LIGAND PHARMACEUTICALS INC
Form 424B3
November 14, 2006

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PROSPECTUS FILED PURSUANT TO RULE 424(B)(3)
LIGAND PHARMACEUTICALS INCORPORATED

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

**Prospectus Supplement No. 13**
**(to Prospectus dated April 12, 2006, as supplemented and amended by that Prospectus Supplement No. 1 dated May 15, 2006, that Prospectus Supplement No. 2 dated June 12, 2006, that Prospectus Supplement No. 3 dated June 29, 2006, that Prospectus Supplement No. 4 dated August 4, 2006, that Prospectus Supplement No. 5 dated August 9, 2006, that Prospectus Supplement No. 6 dated August 30, 2006, that Prospectus Supplement No. 7 dated September 11, 2006, that Prospectus Supplement No. 8 dated September 12, 2006, that Prospectus Supplement No. 9 dated October 2, 2006, that Prospectus Supplement No. 10 dated October 17, 2006, that Prospectus Supplement No. 11 dated October 20, 2006, and that Prospectus Supplement No. 12 dated October 31, 2006)**

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

On November 14, 2006, we filed with the Securities and Exchange Commission our Quarterly Report on Form 10-Q for the quarter ended September 30, 2006. The information set forth below supplements and amends the information contained in the Prospectus.

This Prospectus Supplement No. 13 should be read in conjunction with, and delivered with, the Prospectus and is qualified by reference to the Prospectus except to the extent that the information in this Prospectus Supplement No. 13 updates or supersedes the information contained in the Prospectus.

Our common stock is quoted on The Nasdaq Global Market under the symbol LGND. On November 13, 2006, the closing price of our common stock was $11.18 per share.

Investing in our common stock involves risk. See Risk Factors beginning on page 7 of the Prospectus and beginning on page 62 of this Prospectus Supplement No. 13.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if the Prospectus or this Prospectus Supplement No. 13 is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this Prospectus Supplement No. 13 is November 14, 2006.

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

**Mark One**

þ **Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
**For the quarterly period ended September 30, 2006 or**

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the Transition Period From __________ to __________ .**

**Commission File Number: 0-20720**
**LIGAND PHARMACEUTICALS INCORPORATED**
**(Exact Name of Registrant as Specified in its Charter)**

| | |
|---|---|
| **Delaware**<br>**(State or Other Jurisdiction of Incorporation or Organization)** | **77-0160744**<br>**(I.R.S. Employer Identification No.)** |
| **10275 Science Center Drive**<br>**San Diego, CA**<br>**(Address of Principal Executive Offices)** | **92121-1117**<br>**(Zip Code)** |

**Registrant s Telephone Number, Including Area Code: (858) 550-7500**

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large Accelerated Filer o Accelerated Filer þ Non-Accelerated Filer o

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

As of October 31, 2006, the registrant had 79,229,629 shares of common stock outstanding.

**LIGAND PHARMACEUTICALS INCORPORATED**
**QUARTERLY REPORT**
**FORM 10-Q**
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* No information provided due to inapplicability of item

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

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

| | September 30, 2006 | December 31, 2005 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 10,029 | $ 66,756 |
| Short-term investments | 21,862 | 20,174 |
| Accounts receivable, net | 7,077 | 20,954 |
| Current portion of inventories, net | 5,039 | 9,333 |
| Other current assets | 12,465 | 15,750 |
| Current portion of assets held for sale | 8,055 | |
| Total current assets | 64,527 | 132,967 |
| Restricted investments | 1,826 | 1,826 |
| Long-term portion of inventories, net | | 5,869 |
| Property and equipment, net | 21,453 | 22,483 |
| Acquired technology and product rights, net | 84,990 | 146,770 |
| Long-term portion of assets held for sale | 57,807 | |
| Other assets | 1,264 | 4,704 |
| Total assets | $ 231,867 | $ 314,619 |
| **LIABILITIES AND STOCKHOLDERS DEFICIT** | | |
| Current liabilities: | | |
| Accounts payable | $ 16,080 | $ 15,360 |
| Accrued liabilities | 52,902 | 59,587 |
| Current portion of deferred revenue, net | 80,395 | 157,519 |
| Current portion of co-promote termination liability | 47,722 | |
| Current portion of equipment financing obligations | 2,150 | 2,401 |
| Current portion of long-term debt | 363 | 344 |
| Current portion of liabilities related to assets held for sale | 26,803 | |
| Total current liabilities | 226,415 | 235,211 |
| Long-term debt | 139,371 | 166,745 |
| Long-term portion of co-promote termination liability | 95,258 | |
| Long-term portion of equipment financing obligations | 2,699 | 3,430 |
| Long-term portion of deferred revenue, net | 2,546 | 4,202 |
| Long-term portion of liabilities related to assets held for sale | 2,017 | |
| Other long-term liabilities | 2,406 | 3,105 |

| | | |
|---|---|---|
| Total liabilities | 470,712 | 412,693 |
| Commitments and contingencies | | |
| Common stock subject to conditional redemption; 997,568 shares issued and outstanding at September 30, 2006 and December 31, 2005 | 12,345 | 12,345 |
| Stockholders deficit: | | |
| Convertible preferred stock, $0.001 par value; 5,000,000 shares authorized; none issued | | |
| Common stock, $0.001 par value; 200,000,000 shares authorized; 77,789,924 and 73,136,340 shares issued at September 30, 2006 and December 31, 2005, respectively | 78 | 73 |
| Additional paid-in capital | 753,947 | 720,988 |
| Accumulated other comprehensive (loss) income | (138) | 490 |
| Accumulated deficit | (1,004,166) | (831,059) |
| | (250,279) | (109,508) |
| Treasury stock, at cost; 73,842 shares | (911) | (911) |
| Total stockholders deficit | (251,190) | (110,419) |
| | $ 231,867 | $ 314,619 |

*See accompanying notes.*

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

| | Three Months Ended September 30, 2006 | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2006 | Nine Months Ended September 30, 2005 |
|---|---|---|---|---|
| Revenues: | | | | |
| Product sales | $ 36,707 | $ 29,908 | $ 102,853 | $ 79,367 |
| Collaborative research and development and other revenues | | 2,095 | 3,977 | 7,944 |
| Total revenues | 36,707 | 32,003 | 106,830 | 87,311 |
| Operating costs and expenses: | | | | |
| Cost of products sold | 5,800 | 6,422 | 16,768 | 17,987 |
| Research and development | 10,468 | 7,920 | 29,013 | 23,787 |
| Selling, general and administrative | 20,085 | 14,484 | 58,077 | 43,133 |
| Co-promotion | 11,776 | 7,766 | 33,656 | 22,472 |
| Co-promote termination charges | 3,643 | | 142,980 | |
| Total operating costs and expenses | 51,772 | 36,592 | 280,494 | 107,379 |
| Loss from operations | (15,065) | (4,589) | (173,664) | (20,068) |
| Other income (expense): | | | | |
| Interest income | 577 | 483 | 1,737 | 1,325 |
| Interest expense | (2,547) | (3,118) | (7,920) | (9,247) |
| Other, net | 66 | (60) | 1,068 | 173 |
| Total other expense, net | (1,904) | (2,695) | (5,115) | (7,749) |
| Loss before income taxes | (16,969) | (7,284) | (178,779) | (27,817) |
| Income tax benefit | 828 | | 2,290 | |
| Loss from continuing operations | (16,141) | (7,284) | (176,489) | (27,817) |
| Income (loss) from discontinued operations, net of income tax | 1,223 | 1,003 | 3,382 | (5,860) |
| Net loss | $ (14,918) | $ (6,281) | $ (173,107) | $ (33,677) |
| Basic and diluted per share amounts: | | | | |
| Loss from continuing operations | $ (0.21) | $ (0.10) | $ (2.26) | $ (0.38) |
| Income (loss) from discontinued operations | 0.02 | 0.02 | 0.05 | (0.08) |
| Net loss | $ (0.19) | $ (0.08) | $ (2.21) | $ (0.46) |

| | | | | |
|---|---|---|---|---|
| Weighted average number of common shares | 78,670,137 | 74,041,204 | 78,239,868 | 73,998,594 |

*See accompanying notes.*

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

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2006** | **2005** |
| **Operating activities** | | |
| Net loss | $ (173,107) | $ (33,677) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Amortization of acquired technology and license rights | 10,248 | 10,376 |
| Depreciation and amortization of property and equipment | 2,576 | 2,779 |
| Amortization of debt issue costs | 705 | 775 |
| Gain on sale of Exelixis stock | (953) | (171) |
| Stock-based compensation | 3,981 | |
| Non-cash interest expense | 60 | |
| Other | (16) | 79 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 13,877 | 6,469 |
| Inventories, net | (514) | (3,103) |
| Other current assets | 1,976 | 5,041 |
| Accounts payable and accrued liabilities | (5,753) | 2,286 |
| Other liabilities | (14) | (24) |
| Deferred revenue, net | (50,498) | 5,463 |
| Co-promote termination liability | 142,980 | |
| Net cash used in operating activities | (54,452) | (3,707) |
| **Investing activities** | | |
| Purchases of short-term investments | (18,324) | (28,253) |
| Proceeds from sale of short-term investments | 16,963 | 24,748 |
| Increase in restricted investments | ¾ | (170) |
| Purchases of property and equipment | (1,592) | (1,770) |
| Payment to buy-down ONTAK royalty obligation | ¾ | (33,000) |
| Capitalized portion of payment of lasofoxifene royalty rights | ¾ | (558) |
| Other, net | 72 | 165 |
| Net cash used in investing activities | (2,881) | (38,838) |
| **Financing activities** | | |
| Principal payments on equipment financing obligations | (2,012) | (2,147) |
| Proceeds from equipment financing arrangements | 1,030 | 1,390 |
| Repayment of long-term debt | (255) | (238) |
| Proceeds from issuance of common stock | 1,981 | 912 |
| Decrease in other long-term liabilities | (138) | (94) |

| | | | | |
|---|---|---|---|---|
| Net cash provided by (used in) financing activities | | 606 | | (177) |
| Net decrease in cash and cash equivalents | | (56,727) | | (42,722) |
| Cash and cash equivalents at beginning of period | | 66,756 | | 92,310 |
| Cash and cash equivalents at end of period | $ | 10,029 | $ | 49,588 |
| **Supplemental disclosure of cash flow information** | | | | |
| Interest paid | $ | 5,283 | $ | 5,569 |
| **Non-cash impact of the conversion of 6% convertible subordinated notes into common stock:** | | | | |
| Conversion of principal amount of convertible notes | $ | 27,100 | $ | |
| Conversion of unamortized debt issue costs | | (362) | | |
| Conversion of unpaid accrued interest | | 264 | | |
| | $ | 27,002 | $ | |

*See accompanying notes.*

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

**1. Basis of Presentation**

The accompanying condensed consolidated financial statements of Ligand Pharmaceuticals Incorporated (the Company or Ligand ) were prepared in accordance with instructions for Form 10-Q and, therefore, do not include all information necessary for a complete presentation of financial condition, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America. However, all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for a fair presentation of the condensed consolidated financial statements, have been included. The results of operations for the three and nine month periods ended September 30, 2006 and 2005 are not necessarily indicative of the results that may be expected for the entire fiscal year or any other future period.

As further discussed in Note 2, the Company sold its oncology products ( Oncology ) effective October 25, 2006. The operating results for Oncology for all periods presented have been presented in the accompanying condensed consolidated financial statements as Discontinued Operations . Likewise, assets and liabilities associated with Oncology are presented as Assets held for sale and Liabilities related to assets held for sale as of September 30, 2006. Additionally, as discussed in Note 13, on September 7, 2006 the Company announced plans to sell its AVINZA product line, subject to shareholder approval. Due to the uncertainty surrounding shareholder approval, the operating results for the AVINZA product line do not qualify for discontinued operations (held for sale) presentation and therefore are presented in the accompanying condensed consolidated financial statements as continuing operations. Furthermore, the Company, along with its wholly-owned subsidiary Nexus Equity VI, LLC ( Nexus ) entered into an agreement with Slough Estates USA, Inc. ( Slough ) for the sale of the Company s real property located in San Diego, California. The transaction closed in November 2006 and includes an agreement between the Company and Slough for the Company to leaseback the building for a period of 15 years. In connection with the sale transaction, on November 6, 2006, the Company paid off the existing mortgage on the building of approximately $11.6 million.

These statements should be read in conjunction with the consolidated financial statements and related notes, which are included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

*Principles of Consolidation*

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

*Use of Estimates*

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

*Income (Loss) Per Share*

Net loss per share is computed using the weighted average number of common shares outstanding. Basic and diluted income (loss) per share amounts are equivalent for the periods presented as the inclusion of potential common shares in the number of shares used for the diluted computation would be anti-dilutive to loss per share from continuing operations. In accordance with SFAS No. 128, *Earnings Per Share*, no potential common shares

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are included in the computation of any diluted per share amounts, including income (loss) per share from discontinued operations, as the Company reported a net loss from continuing operations for all periods presented. Potential common shares, the shares that would be issued upon the conversion of convertible notes and the exercise of outstanding warrants and stock options, were 28.6 million and 32.6 million at September 30, 2006 and 2005, respectively. As of October 6, 2006, all outstanding warrants to purchase 748,800 shares of the Company s common stock expired.

*Guarantees and Indemnifications*

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

Under its bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer s or director s serving in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. However, the Company has a directors and officers liability insurance policy that limits its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal and has no liabilities recorded for these agreements as of September 30, 2006 and December 31, 2005.

The Company enters into indemnification provisions under its agreements with other companies in its ordinary course of business, typically with business partners, contractors, customers and landlords. Under these provisions the Company generally indemnifies and holds harmless the indemnified party for direct losses suffered or incurred by the indemnified party as a result of the Company s activities or, in some cases, as a result of the indemnified party s activities under the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of September 30, 2006 and December 31, 2005.

*Accounting for Stock-Based Compensation*

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

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards ( SFAS ) 123 (revised 2004), *Share-Based Payment* ( SFAS 123(R) ), using the modified prospective transition method. No stock-based employee compensation cost was recognized prior to January 1, 2006, as all options granted prior to 2006 had an exercise price equal to the market value of the underlying common stock on the date of the grant. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ( SAB 107 ) relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R). Under the transition method, compensation cost recognized in 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted in the nine months ended September 30, 2006, based on grant-date fair value estimated in accordance with the provisions of SFAS 123(R).

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

Results for the three and nine months ended September 30, 2005 have not been retrospectively adjusted. The fair value of the options was estimated using a Black-Scholes option-pricing formula and amortized to expense over the options vesting periods.

The following table illustrates the pro forma effect of share-based compensation on net loss and loss per share for the three and nine months ended September 30, 2005 (in thousands, except per share data):

| | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2005 |
|---|---|---|
| Net loss, as reported | $ (6,281) | $ (33,677) |
| Stock-based employee compensation expense included in reported net loss | | |
| Less: total stock-based compensation expense determined under fair value based method for all awards continuing to vest | (723) | (2,261) |
| Less: total stock-based compensation expense determined under fair value based method for options accelerated in January 2005 (1) | | (12,455) |
| Net loss, pro forma | $ (7,004) | $ (48,393) |
| Basic and diluted per share amounts: | | |
| Net loss per share as reported | $ (0.08) | $ (0.46) |
| Net loss per share pro forma | $ (0.09) | $ (0.65) |

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

The estimated weighted average fair value at grant date for the options granted for the three and nine months ended September 30, 2005 was $7.37 and $7.25, respectively.

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

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

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

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Other Stock-Related Information

The 2002 Stock Incentive Plan contains four separate equity programs Discretionary Option Grant Program, Automatic Option Grant Program, Stock Issuance Program and Director Fee Option Grant Program ( the 2002 Plan ). On January 31, 2006, shareholders of the Company approved an amendment to the 2002 Plan to increase the number of shares of the Company s common stock authorized for issuance by 750,000 shares, from 8.3 million shares to 9.1 million shares. As of September 30, 2006, options for 7,058,435 shares of common stock were outstanding under the 2002 plan and 499,535 shares remained available for future option grant or direct issuance.

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

Stock-based compensation cost for awards to employees and non-employee directors is recognized on a straight-line basis over the vesting period until the last tranche vests. Compensation cost for consultant awards is recognized over each separate tranche s vesting period. The Company recognized compensation expense of approximately $1.9 million and $4.0 million for the three and nine months ended September 30, 2006, respectively, associated with option awards and restricted stock. Of the total compensation expense associated with option awards, approximately $0.1 million and $0.3 million related to options granted to non-employee consultants for the three and nine months ended September 30, 2006, respectively. There was no deferred tax benefit recognized in connection with this cost.

The fair-value for options that were awarded to employees and directors was estimated at the date of grant using the Black-Scholes option valuation model with the following weighted average assumptions:

| | **Three Months Ended September 30** | | **Nine Months Ended September 30** | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Risk-free interest rate | 4.8% | 4.2% | 4.8% | 4.2% |
| Dividend yield | | | | |
| Expected volatility | 70% | 73% | 70% | 73% |
| Expected term | 5.7 years | 5 years | 5.9 years | 5 years |

The expected term of the employee and non-employee director options is the estimated weighted-average period until exercise or cancellation of vested options (forfeited unvested options are not considered). SAB 107 guidance permits companies to use a safe harbor expected term assumption for grants up to December 31, 2007 based on the mid-point of the period between vesting date and contractual term, averaged on a tranche-by-tranche basis. The Company used the safe harbor in selecting the expected term assumption in 2006. The expected term for consultant awards is the remaining period to contractual expiration.

Volatility is a measure of the expected amount of variability in the stock price over the expected life of an option expressed as a standard deviation. SFAS 123(R) requires an estimate of future volatility. In selecting this assumption, the Company used the historical volatility of the Company s stock price over a period equal to the expected term.

For options granted to the Company s former Chief Executive Officer ( CEO ) and for shares purchased under the Company s employee stock purchase plan ( ESPP ), an expected volatility of 50% was used for the three and nine months ended September 30, 2006. The expected term of the options granted to the former CEO is 5.5 months. The expected term for shares issued under the ESPP is three months.

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Stock Option Activity

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term in Years | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Balance at December 31, 2005 | 7,001,657 | $ 11.76 | | |
| Granted | 1,161,518 | 10.84 | | |
| Exercised | (233,885) | 7.98 | | |
| Forfeited | (177,834) | 9.51 | | |
| Cancelled | (693,021) | 13.09 | | |
| Balance at September 30, 2006 | 7,058,435 | | | |