of the Oncology transaction, the Company is required to transfer manufactured product inventory to Eisai of at least \$9.8 million (the Required Closing Date Inventory Value). To the extent the actual inventory value is less than the Required Closing Date Inventory Value, the Oncology Purchase Agreement provides for a corresponding decrease to the purchase price. As of June 30, 2006, Oncology inventory exceeded \$9.8 million. Furthermore, the Company believes that Oncology inventory exceeded \$9.8 million on October 25, 2006, the date the sale of Oncology was consummated. Accordingly, no such adjustment has been reflected in the accompanying unaudited pro forma condensed consolidated balance sheet. However, there can be no assurance that the actual inventory value as of the Oncology closing date did exceed the Required Closing Date Inventory, until final approval from Eisai is obtained.

- D.** Reflects the removal of deferred revenue, deferred cost of products sold and deferred royalty cost related to AVINZA and Oncology due to the Transactions.

The Company accounts for domestic product shipments made to wholesalers for AVINZA and Oncology under the sell-through revenue recognition method. For these product sales, the Company records deferred revenue and classifies inventory held by the wholesaler as deferred cost of products sold within other current assets. The Company recognizes revenue when such inventory is sold through to the wholesaler's customers (Oncology) or when a prescription is filled (AVINZA). Consequently, royalty cost associated with these product sales is also deferred until the product revenue is recognized. Upon closing of the AVINZA and Oncology transactions, the deferred revenue, deferred cost of products sold, and the deferred royalty cost associated with these product sales will be removed from Ligand's balance sheet and recognized as part of the gain on the disposals of AVINZA and Oncology.

- E.** Reflects the write-off of debt issuance costs associated with the redemption of the 6% convertible subordinated notes (see Note I below).
- F.** Reflects adjustments to accrued liabilities related to the Transactions for royalty payments, rebates and chargebacks.

The Company records accruals for royalty payments, rebates and chargebacks when product sales are recognized as revenue under the sell-through method. In connection with eliminating the deferred revenue balances associated with AVINZA and Oncology upon disposition (see note D above), the Company will accrue for royalty payments, rebates and chargebacks, related to product in the distribution channel which has not sold-through and for which the Company will retain the liability subsequent to the disposal of AVINZA and Oncology.

- G.** Reflects adjustments to record an estimate of product in the wholesale and retail distribution channels that could be returned based on estimated channel inventories as of June 30, 2006. Based on the terms of the AVINZA and Oncology transactions, the Company is required to retain the obligation for returns for product shipped to

wholesalers prior to the closing of the transactions. As further discussed under Note C, the Company expects product inventories in the distribution channels at the time of close of each transaction to be significantly lower than the levels estimated as of June 30, 2006.

However, there can be no assurance that any such decrease in inventories will be achieved or result in a lower estimate of product returns.

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- H.** Reflects the repayment of equipment financing obligations related to equipment to be transferred to King and Eisai as a result of the Transactions.
- I.** Reflects the redemption of the 6% convertible subordinated notes as required by the AVINZA Purchase Agreement.

Though the AVINZA Purchase Agreement requires redemption of the 6% subordinated notes, note holders have the option to convert the notes to Ligand common stock prior to redemption at a rate of 161.9905 shares of common stock per \$1,000 principal amount of securities (effective conversion price of approximately \$6.17 per share of common stock). If a portion or all of the notes are converted to equity instruments rather than redeemed, the pro forma cash balances would increase by an amount up to \$132.2 million, reflecting the principal amount of the notes, accrued interest and the redemption premium. However, there can be no assurance that any or all of the note holders will convert prior to redemption or the amount by which cash balances may be adjusted.

- J.** Reflects the sale and subsequent leaseback of the Company's corporate office building and land in San Diego, California (the "Sale Leaseback").

On October 25, 2006, the Company entered into a purchase agreement with Slough Estates USA Inc. (the "Buyer") to sell the facilities encompassing the Company's corporate headquarters and two land parcels. The total purchase price for the facilities and land was approximately \$47.6 million. As a term of the purchase agreement, the Company will pay off the outstanding bank loan on the building, the balance of which approximated \$11.7 million as of June 30, 2006. A prepayment penalty approximating \$0.4 million is expected to be incurred (see Note L). Concurrently, the Company entered into a lease agreement (the "Lease") with the Buyer dated October 25, 2006 to leaseback the office building housing the Company's corporate headquarters. The lease has a term of 15 years with a basic annual rent, subject to an annual fixed percentage increase. The Sale Leaseback transaction will be recorded per Statement of Financial Accounting Standard No. 13 *Accounting for Leases*. The Company expects to record an immediate gain on the sale totalling approximately \$2.8 million and defer a gain of approximately \$29.5 million on the sale of the corporate headquarters, which will be recognized on a straight-line basis over the 15-year life of the lease at a rate of approximately \$2.0 million per year.

- K.** Reflects current tax liabilities for federal Alternative Minimum Tax ("AMT") and certain state taxes associated with the sales of AVINZA and Oncology and the Sale Leaseback, based on the expected proceeds to be received in the current period. Future royalties to be received from King on sales of AVINZA and the release of escrow amounts for both the AVINZA and Oncology sales transactions are expected to be taxable in the year received by the Company. There can be no assurance of the extent to which net operating loss carryforwards ("NOLs") or tax credits will be available to offset or otherwise minimize any such taxable gains.

The estimated taxable gains on the dispositions of AVINZA and Oncology and the Sale Leaseback have been reduced, fully for federal purposes and partially for state purposes, by the estimated utilization of NOLs, which the Company has estimated to be available. However, the Company has not completed its analysis of the tax implications of the Transactions. Accordingly, the Company's ability to utilize its NOLs and research and development credit carryforwards ("R&D Credits") for State of California purposes may materially differ from the amounts assumed to be used in the unaudited pro forma condensed consolidated financial statements. In particular:

The Company's expectation of federal tax to the extent of AMT is predicated upon the full value of the NOLs being available, which in turn is predicated on certain assumptions regarding the valuation of the Company's intellectual property on the date of the Transactions and the dates of prior ownership changes and certain tax elections and options which may be available to the Company. Changes to the valuations of intellectual property

could result in material limitations on the Company's ability to fully utilize such NOLs.

The Company has not completed its study of the availability of R&D Credits in the State of California. While the Company believes it has sufficient R&D credits to offset some or all of the taxable gains from the Transactions, it has assumed no R&D Credit utilization in the unaudited pro forma condensed consolidated

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financial statements, as it can not yet determine a reasonable estimate of the R&D Credits which ultimately may be available.

Furthermore, the tax implications of the Transactions could be affected by the ultimate decisions by the holders of the 6% subordinated notes to accept redemption of their notes or to convert their notes to shares in the Company's stock. For example, a conversion of notes could result in a change in ownership which could in turn result in limitations on the utilization of NOLs generated since the Company last determined an ownership change in 2005. As described in Note I above, the unaudited pro forma condensed consolidated financial statements assume that the 6% subordinated notes will be fully redeemed.

- L. Reflects an estimated net gain, net of tax, on the sales of AVINZA and Oncology, the Sale Leaseback, an estimated loss on redemption of the 6% subordinated notes, and extinguishment of the mortgage debt.

*The amounts in thousands*

***Gain on AVINZA Transaction***

	<b>AVINZA</b>
Adjusted cash consideration	\$ 187,615
Total assets transferred	(90,526)
Total liabilities assumed	139,307
Other assets and liabilities removed and created upon disposal	55,155
<b><i>Debt Redemption</i></b>	
Cash paid to redeem 6% subordinated notes	(132,187)
Debt issuance cost write-off	(1,358)
Carrying value of 6% subordinated notes	128,150
Accrued interest	961
Estimated gain on disposal of AVINZA	287,117
Estimated tax on gain	(15,849)
<b>Estimated net gain from AVINZA transaction</b>	<b>\$ 271,268</b>

***Gain on Oncology Transaction***

	<b>Oncology</b>
Adjusted cash consideration	\$ 182,290
Total assets transferred	(65,813)
Total liabilities assumed	584
Other assets and liabilities removed and created upon disposal	10,778
Estimated tax on gain	(7,105)
<b>Estimated net gain from Oncology transaction</b>	<b>\$ 120,734</b>





**Table of Contents*****Gain on Sale Leaseback Transaction***

Cash proceeds from Sale Leaseback, net of transaction costs of \$719	\$ 46,923
Carrying value of land sold	(5,176)
Carrying value of building sold	(5,778)
Carrying value of leasehold improvements sold	(3,712)
Total pre-tax gain on Sale Leaseback	32,257
Less: current portion of pre-tax deferred gain	1,964
Less: non-current portion of pre-tax deferred gain	27,498
Pre-tax gain immediately recognized on sale	2,795
Pre-tax loss on early extinguishment of debt	(400)
Estimated tax on gain	(2,309)
<b>Estimated net current gain from Sale Leaseback Transaction</b>	<b>\$ 86</b>

- M.** Reflects adjustments to remove the results of operations directly attributable to the AVINZA Product Line. Income tax expense has been computed using statutory rates on the pro forma adjustments to the extent of Product Line income. However, since the Company retains a full valuation allowance with respect to its net deferred tax assets, an offsetting adjustment has been reflected through other AVINZA adjustments. A non-recurring net gain on sale has been excluded from the unaudited pro forma condensed consolidated statements of operations, but will be included in the Company's consolidated statement of operations when the sale of AVINZA is concluded.
- N.** Reflects adjustments to remove the results of operations directly attributable to the Oncology Product Line. Income tax expense has been computed using statutory rates on the pro forma adjustments to the extent of Product Line income. However, since the Company retains a full valuation allowance with respect to its net deferred tax assets, an offsetting adjustment has been reflected through other adjustments. A non-recurring net gain on sale has been excluded from the unaudited pro forma condensed consolidated statements of operations, but will be included in the Company's consolidated statement of operations when the sale of Oncology is concluded.
- O.** Reflects adjustments to remove interest expense and related amortization of deferred debt costs attributable to the 6% convertible subordinated notes. A non-recurring loss of \$4.4 million associated with the Debt Redemption has been excluded from the unaudited pro forma condensed consolidated statements of operations, but will be included in the Company's consolidated statement of operations if the debt is fully redeemed rather than being converted to shares of the Company's common stock at the time of such redemption.
- P.** Reflects adjustments to reverse historical expenses for depreciation, mortgage interest and other operating expenses recorded in the Company's historical consolidated financial statements for the Company's corporate headquarters, which was sold in the Sale Leaseback.
- Q.** Reflects adjustments to record annual base rent expense of \$3.7 million and annual executory costs of \$0.4 million for the lease of the Company's corporate headquarters entered into in connection with the Sale Leaseback. These expenses have been allocated to research and development expenses and selling, general, and administrative expenses in the unaudited pro forma condensed consolidated statements of operations using the

Company's historical allocation percentages.

- R.** Reflects the accretion of the deferred gain resulting from the Sale Leaseback over the 15- year term of the related lease.

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**UNAUDITED FINANCIAL STATEMENTS OF AVINZA PRODUCT LINE OF LIGAND  
PHARMACEUTICALS INCORPORATED**

The following are unaudited financial statements of the AVINZA product line of Ligand Pharmaceuticals Incorporated (the Company or Ligand ). These unaudited financial statements have been derived from historical financial data of Ligand Pharmaceuticals Incorporated and include unaudited balance sheets of the AVINZA product line as of June 30, 2006 and December 31, 2005 and 2004, and the related unaudited statements of operations and cash flows for the six months ended June 30, 2006 and 2005, and for each of the years in the three year period ended December 31, 2005. These unaudited financial statements reflect the assets and liabilities, operations and cash flows of the AVINZA product line and include allocations for expenses incurred by Ligand on behalf of the AVINZA product line. The unaudited financial statements are not necessarily indicative of the financial position, results of operations or cash flows that would have occurred had the AVINZA product line been a stand-alone entity during the periods presented, nor is it indicative of future results of the AVINZA product line.

The unaudited financial statements of the AVINZA product line are qualified in their entirety by, and should be read in conjunction with, the audited historical consolidated financial statements of Ligand Pharmaceuticals Incorporated including the notes thereto, in the Company s Annual Report on Form 10-K for the year ended December 31, 2005, and the Company s Quarterly Report on Form 10-Q for the quarter ended June 30, 2006, which are incorporated by reference herein.

**Table of Contents****AVINZA PRODUCT LINE OF LIGAND PHARMACEUTICALS INCORPORATED****BALANCE SHEETS**  
**(Unaudited)**  
**(In thousands)**

	<b>June 30,</b>	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>ASSETS</b>			
Current assets			
Accounts receivable, net	\$ 12,073	\$ 14,842	\$ 22,508
Inventories, net	2,922	2,870	3,742
Other current assets	9,175	10,017	8,786
Total current assets	24,170	27,729	35,036
Restricted investments	309	317	188
Equipment, net	765	849	937
Acquired technology and product rights, net	86,897	90,712	98,341
Other assets	44	56	86
Total assets	\$ 112,185	\$ 119,663	\$ 134,588
<b>LIABILITIES AND NET PRODUCT LINE DEFICIT</b>			
Current liabilities			
Accounts payable	\$ 8,260	\$ 5,062	\$ 7,502
Accrued liabilities	29,970	41,931	24,627
Deferred revenue, net	107,537	115,235	102,765
Current portion of co-promote termination liability	45,046		
Current portion of equipment financing obligations	274	270	273
Total current liabilities	191,087	162,498	135,167
Long-term portion of co-promote termination liability	94,261		
Long-term portion of equipment financing obligations	284	406	642
Total liabilities	285,632	162,904	135,809
Commitments and contingencies			
Net product line deficit	(173,447)	(43,241)	(1,221)
Total liabilities and net product line deficit	\$ 112,185	\$ 119,663	\$ 134,588

The accompanying notes are integral part of these unaudited financial statements.

**Table of Contents****AVINZA PRODUCT LINE OF LIGAND PHARMACEUTICALS INCORPORATED****STATEMENTS OF OPERATIONS****(Unaudited)****(In thousands)**

	<b>Six Months Ended</b>		<b>Years Ended December 31,</b>		
	<b>June 30,</b>		<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>2006</b>	<b>2005</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
Revenues:					
Product sales, net	\$ 66,146	\$ 49,458	\$ 112,793	\$ 69,470	\$ 16,482
Operating costs and expenses:					
Cost of products sold	10,968	11,565	23,090	18,264	12,383
Research and development	173	600	2,972	2,567	1,417
Selling, general and administrative	27,552	22,745	42,476	38,331	26,094
Co-promotion	21,880	14,706	32,501	30,077	9,360
Co-promote termination charges	132,507				
Total operating costs and expenses	193,080	49,616	101,039	89,239	49,254
Income (loss) from operations	(126,934)	(158)	11,754	(19,769)	(32,772)
Interest expense	(7,115)	(309)	(558)	(469)	(370)
Income (loss) before income taxes	(134,049)	(467)	11,196	(20,238)	(33,142)
Income tax benefit (expense)	(2,149)	501	(12,015)	(8,952)	(1,522)
Net income (loss)	\$ (136,198)	\$ 34	\$ (819)	\$ (29,190)	\$ (34,664)

The accompanying notes are integral part of these unaudited financial statements.

**Table of Contents****AVINZA PRODUCT LINE OF LIGAND PHARMACEUTICALS INCORPORATED****STATEMENTS OF CHANGES IN NET PRODUCT LINE EQUITY/(DEFICIT)****(Unaudited)  
(In thousands)**

Balance at December 31, 2002	\$ 99,417
Net loss	(34,664)
Net distributions to Ligand	(18,822)
Balance at December 31, 2003	45,931
Net loss	(29,190)
Net distributions to Ligand	(17,962)
Balance at December 31, 2004	(1,221)
Net loss	(819)
Net distributions to Ligand	(41,201)
Balance at December 31, 2005	(43,241)
Net loss	(136,198)
Stock compensation expense	175
Net contributions from Ligand	5,817
Balance at June 30, 2006	\$ (173,447)

The accompanying notes are integral part of these unaudited financial statements.

**Table of Contents****AVINZA PRODUCT LINE OF LIGAND PHARMACEUTICALS INCORPORATED****STATEMENTS OF CASH FLOWS****(Unaudited)**  
**(In thousands)**

	<b>Six Months Ended</b>		<b>Years Ended December 31,</b>		
	<b>June 30,</b>		<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>2006</b>	<b>2005</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Operating activities</b>					
Net income (loss)	\$ (136,198)	\$ 34	\$ (819)	\$ (29,190)	\$ (34,664)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Amortization of acquired technology and product rights	3,815	3,814	7,629	7,629	7,644
Depreciation of equipment	176	180	358	300	226
Stock based compensation expense	175				
Other	(8)	(6)		(5)	6
Changes in current assets and liabilities					
Accounts receivable, net	2,769	3,810	7,666	(10,427)	(11,010)
Inventories, net	(52)	1,554	872	(3,162)	696
Other current assets	842	1,034	(1,231)	(3,610)	(2,538)
Accounts payable and accrued liabilities	(8,764)	(885)	14,865	13,492	16,338
Deferred revenue, net	(7,698)	6,078	12,470	42,511	47,402
Co-promote termination liability	139,307				
Net cash provided by (used in) operating activities	(5,636)	15,613	41,810	17,538	24,100
<b>Investing activities</b>					
Decrease (increase) in restricted investments	9	(124)	(129)	(13)	(124)
Purchases of equipment	(92)	(201)	(270)	(364)	(1,058)
Payment for AVINZA <sup>®</sup> royalty rights					(4,133)
Other, net	20	22	30	10	(31)
Net cash used in investing activities	(63)	(303)	(369)	(367)	(5,346)
<b>Financing activities</b>					
Principal payments on equipment financing obligations	(149)	(155)	(333)	(201)	
Proceeds from equipment financing arrangements	31	71	93	992	68
Net contributions from (distributions to) Ligand	5,817	(15,226)	(41,201)	(17,962)	(18,822)



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Net cash provided by (used in) financing activities	5,699	(15,310)	(41,441)	(17,171)	(18,754)
Net change in cash and cash equivalents					
Cash and cash equivalents, beginning of period					
Cash and cash equivalents, end of period	\$	\$	\$	\$	\$

The accompanying notes are integral part of these unaudited financial statements.

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**AVINZA PRODUCT LINE OF LIGAND PHARMACEUTICALS INCORPORATED**

**NOTES TO FINANCIAL STATEMENTS  
(UNAUDITED)**

**Note 1: Description of Business and Basis of Presentation**

The AVINZA product business ( AVINZA or the Business ) is a product line of Ligand Pharmaceuticals Incorporated (the Company or Ligand). AVINZA was approved by the Food and Drug Administration ( FDA) in March 2002 for the once-daily treatment of moderate-to-severe pain in patients who require continuous, around-the-clock opioid therapy for an extended period of time. Ligand launched the product in the second quarter of 2002. AVINZA consists of two components: an immediate-release component that rapidly achieves morphine concentrations in plasma, and an extended-release component that maintains plasma concentrations throughout a 24-hour dosing interval. AVINZA was developed by Elan Corporation, plc ( Elan ), which licensed the U.S. and Canadian rights to the Company in 1998. Early in 2003, Ligand finalized a co-promotion agreement with Organon Pharmaceuticals USA Inc. ( Organon ), which was subsequently terminated effective January 1, 2006. However, the parties agreed to continue to cooperate during a transition period ending September 30, 2006 to promote the product. The AVINZA financial statements include the unaudited financial position, results of operations, and cash flows of the Business.

The unaudited financial statements have been carved out from the consolidated financial statements of Ligand using the historical assets and liabilities, results of operations and cash flows of Ligand attributable to AVINZA. The carve out financial statements include allocations for certain corporate expenses incurred by Ligand on behalf of the Business. See Note 4, Corporate Expense Allocations . Management believes the assumptions underlying the unaudited carve-out financial statements of AVINZA are reasonable; however, AVINZA 's financial position, results of operations, and cash flows may have been materially different if it was operated as a stand-alone entity as of and for the periods presented.

As a product line of Ligand, AVINZA is dependent upon Ligand for all of its working capital and financing requirements. Accordingly, the transfers of financial resources between Ligand and the Business are reflected as a component of net product line deficit in lieu of cash, intercompany debt, and equity accounts.

**Note 2: Summary of Significant Accounting Policies**

***Use of Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, including disclosure of contingent assets and contingent liabilities, at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The Business 's critical accounting policies are those that are both most important to the Business 's financial condition and results of operations and require the most difficult, subjective or complex judgments on the part of management in their application, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

Because of the uncertainty of factors surrounding the estimates or judgments used in the preparation of the financial statements, actual results may materially vary from these estimates.

***Restricted Investments***

Restricted investments consist of certificates of deposit entered into by Ligand and attributable to AVINZA held with a financial institution as collateral under a third-party service provider arrangement. These certificates have been classified by management as held-to-maturity and are accounted for at amortized cost.

*Concentrations of Credit Risk*

Financial instruments that potentially subject the Business to significant concentrations of credit risk consist primarily of accounts receivable. The Business extends credit on an uncollateralized basis primarily to wholesale

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drug distributors throughout the United States. Prior to entering into sales agreements with new customers, and on an ongoing basis for existing customers, the Business performs credit evaluations. To date, the Business has not experienced significant losses on customer accounts.

As more fully discussed in Note 5, Ligand sells certain of the Business' accounts receivable under a non-recourse factoring arrangement with a finance company. Ligand can transfer funds in any amount up to a specified percentage of the net amount due from the Business' trade customers at the time of the sale to the finance company, with the remaining funds available upon collection of the trade receivable. As of June 30, 2006, the gross amount due from the finance company for the sale of AVINZA related receivables was \$9.2 million (see Note 3).

***Inventories, net***

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

	<b>June 30, 2006</b>	<b>December 31, 2005</b>	<b>2004</b>
Work-in-process	\$ 760	\$ 554	\$
Finished goods	2,162	2,601	3,742
Less inventory reserves		(285)	
	<b>\$ 2,922</b>	<b>\$ 2,870</b>	<b>\$ 3,742</b>

***Equipment***

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

	<b>June 30, 2006</b>	<b>December 31, 2005</b>	<b>2004</b>
Equipment	\$ 1,217	\$ 1,250	\$ 1,203
Less accumulated depreciation	(452)	(401)	(266)
	<b>\$ 765</b>	<b>\$ 849</b>	<b>\$ 937</b>

Depreciation of equipment is computed using the straight-line method over the estimated useful lives of the assets which range from three to ten years.

***Acquired Technology and Product Rights***

In accordance with Statement of Financial Accounting Standard (SFAS) No. 142, *Goodwill and Other Intangibles* ( SFAS 142 ), the Business amortizes intangible assets with finite lives in a manner that reflects the pattern in which the economic benefits of the assets are consumed or otherwise used up. If that pattern cannot be reliably determined, the assets are amortized using the straight-line method. Acquired technology and product rights, which are being amortized through November 2017, consist of the following (in thousands):

	<b>June 30, 2006</b>	<b>December 31, 2005</b>	<b>December 31, 2004</b>
AVINZA	\$ 114,437	\$ 114,437	\$ 114,437
Less accumulated depreciation	(27,540)	(23,725)	(16,096)
	<b>\$ 86,897</b>	<b>\$ 90,712</b>	<b>\$ 98,341</b>

Amortization of acquired technology and product rights for each of the six months ended June 30, 2006 and 2005 was \$3.8 million and for each of the years ended December 31, 2005, 2004 and 2003 was \$7.6 million.

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**AVINZA PRODUCT LINE OF LIGAND PHARMACEUTICALS INCORPORATED**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

Estimated annual amortization for these assets for each of the years in the period from 2006 to 2010 is \$7.6 million and \$52.7 million, thereafter.

***Fair Value of Financial Instruments***

The carrying amounts of accounts receivable, restricted investments, accounts payable and accrued liabilities at June 30, 2006, December 31, 2005 and December 31, 2004 are considered to be reasonable estimates of their fair values due to the short-term nature of those instruments. As of June 30, 2006, December 31, 2005 and December 31, 2004, the carrying amounts of equipment financing obligations represent reasonable estimates of their fair value due to their interest rates approximating current market rates. The carrying amount of the co-promotion termination liability is based upon the present value of future cash payments expected to be made under the arrangement, which is believed to represent fair value.

***Revenue Recognition***

The Business has determined that shipments made to wholesalers for AVINZA do not meet the revenue recognition criteria of SFAS No. 48, *Revenue Recognition When Right of Return Exists* ( SFAS 48 ), and Staff Accounting Bulletin ( SAB ) 104, *Revenue Recognition* ( SAB 104 ), at the time of shipment, and therefore such shipments are accounted for using the sell-through method. Under the sell-through method, the Business does not recognize revenue upon shipment of product to the wholesaler. For these product sales, the Business invoices the wholesaler, records deferred revenue at gross invoice sales price less estimated cash discounts and classifies the inventory held by the wholesaler as deferred cost of goods sold within other current assets . At that point, the Business makes an estimate of units that may be returned and records a reserve for those units against the deferred cost of goods sold account. The Business recognizes revenue when such inventory is sold through, on a first-in, first-out (FIFO) basis. Sell-through for AVINZA is considered to be at the prescription level or at the point of patient consumption for channels with no prescription requirements.

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

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

The Business uses information from external sources to estimate its gross product sales under the sell-through revenue recognition method and significant gross to net sales adjustments. Such estimates include product information with respect to prescriptions, wholesaler out-movement and inventory levels, retail pharmacy stocking levels, and the Business' own internal information. The Business receives information from IMS Health, a supplier of market research to the pharmaceutical industry, which it uses to estimate sell-through demand for its products and retail pharmacy inventory levels. The Business also receives wholesaler out-movement and inventory information

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from its wholesaler customers that is used to support and validate its demand-based, sell-through revenue recognition estimates. The inventory information received from wholesalers is a product of their record-keeping process and their internal controls surrounding such processes.

Net product sales represent total product sales less allowances for rebates, chargebacks, discounts, promotions and losses to be incurred on returns from wholesalers resulting from increases in the selling price of the Business products. In addition, the Business incurs certain distributor service agreement fees related to the management of its product by wholesalers. These fees have been recorded within net revenues.

***Deferred Revenue, Net***

Under the sell-through revenue recognition method, the Business does not recognize revenue upon shipment of product to the wholesaler. For these shipments, the Business invoices the wholesaler, records deferred revenue at gross invoice sales price, and classifies the inventory held by the wholesaler and subsequently held by retail pharmacies as deferred cost of goods sold within other current assets. Deferred revenue is presented net of deferred cash and other discounts.

The composition of deferred revenue, net is as follows (in thousands):

	<b>June 30, 2006</b>	<b>December 31,</b>	
		<b>2005</b>	<b>2004</b>
Deferred product revenue	\$ 109,025	\$ 116,538	\$ 104,675
Deferred discounts	(1,488)	(1,303)	(1,910)
Deferred revenue, net(1)	\$ 107,537	\$ 115,235	\$ 102,765

- (1) Deferred revenue does not include other gross to net revenue adjustments made when the Business reports net product sales. Such adjustments include Medicaid rebates, managed health care rebates, and government chargebacks, which are included in accrued liabilities in the accompanying consolidated financial statements.

***Allowance for Return Losses***

Product sales are net of adjustments for losses resulting from price increases the Business may experience on product returns from its wholesaler customers. The Business policy for returns of AVINZA allows customers to return the product six months prior to and six months after expiration. Upon an announced price increase, typically in the quarter prior to when a price increase becomes effective, the Business revalues its estimate of deferred product revenue to be returned to recognize the potential higher credit a wholesaler may take upon product return determined as the difference between the new price and the previous price used to value the allowance.

***Medicaid Rebates***



The Business products are subject to state government-managed Medicaid programs whereby discounts and rebates are provided to participating state governments. Medicaid rebates are accounted for by establishing an accrual in an amount equal to the Business estimate of Medicaid rebate claims attributable to sales recognized in that period. The estimate of the Medicaid rebates accrual is determined primarily based on historical experience regarding Medicaid rebates, as well as current and historical prescription activity provided by external sources, current contract prices and any expected contract changes. The Business additionally considers any legal interpretations of the applicable laws related to Medicaid and qualifying federal and state government programs and any new information regarding changes in the Medicaid programs regulations and guidelines that would impact the amount of the rebates. The Business adjusts the accrual periodically throughout each period to reflect actual experience, expected changes in future prescription volumes and any changes in business circumstances or trends.

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**AVINZA PRODUCT LINE OF LIGAND PHARMACEUTICALS INCORPORATED**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

***Government Chargebacks***

The Business products are subject to certain programs with federal government entities and other parties whereby pricing on products is extended below wholesaler list price to participating entities. These entities purchase products through wholesalers at the lower vendor price, and the wholesalers charge the difference between their acquisition cost and the lower vendor price back to the Business. Chargebacks are accounted for by establishing an accrual in an amount equal to the estimate of chargeback claims. The Business determines estimates of the chargebacks primarily based on historical experience regarding chargebacks and current contract prices under the vendor programs. The Business considers vendor payments and claim processing time lags and adjusts the accrual periodically throughout each period to reflect actual experience and any changes in business circumstances or trends.

***Managed Health Care Rebates and Other Contract Discounts***

The Business offers rebates and discounts to managed health care organizations and to other contract counterparties such as hospitals and group purchasing organizations in the U.S. Managed health care rebates and other contract discounts are accounted for by establishing an accrual in an amount equal to the estimate of managed health care rebates and other contract discounts. Estimates of the managed health care rebates and other contract discounts accruals are determined primarily based on historical experience regarding these rebates and discounts and current contract prices. The Business also considers the current and historical prescription activity provided by external sources, current contract prices and any expected contract changes and adjusts the accrual periodically throughout each period to reflect actual experience and any changes in business circumstances or trends.

***Costs and Expenses***

Cost of products sold includes manufacturing costs, amortization of acquired technology and product rights, and royalty expenses. Research and development costs are expensed as incurred. Direct advertising expenses incurred by the Business are minimal in nature. Other advertising expenses are incurred by Organon and recharged to the Business, which are included in selling, general and administrative expenses in the statement of operations. The Business does not have visibility with respect to the exact amounts related to advertising incurred and charged by Organon.

***Income Taxes***

The Business does not file separate tax returns but rather is included in the income tax returns filed by Ligand in various domestic and foreign jurisdictions. For purposes of these unaudited historical carve-out financial statements, the tax provision of the Business was determined from the AVINZA financial information carved out of the consolidated financial statements of Ligand, including allocations deemed necessary by management as though the Business were filing its own tax return.

The Business recognizes liabilities or assets for the deferred tax consequences of temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes* ( SFAS 109 ). These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets or liabilities are recovered or settled. SFAS 109 requires that a valuation allowance be established when management determines that it is more likely than not that all or a portion of a deferred tax asset will not be realized. The Business evaluates the realizability of its net

deferred tax assets and valuation allowances are provided, as necessary. During this evaluation, the Business reviews its forecasts of income in conjunction with other positive and negative evidence surrounding the realizability of its deferred tax assets to determine if a valuation allowance is required. Adjustments to the valuation allowance will increase or decrease the Business income tax provision or benefit.

**Table of Contents****AVINZA PRODUCT LINE OF LIGAND PHARMACEUTICALS INCORPORATED****NOTES TO FINANCIAL STATEMENTS (Continued)*****Accounting for Stock-Based Compensation***

The Business employees participate in various Ligand stock compensation plans. Prior to January 1, 2006, Ligand accounted for stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ( APB No. 25 ), and related interpretations and Financial Accounting Standards Board ( FASB ) Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation* ( FIN No. 44 ). Accordingly, the Business also applied APB No. 25 to account for awards to its employees under Ligand stock compensation plans. Under the intrinsic-value method prescribed by APB No. 25, the Business recognized compensation expense for awards to the Business employees only when it granted stock-based compensation with an option exercise price that was lower than the fair value of the underlying stock. Historically, stock options were granted to employees of the Business with an exercise price equal to the market value of the underlying common stock on the date of the grant; therefore, no compensation expense was recorded prior to January 1, 2006.

Effective January 1, 2006, the Business adopted SFAS No. 123 (revised 2004), *Share-Based Payment* ( SFAS No. 123(R) ), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. SFAS No. 123(R) replaced the existing SFAS No. 123 and supersedes the Business previous accounting under APB No. 25. In March 2005, the Securities and Exchange Commission issued SAB No. 107 ( SAB No. 107 ) relating to SFAS No. 123(R). The Business has applied the provisions of SAB No. 107 in its adoption of SFAS No. 123(R).

The Business adopted SFAS No. 123(R) using the modified prospective transition method. In accordance with the modified prospective transition method, the Business financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). 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 No. 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).

In accordance with SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* ( SFAS No. 148 ), the following table summarizes the Business results on a pro forma basis as if it had recorded compensation expense for Ligand employees that provide direct and indirect support to the Business based upon the fair value at the grant date for awards under these plans consistent with the methodology prescribed under SFAS No. 123 for the six months ended June 30, 2005 and for the years ended December 31, 2005, 2004 and 2003 (in thousands):

	<b>Six Months Ended June 30, 2005</b>	<b>Years Ended December 31, 2005      2004      2003</b>		
Net income (loss), as reported	\$ 34	\$ (819)	\$ (29,190)	\$ (34,664)
Stock-based employee compensation included in reported net loss				

Less: total stock-based compensation expense determined under fair value method for all awards continuing to vest	(161)	(307)	(775)	(616)
Less: total stock-based compensation expense determined under fair value based method for options accelerated in January 2005(1)	(2,025)	(2,025)		
Net loss, pro forma	\$ (2,152)	\$ (3,151)	\$ (29,965)	\$ (35,280)

(1) Represents pro forma unrecognized expense for accelerated options as of the date of acceleration. Total compensation expense for stock-based compensation for the six months ended June 30, 2006 was approximately \$0.2 million. There was no deferred tax benefit recognized in connection with this cost.

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Options were also granted to non-employee consultants that provided direct support to the Business. Fair value of options granted to non-employee consultants are accounted for under Emerging Issues Task Force ( EITF ) 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction With Selling, Goods or Services*. Options granted to non-employee consultants generally vest between 24 and 36 months. All option awards generally expire ten years from the date of the grant. Stock-based compensation cost for awards to employees is recognized on a straight-line basis over the vesting period until the last tranche vests. Compensation cost for consultant awards is recognized over each separate tranche's vesting period.

The Black-Scholes option pricing valuation model was developed for use in estimating the fair value of stock option grants awarded to employees and directors that have no vesting restrictions and are fully transferable with the assumptions listed in the below table. The expected term of the employee options is the estimated weighted-average period until exercise or cancellation of vested options (forfeited unvested options are not considered). As permitted by SAB No. 107 guidance, the Business used the safe harbor expected term assumption for grants up to December 31, 2007, based on the mid-point of the period between vesting date and contractual term, averaged on a tranche-by-tranche basis. The Business used the safe harbor in selecting the expected term assumption in 2006. The expected term for consultant awards is the remaining period to contractual expiration. In selecting the assumption for future volatility, the Business used the historical volatility of Ligand's stock price over a period equal to the expected term. The assumptions used and fair values of such awards are indicative of a Ligand stock option and may not necessarily be representative of the value of a comparable award granted by the Business.

	<b>Six Months Ended</b>		<b>Years Ended December 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
Risk-free interest rates	4.70%	3.70%	4.35%	3.61%	3.25%
Dividend yields					
Expected volatility	70%	73%	72%	74%	72%
Weighted average expected life	6yrs	5yrs	5yrs	5yrs	5yrs

On January 31, 2005, Ligand accelerated the vesting of certain unvested and out-of-the-money stock options previously awarded to certain employees of the Business under Ligand's 1992 and 2002 stock option plans which had an exercise price greater than \$10.41, the closing price of Ligand's stock on that date. The vesting for options to purchase approximately 0.3 million shares of common stock held by employees of the Business were accelerated.

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

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

***Employees Stock Purchase Plan***

Ligand also has an employee stock purchase plan (the 2002 ESPP ). The 2002 ESPP was originally adopted July 1, 2001 and amended through June 30, 2003 to allow employees to purchase a limited amount of common stock at the end of each three month period at a price equal to the lesser of 85% of fair market value on a) the first trading

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day of the period, or b) the last trading day of the period (the Lookback Provision ). The 15% discount and the Lookback Provision make the plan compensatory under SFAS 123(R). Since the adoption in 2002, a total of 510,248 shares of common stock have been reserved for issuance by Ligand under the 2002 ESPP (includes shares transferred from the predecessor plan). As of June 30, 2006, 60,028 shares of common stock had been issued under the 2002 ESPP to Ligand employees that provided direct support to the Business and 147,510 shares are available for future issuance to all Ligand employees. For the six months ended June 30, 2006, there were no issuances of common shares under the ESPP to the Ligand employees that provided direct support to the Business.

***Segment Reporting***

The Business represents a single operating segment.

**Note 3: Balance Sheet Details**

Balance sheet details as of June 30, 2006 and December 31, 2005 and 2004 are as follows:

Accounts receivable consist of the following (in thousands):

	<b>June 30, 2006</b>	<b>December 31,</b>	
		<b>2005</b>	<b>2004</b>
Trade accounts receivable	\$ 3,406	\$ 1,588	\$ 19,730
Due from finance company	9,209	13,788	3,415
Less discounts and allowances	(542)	(534)	(637)
	<b>\$ 12,073</b>	<b>\$ 14,842</b>	<b>\$ 22,508</b>

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

	<b>June 30, 2006</b>	<b>December 31,</b>	
		<b>2005</b>	<b>2004</b>
Deferred royalty cost	\$ 3,604	\$ 3,890	\$ 4,444
Deferred cost of products sold	4,860	4,432	3,552
Prepaid insurance	207	466	393
Prepaid other	464	1,205	342
Other	40	24	55
	<b>\$ 9,175</b>	<b>\$ 10,017</b>	<b>\$ 8,786</b>



Accrued liabilities consist of the following (in thousands):

	<b>June 30, 2006</b>	<b>December 31,</b>	
		<b>2005</b>	<b>2004</b>
Allowances for loss on returns, rebates, chargebacks and other discounts	\$ 10,737	\$ 11,485	\$ 10,159
Co-promotion	14,406	24,778	7,845
Distribution services	2,166	2,435	1,939
Compensation	1,531	1,631	938
Royalties	1,124	1,398	2,394
Other	6	204	1,352
	<b>\$ 29,970</b>	<b>\$ 41,931</b>	<b>\$ 24,627</b>

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

	<b>Losses on Returns Due to Changes In Price</b>	<b>Medicaid Rebates</b>	<b>Managed Care Rebates and Other Rebates</b>	<b>Charge- Backs</b>	<b>Other Discounts</b>	<b>Total</b>
Balance at January 1, 2003	\$ 190	\$ 16	\$ 31	\$	\$ 46	\$ 283
Provision	2,389	1,732	852	70	4,335	9,378
Payments		(368)	(457)	(61)	(4,293)	(5,179)
Charges	(213)					(213)
Balance at December 31, 2003	2,366	1,380	426	9	88	4,269
Provision	2,830	12,988	5,721	372	2,628	24,539
Payments		(9,766)	(4,454)	(381)	(2,716)	(17,317)
Charges	(1,332)					(1,332)
Balance at December 31, 2004	3,864	4,602	1,693			10,159
Provision	911	17,412	10,331	345		28,999
Payments		(17,128)	(8,691)	(145)		(25,964)
Charges	(1,709)					(1,709)
Balance at December 31, 2005	3,066	4,886	3,333	200		11,485
Provision	1,552	2,586	6,277	237		10,652
Payments		(5,896)	(3,054)	(429)		(9,379)
Charges	(2,021)					(2,021)
Balance at June 30, 2006	\$ 2,597	\$ 1,576	\$ 6,556	\$ 8	\$	\$ 10,737

**Note 4: Corporate Expense Allocations**

The Business receives services and support functions from Ligand. The Business operations are dependant upon Ligand's ability to perform these services and support functions. The costs associated with these services and support functions have been allocated to the Business using methodologies established by the Company's management and considered to be a reasonable reflection of the utilization of services provided to the Business. Allocations for research and development expenses are based primarily on headcount. Allocations for selling expenses are based primarily on headcount. Allocations for general and administration expenses are based primarily on proportionate operating expenses adjusted for non-cash expenses. The financial information included herein may not reflect the financial position, the results of operations and cash flows of the Business in the future or had the Business been a separate,

stand-alone entity during the periods presented.

Expense allocations for the following periods were (in thousands):

	<b>June 30,</b>		<b>December 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
Corporate functions, finance, legal and treasury	\$ 6,393	\$ 3,162	\$ 7,733	\$ 3,450	\$ 2,544
Gov t affairs, health and environmental services	111	108	227	158	67
Information technology	369	339	712	502	248
Other operational and infrastructure charges	664	616	1,356	959	588
	\$ 7,537	\$ 4,225	\$ 10,028	\$ 5,069	\$ 3,447

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Corporate expense allocations as presented in the statements of operations, for the following periods were (in thousands):

	<b>June 30,</b>		<b>December 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
Research and development	\$ 133	\$ 182	\$ 586	\$ 589	\$ 70
Selling, general and administration	7,404	4,043	9,442	4,480	