RIGEL PHARMACEUTICALS INC
Form 10-Q
May 05, 2009
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

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# FORM 10-Q

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

**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2009**

**OR**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**FOR THE TRANSITION PERIOD FROM TO**

**Commission File Number 0-29889**

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# Rigel Pharmaceuticals, Inc.

(Exact name of registrant as specified in its charter)

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

**(650) 624-1100**

(Registrant s telephone number, including area code)

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

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

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

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

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

As of April 30, 2009, there were **36,700,860** shares of the registrant s common stock outstanding.

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**QUARTERLY REPORT ON FORM 10-Q**
**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2009**

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**PART I. FINANCIAL INFORMATION**

**Item 1. Condensed Financial Statements**

**RIGEL PHARMACEUTICALS, INC.**

**CONDENSED BALANCE SHEETS**

**(In thousands, except share and per share amounts)**

| | March 31, 2009 (unaudited) | December 31, 2008 (1) |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 36,729 | $ 46,005 |
| Available-for-sale securities | 68,082 | 88,472 |
| Prepaid expenses and other current assets | 3,187 | 3,610 |
| Total current assets | 107,998 | 138,087 |
| | | |
| Property and equipment, net | 3,258 | 3,567 |
| Other assets | 2,770 | 2,204 |
| | $ 114,026 | $ 143,858 |
| | | |
| **Liabilities and stockholders equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 6,790 | $ 5,984 |
| Accrued compensation | 1,651 | 1,625 |
| Other accrued liabilities | 9,400 | 12,029 |
| Deferred rent | 634 | 3,174 |
| Capital lease obligations | 1,226 | 1,339 |
| Total current liabilities | 19,701 | 24,151 |
| | | |
| Long-term portion of capital lease obligations | 1,730 | 2,053 |
| Long-term portion of deferred rent | 15,456 | 13,311 |
| Other long-term liabilities | 171 | 178 |
| | | |
| Commitments and contingencies | | |
| | | |
| Stockholders equity: | | |
| Preferred stock, $0.001 par value; 10,000,000 shares authorized; none issued and outstanding as of March 31, 2009 and December 31, 2008 | | |
| Common stock, $0.001 par value; 100,000,000 shares authorized; 36,700,860 and 36,646,397 shares issued and outstanding on March 31, 2009 and December 31, 2008, respectively | 37 | 37 |
| Additional paid-in capital | 608,489 | 605,509 |
| Accumulated other comprehensive income | 141 | 396 |
| Accumulated deficit | (531,699) | (501,777) |
| Total stockholders equity | 76,968 | 104,165 |
| | $ 114,026 | $ 143,858 |

(1) The balance sheet at December 31, 2008 has been derived from the audited financial statements at that date included in Rigel s Annual Report on Form 10-K for the year ended December 31, 2008.

See Accompanying Notes.

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**RIGEL PHARMACEUTICALS, INC.**

**CONDENSED STATEMENTS OF OPERATIONS**

**(In thousands, except per share amounts)**

**(unaudited)**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2009** | **2008** |
| Contract revenues | $ | $ |
| Costs and expenses: | | |
| Research and development | 24,538 | 21,620 |
| General and administrative | 4,603 | 7,125 |
| Restructuring charges | 1,141 | |
| | 30,282 | 28,745 |
| | | |
| Loss from operations | (30,282) | (28,745) |
| Interest income | 347 | 1,530 |
| Interest expense | (53) | (47) |
| Loss before income taxes | (29,988) | (27,262) |
| Income tax benefit | 66 | |
| Net loss | $ (29,922) | $ (27,262) |
| | | |
| Net loss per share, basic and diluted | $ (0.82) | $ (0.79) |
| | | |
| Weighted average shares used in computing net loss per common share, basic and diluted | 36,699 | 34,417 |

See Accompanying Notes.

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**RIGEL PHARMACEUTICALS, INC.**

**CONDENSED STATEMENTS OF CASH FLOWS**

**(In thousands)**

**(unaudited)**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2009** | **2008** |
| **Operating activities** | | |
| Net loss | $ (29,922) | $ (27,262) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 320 | 342 |
| Stock-based compensation expense | 2,266 | 5,846 |
| Changes in assets and liabilities: | | |
| Prepaid expenses and other current assets | 423 | (951) |
| Other assets | 50 | 38 |
| Accounts payable | 806 | (732) |
| Accrued compensation | 26 | (5,190) |
| Other accrued liabilities | (2,629) | 974 |
| Deferred rent and other long-term liabilities | (402) | (145) |
| Net cash used in operating activities | (29,062) | (27,080) |
| | | |
| **Investing activities** | | |
| Purchases of available-for-sale securities | (27,034) | (73,605) |
| Maturities of available-for-sale securities | 44,190 | 30,676 |
| Sale of available-for-sale securities | 2,979 | |
| Capital expenditures | (11) | (297) |
| Net cash provided by (used in) investing activities | 20,124 | (43,226) |
| | | |
| **Financing activities** | | |
| Proceeds from capital lease financings | | 219 |
| Payments on capital lease obligations | (436) | (316) |
| Net proceeds from issuances of common stock | 98 | 128,496 |
| Net cash (used in) provided by financing activities | (338) | 128,399 |
| | | |
| Net (decrease) increase in cash and cash equivalents | (9,276) | 58,093 |
| | | |
| Cash and cash equivalents at beginning of period | 46,005 | 44,503 |
| | | |
| Cash and cash equivalents at end of period | $ 36,729 | $ 102,596 |
| | | |
| **Supplemental disclosure of cash flow information** | | |
| Interest paid | $ 55 | $ 45 |
| | | |
| **Schedule of non cash transactions** | | |
| Issuance of warrants with lease amendment | $ 616 | $ |

See Accompanying Notes.

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**Rigel Pharmaceuticals, Inc.**

**Notes to Condensed Financial Statements**

**(unaudited)**

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

**1. Nature of Operations**

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

**2. Basis of Presentation**

Our accompanying unaudited condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. These unaudited condensed financial statements include all normal and recurring adjustments that we believe are necessary to fairly state our financial position and the results of our operations and cash flows. Interim-period results are not necessarily indicative of results of operations or cash flows for a full-year. The balance sheet at December 31, 2008 has been derived from audited financial statements at that date, but does not include all disclosures required by U.S. generally accepted accounting principles for complete financial statements. Because all of the disclosures required by U.S. generally accepted accounting principles for complete financial statements are not included herein, these interim unaudited condensed financial statements and the notes accompanying them should be read in conjunction with our audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008.

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

**3. Recent Accounting Pronouncements**

On June 25, 2008, the Financial Accounting Standards Board, or FASB, ratified the consensus reached by the Emerging Issues Task Force, or EITF, on EITF Issue No. 07-5 *Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity s Own Stock,* or EITF 07-5. EITF 07-5 provides guidance on how to determine whether certain instruments or features were indexed to the company s own stock. EITF 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We adopted EITF 07-5 on January 1, 2009 and concluded it had no material impact on our financial statements.

On December 12, 2007, the FASB ratified the consensus reached by the EITF on EITF Issue No. 07-1, *Accounting for Collaborative Arrangements,* or EITF 07-1. EITF 07-1 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF 07-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and will be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. We adopted EITF 07-1 on January 1, 2009 and concluded it had no material impact on our financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards, or SFAS, No. 157, *Fair Value Measurements,* or SFAS No. 157. This standard defines fair value, establishes a framework for measuring fair value under U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, except that under FASB Staff Position, or FSP 157-2, *Effective Date of FASB Statement No. 157,* companies are allowed to delay the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities that are not recognized or disclosed at fair value on a recurring basis until fiscal years beginning after November 15, 2008. In October 2008, FSP 157-3, *Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active,* or FSP 157-3, was issued and effective upon issuance, including prior periods for which financial statements have not been issued. FSP 157-3 clarified the application of SFAS No. 157 in a market that is not active. Effective January 1, 2008, we adopted the provisions of SFAS No. 157 for all financial assets and liabilities. Effective January 1, 2009, we adopted SFAS No. 157 for non-financial assets and liabilities. There was no material impact on our financial statements from the adoption of SFAS No. 157 for our financial or non-financial assets and liabilities.

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**4. Basic and Diluted Net Loss Per Share**

Basic and diluted net loss per share was computed by dividing the net loss for the period by the weighted average number of shares of common stock outstanding during the period. The calculation of diluted net loss per share excluded shares of potential common stock, consisting of stock options and warrants, because their effect would have been anti-dilutive.

**5. Stock Award Plans**

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

| | Three Months Ended March 31, | |
|---|---|---|
| | **2009** | **2008** |
| Research and development | $ 1,425 | $ 3,092 |
| General and administrative | 719 | 2,754 |
| Restructuring charges | 122 | |
| Total stock-based compensation expense | $ 2,266 | $ 5,846 |

In February 2009, we announced that we cut our research programs in virology and oncology as well as terminated certain related development and administrative staff, which resulted in the dismissal of 36 employees, or approximately 20% of our workforce. This measure was intended to maintain our emphasis on active preclinical and clinical programs, while conserving our resources. As part of a package we offered the terminated employees, we extended the date the terminated employees had to exercise their vested options to December 31, 2008 rather than 90 days from the termination date as is typically required under our equity incentive plan. We recorded $122,000 of non-cash stock-based compensation expense related to this modification.

Under SFAS No. 123(R), *Accounting for Stock-Based Compensation*, the fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. We have segregated option awards into three homogenous groups for purposes of determining fair values of options: officers and directors, all other employees, and consultants.

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

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

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

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

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

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

The following table summarizes the weighted-average assumptions relating to options granted pursuant to our equity incentive plans for the three months ended March 31, 2009 and 2008:

| | Three Months Ended March 31, | |
|---|---|---|
| | **2009** | **2008** |
| Risk-free interest rate | 1.8% | 2.7% |
| Expected term (in years) | 4.4 | 4.6 |
| Dividend yield | 0.0% | 0.0% |
| Expected volatility | 98.4% | 93.2% |

Options are priced at the market price of our common stock on the date immediately preceding the date of grant, become exercisable at varying dates and generally expire ten years from the date of grant. We granted options to purchase 1,982,473 shares of common stock during the three months ended March 31, 2009, with a grant-date weighted average fair value of $4.60 per share. We granted options to purchase 1,305,691 shares of common stock during the three months ended March 31, 2008, with a grant-date weighted average fair value of $18.48 per share. As of March 31, 2009, there was approximately $17.9 million of total unrecognized stock-based compensation cost, net of estimated forfeitures, related to unvested options granted under our stock option plans. At March 31, 2009, 2,589,743 shares of common stock were available for future grant under our equity incentive plans and options to purchase 54,463 shares were exercised during the three months ended March 31, 2009.

***Employee Stock Purchase Plan (ESPP)***

The fair value of awards granted under our ESPP is estimated on the date of grant using the Black-Scholes option pricing model, which uses the weighted-average assumptions set forth on the following table. Our ESPP provides for a twenty-four month offering period comprised of four six-month purchase periods with a look-back option. A look-back option is a provision in our ESPP under which eligible employees can purchase shares of our common stock at a price per share equal to the lesser of 85% of the fair market value on the first day of the offering period or 85% of the fair market value on the purchase date.

Our ESPP also includes a feature that provides for a new offering period to begin when the fair market value of our common stock on any purchase date during an offering period falls below the fair market value of our common stock on the first day of such offering period. This feature is called a reset. Participants are automatically enrolled in the new offering period. We had a reset on January 2, 2009 because the fair market value of our stock on December 31, 2008 was lower than the fair market value of our stock on July 1, 2008, the first day of the offering period. We applied modification accounting in accordance with SFAS No. 123(R) to determine the incremental fair value associated with this ESPP reset and recognized the related stock-based compensation expense according to the FASB Technical Bulletin, or FTB, No. 97-1, *Accounting Under Statement 123 for Certain Employee Stock Purchase Plans with a Look-back Option.* The total incremental fair value for this ESPP reset was $1,443,848, which will be recognized over the new twenty-four month offering period.

As of March 31, 2009, there were approximately 1,409,931 shares reserved for future issuance under the ESPP. The following table summarizes the weighted-average assumptions related to our ESPP for the three months ended March 31, 2009 and 2008. Expected volatilities for our ESPP are based on the historical volatility of our stock. Expected term represents the weighted average of the purchase periods within the offering period. The risk-free interest rate for periods within the expected term is based on U.S. Treasury constant maturity rates.

| | Three Months Ended March 31, | |
|---|---|---|
| | **2009** | **2008** |
| Risk-free interest rate | 1.1% | 2.1% |
| Expected term (in years) | 1.3 | 1.2 |
| Dividend yield | 0.0% | 0.0% |
| Expected volatility | 112.0% | 99.0% |

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**6. Revenue Recognition**

We recognize revenue from our collaboration arrangements in accordance with Emerging Issues Task Force, or EITF, No. 07-1, *Accounting for Collaborative Arrangements* . Our revenue arrangements with multiple elements are evaluated under EITF No. 00-21, *Revenue Arrangements with Multiple Deliverables,* and are divided into separate units of accounting if certain criteria are met, including whether the delivered element has stand- alone value to the customer and whether there is objective and reliable evidence of the fair value of any undelivered items. The consideration we receive is allocated among the separate units based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. Advance payments received in excess of amounts earned are classified as deferred revenue until earned.

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

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

Revenues associated with at-risk milestones pursuant to collaborative agreements are recognized upon achievement of the milestones as set forth in the applicable agreement.

**7. Cash, Cash Equivalents and Available-For-Sale Securities**

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

| | March 31, 2009 | December 31, 2008 |
|---|---|---|
| Checking account | $ 904 | $ 491 |
| Money market funds | 30,825 | 45,514 |
| U. S. treasury bills | 24,941 | 26,085 |
| Government-sponsored enterprise securities | 28,610 | 34,641 |
| Corporate bonds and commercial paper | 19,531 | 27,746 |
| | $ 104,811 | $ 134,477 |

Reported as:

| | | |
|---|---|---|
| Cash and cash equivalents | $ 36,729 | $ 46,005 |
| Available-for-sale securities | 68,082 | 88,472 |
| | $ 104,811 | $ 134,477 |

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

| March 31, 2009 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U. S. treasury bills | $ 24,910 | $ 31 | $ | $ 24,941 |
| Government-sponsored enterprise securities | 28,567 | 49 | (6) | 28,610 |
| Corporate bonds and commercial paper | 19,464 | 67 | | 19,531 |
| Total | $ 72,941 | $ 147 | $ (6) | $ 73,082 |

| December 31, 2008 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U. S. treasury bills | $ 25,972 | $ 113 | $ | $ 26,085 |
| Government-sponsored enterprise securities | 34,501 | 140 | | 34,641 |
| Corporate bonds and commercial paper | 27,603 | 143 | | 27,746 |
| Total | $ 88,076 | $ 396 | $ | $ 88,472 |

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*Available-for-sale Securities.* As of March 31, 2009, all of our cash equivalents and available-for-sale securities had maturities of less than one year. At March 31, 2009, our available-for-sale securities had a weighted average time to maturity of approximately 106 days. We have the ability to hold all investments as of March 31, 2009 to maturity.

At March 31, 2009 and December 31, 2008, we had no investments that had been in a continuous unrealized loss position for more than twelve months. As of March 31, 2009, a total of 8 individual securities were in an unrealized loss position for twelve months or less and were deemed to be temporary.

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

| March 31, 2009 | Fair Value | Unrealized Losses |
|---|---|---|
| Government-sponsored enterprise securities | $ 7,835 | $ (6) |
| Corporate bonds and commercial paper | 4,999 | |
| Total | $ 12,834 | $ (6) |

**8. Fair Value**

Under SFAS No. 157, fair value is defined as the price at which an asset could be exchanged or a liability transferred in a transaction between knowledgeable, willing parties in the principal or most advantageous market for the asset or liability. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or parameters are not available, valuation models are applied.

Financial assets recorded at fair value in our financial statements are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by SFAS No. 157 and directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities, are as follows:

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

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

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

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

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

***Fair Value on a Recurring Basis***

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

| | Assets at Fair Value as of March 31, 2009 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Money market fund | $ 30,825 | $ | $ | $ 30,825 |
| U. S. treasury bills | | 24,941 | | 24,941 |
| Government-sponsored enterprise securities | | 28,610 | | 28,610 |
| Corporate bonds and commercial paper | | 19,531 | | 19,531 |
| | | | | |
| Total | $ 30,825 | $ 73,082 | $ | $ 103,907 |

***Fair Value on a Non-Recurring Basis***

On March 31, 2009, we issued a new warrant granting our landlord the right to purchase 200,000 shares of common stock, and cancelled an existing warrant to purchase 100,000 shares of common stock, in connection with the amendment of our build-to-suit lease agreement (see Note 10 below for more details). We used the Black Scholes option-pricing model and calculated an incremental fair market value of $616,000 related to the new warrants in accordance with SFAS No. 123(R). The new warrants was categorized as level 3 under SFAS No. 157 due to the unobservable inputs we used in the Black Scholes option-pricing model.

The following table summarizes the assumptions used relating to the valuation of the new warrants at March 31, 2009:

| | |
|---|---|
| Risk-free interest rate | 2.2% |
| Expected term (in years) | 7.0 |
| Dividend yield | 0.0% |
| Expected volatility | 99.2% |

**9. Restructuring Charges**

In February 2009, we announced that we cut our research programs in virology and oncology as well as terminated certain related development and administrative staff, which resulted in the dismissal of 36 employees, or approximately 20% of our workforce. This measure was intended to

maintain our emphasis on active preclinical and clinical programs, while conserving our resources. Consequently, we recorded restructuring charges of $1.1 million, including $1.0 million of workforce reduction costs and $122,000 of non-cash stock-based compensation expense as a result of the extension of the date the terminated employees had to exercise their vested options to December 31, 2008 rather than 90 days from termination date as is typically required under our equity incentive plan. At March 31, 2009, $28,000 of the restructuring charges related to COBRA benefits for the remaining periods of 2009 were unpaid and classified under accrued compensation on the balance sheet.

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**10. Amendment to the Build-to-Suit Lease Agreement**

On March 31, 2009, we amended our build-to-suit lease agreement with our landlord HCP BTC, LLC (formerly known as Slough BTC, LLC) to defer certain rental obligations in the aggregate amount of $6.9 million for a period of up to seventeen months. Under the terms of this amendment, we are obligated to repay the deferred rental amounts, including interest accruing at 12% during the deferral period, based on a timeline that can vary depending upon the occurrence of certain financing or collaborative transactions. We consider accrued interest on the deferred amounts to be contingent rent payments and accordingly, recognize such amounts in rent expense as incurred. The amount of contingent rent expense we incurred in the first quarter of 2009 was approximately $138,000. In addition, the amendment to the lease agreement also provided for the cancellation of an existing warrant granting HCP Estates USA Inc. (an affiliate of our landlord) the right to purchase 100,000 shares of common stock and the issuance of a new warrant granting our landlord the right to purchase 200,000 shares of common stock. The exercise price per share of the new warrant is $6.61, which is the average closing price of our common stock for the three business days immediately preceding the execution of the amendment to the lease agreement. The new warrant remains exercisable for 7 years from the date of issuance. We applied modification accounting in accordance with SFAS No. 123(R) and calculated an incremental fair market value of the new warrant of $616,000. This amount has been deferred in other assets and is being amortized into rent expense over the remaining term of the lease.

**11. Contingencies**

On February 6, 2009, a purported securities class action lawsuit was commenced in the United States District Court for the Northern District of California, naming us and certain of our officers, directors and underwriters as defendants for our February 2008 stock offering. The lawsuit alleges violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 in connection with allegedly false and misleading statements made by us related to the results of a Phase 2a clinical trial of our product candidate R788. The plaintiff seeks damages, including rescission or rescissory damages for purchasers in the stock offering, an award of its costs and injunctive and/or equitable relief for purchasers of our common stock during the period between December 13, 2007 and October 27, 2008, including purchasers in the stock offering. An additional purported securities class action lawsuit containing similar allegations was subsequently filed in the United States District Court for the Northern District of California on February 20, 2009. By order of the Court dated March 19, 2009, the two lawsuits were consolidated into a single action. On April 7, 2009, Inter-Local Pension Fund GCC/IBT filed a motion for appointment as lead plaintiff in the case, and for appointment of its counsel as lead counsel. It is possible that additional suits will be filed, or allegations received from stockholders, with respect to these same matters and also naming us and/or our executive officers and directors as defendants**.** If any such additional suits are filed in the same court, we believe that they would be consolidated into the consolidated action.

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

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors

Rigel Pharmaceuticals, Inc.

We have reviewed the condensed balance sheet of Rigel Pharmaceuticals, Inc. as of March 31, 2009, and the related condensed statements of operations and cash flows for the three-month periods ended March 31, 2009 and 2008. These financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed interim financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheet of Rigel Pharmaceuticals, Inc. as of December 31, 2008, and the related statements of operations, stockholders equity, and cash flows for the year then ended (not presented herein) and in our report dated February 24, 2009, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed balance sheet as of December 31, 2008, is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Palo Alto, California
May 1, 2009

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

*This discussion and analysis should be read in conjunction with our financial statements and the accompanying notes included in this report and the audited financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2008. Operating results for the three months ended March 31, 2009 are not necessarily indicative of results that may occur in future periods.*

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

**Overview**

We are a clinical-stage drug development company that discovers and develops novel, small-molecule drugs for the treatment of inflammatory/autoimmune diseases, as well as for certain cancers and metabolic diseases. Our pioneering research focuses on intracellular signaling pathways and related targets that are critical to disease mechanisms. Our productivity has resulted in strategic collaborations with large pharmaceutical partners to develop and market our product candidates. We have product development programs in inflammatory/autoimmune diseases such as rheumatoid arthritis, thrombocytopenia and asthma, as well as in cancer.

We have not been profitable and have incurred operating losses since we were incorporated in June 1996. The extent of our future losses and the timing of potential profitability are highly uncertain, and we may never achieve profitable operations. We incurred net losses of approximately $29.9 million for the three months ended March 31, 2009, $132.3 million in 2008 and $74.3 million in 2007. Currently, our revenues may be generated solely from research milestone payments pursuant to our collaboration agreements and licenses and would be insufficient to generate profitable operations. In addition, we have funded our operations primarily through private and public offerings of our common stock. As of March 31, 2009, we had an accumulated deficit of approximately $531.7 million. We expect to incur losses for at least the next several years and expect that these losses could increase as we expand our research and development activities and incur significant clinical and testing costs. Until we are able to generate a sufficient amount of product revenue, we expect to finance future cash needs through collaboration and licensing arrangements or public and/or private equity or debt offerings, as well as through interest income earned on the investment of our cash balances and short-term investments.

For the foreseeable future, our operations will require significant additional funding, in large part due to our research and development expenses, future preclinical and clinical-testing costs, and the absence of any revenues from product sales. The amount of future funds needed will depend largely on the timing and structure of potential future collaborations. With the exception of milestone and royalty payments that we may receive under our existing collaborations, we do not currently have any commitments for future funding. We continue to pursue a collaboration partner for our lead product candidate, R788, prior to initiating Phase 3 clinical trials. We have engaged in discussions with various parties regarding such a partnership. At the present time, while we have parties who have indicated an interest in entering into a partnership for R788, we believe we will be able to negotiate a more attractive arrangement for us and our stockholders once we have the results from the two Phase 2b clinical trials of R788, *TASKi2* and *TASKi3*. Results from both of these clinical trials are expected to be available in July 2009.

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We will have to raise additional capital if we do not identify a collaboration partner for R788. Recently, the credit markets and the financial services industry have been experiencing a period of unprecedented turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States federal government. These events have generally made equity and debt financing more difficult to obtain. As a result of these and other factors, we do not know whether additional financing will be available when needed, or that, if available, we will obtain financing on reasonable terms.

We believe that our existing capital resources will be sufficient to support our current and projected funding requirements through at least the next 12 months. We have based this estimate on assumptions that may prove to be wrong, and we could utilize our available capital resources sooner than we currently expect. Because of the numerous risks and uncertainties associated with the development of our product candidates and other research and development activities, including risks and uncertainties that could impact the rate of progress of our development activities, we are unable to estimate with certainty the amounts of increased capital outlays and operating expenditures associated with our current and anticipated clinical trials and other research and development activities.

**Product Development Programs**

Our product development portfolio features multiple novel small molecule drug candidates whose specialized mechanisms of action are intended to provide therapeutic benefit for a range of inflammatory/autoimmune diseases, as well as for certain cancers and metabolic diseases. Our multiple product candidates in development are as follows:

- *R788 (fostamatinib disodium) Product Candidate for Rheumatoid Arthritis (RA).* R788 is our lead product candidate. It has a novel mechanism of action, inhibiting immunoglobulins G (IgG) receptor signaling in macrophages and B-cells. Previously, we studied R788 in a Phase 1, single center, double-blind, randomized, placebo-controlled, clinical trial evaluating the safety and pharmacokinetics of escalating single and multiple doses of R788. We also completed a Phase 2a clinical trial of R788 with 189 patients to evaluate its safety and pharmacokinetics in combination with methotrexate, a commonly prescribed treatment for RA. Results of this clinical trial suggested that there is not an adverse interaction between R788 and methotrexate.

In December 2007, we announced the results of a Phase 2a clinical trial of R788 in RA patients simultaneously receiving methotrexate, in which doses of 100 mg PO bid (orally, twice daily) and 150 mg PO bid of R788 produced statistically significant improvement in RA symptoms. The most common clinically meaningful adverse events noted in the clinical trial included dose-related neutropenia, mild elevations of liver function tests and gastrointestinal side effects. Dose reduction (to one-half the assigned dose by taking the drug once per day) was pre-specified in the protocol and contingent on neutrophil counts and/or liver function tests. Notably, a vast majority of the patients who had their doses reduced successfully completed the clinical trial with minimal safety issues.

In June 2008, we commenced two concurrent Phase 2b clinical trials of R788 in RA patients at a number of clinical research centers throughout the United States, Latin America, and Europe to evaluate the efficacy of R788 compared to placebo in distinct RA patient groups. The first Phase 2b clinical trial *(TASKi2)* is evaluating RA patients receiving 100 mg of R788 PO bid (orally, twice daily) or 150 mg of R788 PO qd (orally, once daily), compared with those receiving placebo, in a multi-center, randomized, double blind, placebo controlled, parallel dose study of R788 in patients who have failed to respond to methotrexate. The second Phase 2b clinical trial *(TASKi3)* is evaluating a group of RA patients receiving 100 mg of R788 PO bid, compared with a group receiving placebo, in a multi-center, randomized, double blind, placebo controlled, parallel dose study of R788 in patients who have failed at least one marketed biologic agent. The marketed biologic agents generally includes anti-tumor necrosis factor injectables commonly used to treat RA, but could include other therapies as well. The primary objectives for *TASKi2*

and *TASKi3* are to measure the efficacy of R788 at 6 months and 3 months, respectively, as determined by ACR20 scores (American College of Rheumatology responder rates showing a minimum of 20% improvement in RA symptoms and pain). Secondary objectives include comparing higher ACR response rates (ACR 50 and ACR 70), as well as DAS28 rates (Disease Activity Score including a 28-joint inspection), in addition to various safety measures. *TASKi3* will also include measurement of changes in bone morphology using MRI scans as a secondary measure.

Enrollment for the *TASKi2* clinical trial of R788 in patients with RA who previously failed to respond to methotrexate treatment was completed in December 2008, with 457 patients randomized. The smaller *TASKi3* clinical trial of R788 completed enrollment in March 2009, with 219 patients randomized. *TASKi3* is for RA patients who previously failed to respond to at least one marketed biologic treatment. Results from both of these clinical trials are expected to be available in July 2009. We expect that these results, involving approximately 670 additional patients, will substantially further the understanding of the potential of R788 and may therefore drive enhanced economics in a possible deal.

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The recently completed double-blind, double-dummy, randomized, positive and placebo-controlled parallel study of the effects of R788 on QT/QTc intervals in healthy subjects confirmed that R788 does not elicit a QT/QTc signal. Under a protocol pre-reviewed by the Food and Drug Administration (FDA), a total of 208 healthy volunteers were divided into four dosage groups and were given, in a parallel design, either placebo, a standard dose of 100mg bid of R788, a super dose of 300mg bid of R788, or moxifloxacin (known to elevate QT/QTc intervals in normal healthy adults). All participants were dosed for four days and were evaluated for changes from the time-matched baseline QT/QTc intervals using extractions from continuous Holter monitors. There were no significant effects on the QT/QTc intervals of participants in either the 100mg bid or the 300mg bid R788 dosage groups. As expected, the study found that participants in the moxifloxacin group experienced QT/QTc elevations.

- *R788 Product Candidate for Immune Thombocytopenic Purpura (ITP).* Platelet destruction from ITP is mediated by IgG signaling, and R788 is a potent inhibitor of IgG signaling. In preclinical studies, R788 was shown to improve thrombocytopenia in an ITP mouse model. We recently completed an exploratory Phase 2 clinical trial of R788 to evaluate its safety and initial efficacy in chronic ITP patients. In this clinical trial, R788 was orally administered in varying doses for 30 or more days and demonstrated that it can improve platelet counts in highly refractory patients. We have postponed expanding this clinical trial of R788 in ITP until we have further clarity on development priorities from a potential partner for R788.

- *R788 Product Candidate for B-Cell Lymphoma.* Research has shown that over activity of the signaling enzyme spleen tyrosine kinase, or Syk, appears to have an essential role in the survival and proliferation of certain B-cell lymphoma cell lines, and that R788 can inhibit the growth of B-cell lymphoma driven by Syk over activity. In December 2008, we reported that R788 is well-tolerated by B-cell Lymphoma patients and shows therapeutic benefit in patients suffering from diffuse large B-Cell lymphoma (DLBCL) and chronic lymphocytic leukemia/small lymphocytic lymphoma (CLL/SLL). A total of 68 patients received 200 mg PO bid (orally, twice daily) of R788 until disease progression occurred. Treatment response rates from patients suffering from DLBCL and CLL/SLL were 22% and 55%, respectively. Response to treatment was evaluated using standard NHL response criteria (The Cheson Criteria). Treatment-related adverse events included cytopenias, fatigue, diarrhea/abdominal discomfort and hypertension. Most adverse events were mild to moderate and were reversible.

- *R788 Product Candidate for T-Cell Lymphoma.* Recent research has suggested that syk may be important in the growth of some types of T-cell lymphomas.

In March 2009, we announced the enrollment of the first patient in a Phase 2, multi-center clinical trial of R788 in patients with refractory or relapsed peripheral T-cell lymphoma (PTCL). The primary objective of the clinical trial is to assess the efficacy of R788, an orally bio-available Syk kinase inhibitor, in patients suffering from this subset of non-Hodgkin s lymphoma that originates in the patient s T-cells. Prior studies have suggested increased expression of syk at the cellular level in many of these patients with PTCL.

The Phase 2 clinical trial will be conducted in two stages at several centers in North America with each patient receiving 200mg of R788 orally twice a day for a minimum of 8 weeks, or until disease progression or withdrawal from the clinical trial. During stage one, 19 patients with PTCL who previously failed to respond to standard of care treatment for their disease are expected to be evaluated. Stage two is expected to include the enrollment of approximately 36 patients. Efficacy will be assessed by computerized tomography/positron emission tomography (CT/PET) scans at baseline and CT scans of the disease-involved areas at 8 weeks. Safety will be assessed by periodic physical exams, blood tests and clinical laboratory work, among others. Results of the clinical

trial are expected in the second half of 2010.

- *R788 Product Candidate for Systemic Lupus Erythematosus (SLE or Lupus).* Preclinical studies have shown that R788 is highly effective in a murine model of lupus. The initiation of a clinical trial in Lupus patients has been postponed until we have further clarity on development priorities from a potential partner for R788.

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- *R348 Product Candidate for Psoriasis and other immune disorders.* R348 is a potent and selective JAK3 inhibitor. JAK3 is a cytoplasmic tyrosine kinase that plays an important role in modulating cytokine signaling in T and B cells, as well as affecting lymphocyte differentiation and proliferation in a variety of autoimmune diseases. Moving forward, we plan to focus on psoriasis and possible topical applications of R348 in conjunction with a collaboration partner.

- *R763 Product Candidate for Oncology.* R763/AS703569 is a potent, highly-selective, small-molecule inhibitor of aurora kinase. In October 2005, we signed a licensing agreement with Merck Serono that gave Merck Serono an exclusive license to develop and commercialize inhibitors in our aurora kinase program, including R763/AS703569. In November 2007, Merck Serono exercised its option to add Japan to the territories covered under the current aurora kinase collaboration with respect to R763/AS703569, resulting in a milestone payment to us of $3.0 million. Under the agreement, Merck Serono is responsible for the further development and commercialization of R763/AS703569.

In September 2006, Merck Serono initiated a Phase 1, multi-center clinical trial to evaluate R763/AS703569 for the treatment of patients with refractory solid tumors. In February 2007, Merck Serono began an additional Phase 1 clinical trial evaluating R763/AS703569 on patients with hematological malignancies. In July 2007, Merck Serono initiated its third Phase 1 clinical trial, designed to determine the maximum tolerated dose, safety and dosing regimen of R763/AS703569 in combination with gemcitabine, a commonly prescribed chemotherapeutic agent administered by intravenous infusion. The clinical trial will evaluate two different treatment regimens in which R763/AS703569 will be given in sequence with the gemcitabine over 21-day cycles. As many as 72 patients with advanced malignancies, including pancreatic, ovarian, breast, non-small cell lung and colorectal, will be evaluated. We expect that Merck Serono will initiate a Phase 2 trial by the end of 2009.

- *R343 Product Candidate for Asthma.* In the first quarter of 2005, we announced a collaborative research and license agreement with Pfizer for the development of inhaled products for the treatment of allergic asthma and other respiratory diseases, such as chronic obstructive pulmonary disease. The collaboration is focused on our preclinical small molecule compounds, which inhibit IgE receptor signaling in respiratory tract mast cells by blocking Syk, a novel drug target for respiratory diseases. Mast cells play important roles in both early and late phase allergic reactions, and Syk inhibitors could prevent both phases.

The collaboration is now centered on the development of R343. Pfizer has completed the Phase 1a clinical trial of an inhaled formulation of R343, which commenced in December 2007, resulting in a milestone payment of $5.0 million to us by that time. We expect that Pfizer will initiate a Phase 1b allergen challenge trial in 2009.

**Corporate Collaborations**

We conduct research and development programs independently and in connection with our corporate collaborators. We currently have collaborations with six major pharmaceutical/biotechnology companies.

These collaborations are:

- Janssen Pharmaceutica N.V., a division of Johnson & Johnson, relating to oncology therapeutics and diagnostics;

- Pfizer, Inc., one initiated in 1999 in immunology and the other in January 2005, relating to intrapulmonary asthma and allergy therapeutics;

- Novartis Pharma AG, or Novartis, with respect to four different programs relating to immunology, oncology and chronic bronchitis;

- Daiichi Pharmaceuticals Co., Ltd., or Daiichi, relating to oncology;

- Merck & Co., Inc., or Merck, also relating to oncology;

- Merck Serono, relating to our aurora kinase inhibitor program.

None of these collaborations currently provides us with regular research reimbursement. In all of these collaborations, if certain conditions are met, we are entitled to receive future milestone payments and royalties. We cannot guarantee that these conditions will be met or that research and development efforts will be successful. As a result, we may not receive any further milestone payments or royalties under these agreements.

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**Recent Accounting Pronouncements**

On June 25, 2008, the Financial Accounting Standards Board, or FASB, ratified the consensus reached by the Emerging Issues Task Force, or EITF, on EITF Issue No. 07-5 *Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity s Own Stock,* or EITF 07-5. EITF 07-5 provides guidance on how to determine whether certain instruments or features were indexed to the company s own stock. EITF 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We adopted EITF 07-5 on January 1, 2009 and concluded it had no material impact on our financial statements.

On December 12, 2007, the FASB ratified the consensus reached by the EITF on EITF Issue No. 07-1, *Accounting for Collaborative Arrangements,* or EITF 07-1. EITF 07-1 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF 07-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and will be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. We adopted EITF 07-1 on January 1, 2009 and concluded it had no material impact on our financial statements.

**Critical Accounting Policies and the Use of Estimates**

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

***Revenue Recognition***

We recognize revenue from our collaboration arrangements in accordance with Emerging Issues Task Force, or EITF, No. 07-1, *Accounting for Collaborative Arrangements* . Our revenue arrangements with multiple elements are evaluated under EITF No. 00-21, *Revenue Arrangements with Multiple Deliverables,* and are divided into separate units of accounting if certain criteria are met, including whether the delivered element has stand- alone value to the customer and whether there is objective and reliable evidence of the fair value of any undelivered items. The consideration we receive is allocated among the separate units based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. Advance payments received in excess of amounts earned are classified as deferred revenue until earned.

Non-refundable, up-front payments received in connection with research and development collaboration agreements, including technology access fees, are deferred and recognized on a straight-line basis over the relevant periods of continuing involvement, generally the research term.

When a research term is not specified, we estimate the time it will take us to complete our deliverables under the contract and recognize the upfront fee using the straight-line method over that time period. We review our estimates every quarter for reasonableness.

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

Revenues associated with at-risk milestones pursuant to collaborative agreements are recognized upon achievement of the milestones as set forth in the applicable agreement.

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***Stock-based Compensation***

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

***Research and Development Accruals***

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

**Results of Operations**

**Three Months Ended March 31, 2009 and 2008**

**Revenues**

There were no contract revenues reported during the three months ended March 31, 2009 and 2008. We had no deferred revenue as of March 31, 2009. Our potential future revenues may include certain milestone payments from our current collaboration partners or new collaboration partners with whom we enter into agreements in the future.

**Research and Development Expenses**

**Three Months Ended**

| | March 31, 2009 | 2008 | Aggregate Change |
|---|---|---|---|
| | | (in thousands) | |
| ***Research and development expenses*** | $ 24,538 | $ 21,620 | $ 2,918 |
| ***Stock-based compensation expense included in research and development expenses*** | 1,425 | 3,092 | (1,667) |

The increase in research and development expenses for the three months ended March 31, 2009, compared to the same period in 2008, was primarily due to an increase in clinical costs, partially offset by the combination of a decrease in stock-based compensation expense as discussed under Stock-Based Compensation below and a decrease in bonus expense as we did not book a bonus accrual in the first quarter of 2009. The increase in clinical costs was primarily attributable to increased costs associated with our two Phase 2b clinical trials (*TASKi2* and *TASKi3*), as well as the related extension trials in RA patients and manufacturing R788 material to be used in these clinical trials.

The scope and magnitude of future research and development expenses are difficult to predict given the number of clinical trials that we will need to conduct for any of our potential products, as well as our limited capital resources. In general, biopharmaceutical development involves a series of steps, beginning with identification of a potential target and including, among others, proof of concept in animals and Phase 1, 2 and 3 clinical trials in humans. Each of these steps is typically more expensive than the previous step. Success in early stages of development often results in increasing expenditures for a given product candidate. Our research and development expenditures currently include costs for scientific personnel, supplies, equipment, consultants, sponsored research, allocated facility costs, costs related to preclinical and clinical trials, and stock-based compensation.

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**General and Administrative Expenses**

| | Three Months Ended March 31, | | |
|---|---|---|---|
| | 2009 | 2008 | Aggregate Change |
| | | (in thousands) | |
| ***General and administrative expenses*** | $ 4,603 | $ 7,125 | $ (2,522) |
| ***Stock-based compensation expense included in general and administrative expenses*** | 719 | 2,754 | (2,035) |

The decrease in general and administrative expenses for the three months ended March 31, 2009, as compared to the same period in 2008, was primarily attributable to the decrease in stock-based compensation expense as discussed under Stock-Based Compensation below and a decrease in bonus expense as we did not book a bonus accrual in the first quarter of 2009. Due to the purported securities class action lawsuit recently filed against us, we expect that our legal expenses will increase in 2009, as we will vigorously defend the lawsuit.

**Restructuring Charges**

| | Three Months Ended March 31, | | |
|---|---|---|---|
| | 2009 | 2008 | Aggregate Change |
| | | (in thousands) | |
| ***Restructuring Charges*** | $ 1,141 | $ | $ 1,141 |
| ***Stock-based compensation expense included in restructuring charges*** | 122 | | 122 |

In February 2009, we announced that we cut our research programs in virology and oncology as well as terminated certain related development and administrative staff, which resulted in the dismissal of 36 employees, or approximately 20% of our workforce. This measure was intended to maintain our emphasis on our active preclinical and clinical programs, while conserving our resources. As a result of the restructuring implemented in the first quarter of 2009, we recorded restructuring charges of $1.1 million, including $1.0 million of workforce reduction costs and $122,000 of non-cash stock-based compensation expense as a result of the extension of the option cancellation date for terminated employees to December 31, 2008 rather than 90 days from termination date.

**Stock-Based Compensation**

| | Three Months Ended March 31, | | |
|---|---|---|---|
| | 2009 | 2008 | Aggregate Change |
| | | (in thousands) | |
| **Stock-based compensation expense from:** | | | |
| ***Officer, director and employee options*** | $ 2,266 | $ 5,733 | $ (3,467) |
| ***Consultant options*** | | 113 | (113) |
| ***Total*** | $ 2,266 | $ 5,846 | $ (3,580) |

The decrease in stock-based compensation expense for the three months ended March 31, 2009, as compared to the same period in 2008, was primarily due to the higher valuation of options granted in the first quarter of 2008 and the full recognition of most of the expense associated with those options as of the end of 2008. The decrease was also due to the fact that a majority of the options were being granted at the end of the first quarter of 2009 and had only vested for one day. As a result, the 2009 option grants did not result in a significant recognition of stock-based compensation expense in the first quarter of 2009.

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**Interest Income**

| | Three Months Ended March 31, | | |
|---|---|---|---|
| | 2009 | 2008 | Aggregate Change |
| | | (in thousands) | |
| ***Interest income*** | $ 347 | $ 1,530 | $ (1,183) |

Interest income results from our interest-bearing cash and investment balances. The decrease in interest income for the three months ended March 31, 2009, as compared to the same period in 2008, was due to a lower cash balance and lower interest rates earned on our investments in 2009.

**Interest Expense**

| | Three Months Ended March 31, | | |
|---|---|---|---|
| | 2009 | 2008 | Aggregate Change |
| | | (in thousands) | |
| ***Interest expense*** | $ 53 | $ 47 | $ 6 |

Interest expense results from our capital lease obligations associated with fixed asset acquisitions. The increase in interest expense for the three months ended March 31, 2009, as compared to the same period in 2008, was due to higher outstanding balances on capital lease obligations outstanding during the period.

**Income tax benefit**

| | Three Months Ended March 31, | | |
|---|---|---|---|
| | 2009 | 2008 | Aggregate Change |
| | | (in thousands) | |
| ***Income tax benefit*** | $ 66 | $ | $ 66 |

We recorded an income tax benefit of approximately $66,000 for the period ended March 31, 2009 to reflect tax refunds in accordance with the provisions of the American Recovery and Reinvestment Act of 2009.

**Liquidity and Capital Resources**

**Cash Requirements**

We have financed our operations from inception primarily through sales of equity securities, contract payments under our collaboration agreements and equipment financing arrangements. We have consumed substantial amounts of capital to date, and our operating expenditures are expected to increase over the next several years, in large part due to our research and development expenses, future preclinical and clinical testing costs and the absence of any revenues from product sales.

As of March 31, 2009, we had approximately $104.8 million in cash, cash equivalents and available-for-sale securities, as compared to approximately $134.5 million as of December 31, 2008, a decrease of approximately $29.7 million. The decrease was primarily attributable to the costs associated with our research and development activities. We believe that our existing capital resources will be sufficient to support our current and projected funding requirements through at least the next 12 months. We have based this estimate on assumptions that may prove to be wrong, and we could utilize our available capital resources sooner than we currently expect. Because of the numerous risks and uncertainties associated with the development of our product candidates and other research and development activities, including risks and uncertainties that could impact the rate of progress of our development activities, we are unable to estimate with certainty the amounts of increased capital outlays and operating expenditures associated with our current and anticipated clinical trials and other research and development activities.

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Our operations will require significant additional funding for the foreseeable future. The amount of future funds needed will depend largely on the timing and structure of potential future collaborations. Until we are able to generate a sufficient amount of product revenue, we expect to finance future cash needs through public and/or private equity offerings, debt financings or collaboration and licensing arrangements, as well as through interest income earned on the investment of our cash balances and short-term investments. With the exception of milestone and royalty payments that we may receive under our existing collaborations, we do not currently have any commitments for future funding. Recently, the credit markets and the financial services industry have been experiencing a period of unprecedented turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States federal government. These events have generally made equity and debt financing more difficult to obtain. As a result of these and other factors, we do not know whether additional financing will be available when needed, or that, if available, we will be able to obtain financing on reasonable terms.

To the extent we raise additional capital by issuing equity securities, our stockholders could at that time experience substantial dilution. Any debt financing that we are able to obtain may involve operating covenants that restrict our business. To the extent that we raise additional funds through collaboration and licensing arrangements, we may be required to relinquish some of our rights to our technologies or product candidates, or grant licenses on terms that are not favorable to us.

Our future funding requirements will depend upon many factors, including, but not limited to:

- the progress and success of clinical trials and preclinical activities (including studies and manufacture of materials) of our product candidates conducted by us or our collaborative partners or licensees;

- our ability to establish new collaborations and the terms thereof;

- the progress of research programs carried out by us;

- any changes in the breadth of our research and development programs;

- our ability to meet the milestones identified in our collaborative agreements that trigger payments to us from our collaboration partners;

- the progress of the research and development efforts of our collaborative partners;

- our ability to acquire or license other technologies or compounds that we seek to pursue;

- our ability to manage our growth;
- competing technological and market developments;
- the costs and timing of obtaining, enforcing and defending our patent and intellectual property rights;
- the costs and timing of regulatory approvals and filings by us and our collaborators; and