LIGAND PHARMACEUTICALS INC
Form 10-Q
November 15, 2016
Table of Contents

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

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 September 30, 2016
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: 001-33093

LIGAND PHARMACEUTICALS INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	77-0160744 (I.R.S. Employer Identification No.)
3911 Sorrento Valley Boulevard, Suite 110 San Diego, CA (Address of principal executive offices)	92121 (Zip Code)

(858) 550-7500
(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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 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 November 1, 2016, the registrant had 20,900,189 shares of common stock outstanding.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
QUARTERLY REPORT

FORM 10-Q

TABLE OF CONTENTS

Table of Contents

GLOSSARY OF TERMS AND ABBREVIATIONS

Abbreviation	Definition
2019 Convertible Senior Notes	$245.0 million aggregate principal amount of convertible senior unsecured notes due 2019
Amgen	Amgen, Inc.
AOCI	Accumulated Other Comprehensive Income
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
Company	Ligand Pharmaceuticals Incorporated, including subsidiaries
CorMatrix	CorMatrix Cardiovascular, Inc.
CVR	Contingent value right
CyDex	CyDex Pharmaceuticals, Inc.
DTA	Deferred Tax Asset
Amended ESPP	Employee Stock Purchase Plan, as amended and restated
Eisai	Eisai Incorporated
EMA	European Medicines Agency
FASB	Financial Accounting Standards Board
FDA	Food and Drug Administration
FSGS	Focal segmental glomerulosclerosis
GAAP	Generally accepted accounting principles in the United States
IPO	Initial public offering
IPR&D	In-Process Research and Development
Ligand	Ligand Pharmaceuticals Incorporated, including subsidiaries
LSA	Loan and Security Agreement
Metabasis	Metabasis Therapeutics, Inc.
MLA	Master License Agreement
NOLs	Net Operating Losses
OMT	OMT, Inc. or Open Monoclonal Technology, Inc.
Par	Par Pharmaceuticals, Inc.
Pfizer	Pfizer Inc.
Retrophin	Retrophin Inc.
SEC	Securities and Exchange Commission
Selexis	Selexis, SA
TPE	Third-party evidence
VIE	Variable interest entity
Viking	Viking Therapeutics
Viking IPO	Viking's initial public offering
VSOE	Vendor-specific objective evidence

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
LIGAND PHARMACEUTICALS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands, except share data)

	September 30, 2016	December 31, 2015 restated
ASSETS		
Current assets:		
Cash and cash equivalents	$ 86,580	$97,428
Short-term investments	37,535	102,791
Accounts receivable	6,586	6,170
Note receivable from Viking Therapeutics	3,207	4,782
Inventory	4,027	1,633
Other current assets	2,756	1,908
Total current assets	140,691	214,712
Deferred income taxes	133,486	189,083
Investment in Viking Therapeutics	17,339	29,728
Intangible assets, net	207,435	48,347
Goodwill	72,359	12,238
Commercial license rights, net	25,985	8,554
Property and equipment, net	1,826	372
Other assets	1,744	27
Total assets	$ 600,865	$503,061
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,757	$4,083
Accrued liabilities	6,675	5,397
Current contingent liabilities	5,079	10,414
Current lease exit obligations	—	934
2019 convertible senior notes, net	210,115	201,985
Other current liabilities	1,505	8
Total current liabilities	226,131	222,821
2019 convertible senior notes, net	—	—
Long-term contingent liabilities	3,933	3,033
Other long-term liabilities	408	297
Total liabilities	230,472	226,151
Commitments and Contingencies		
Equity component of currently redeemable convertible notes (Note 5)	32,138	39,628
Stockholders' equity:		
Common stock, $0.001 par value; 33,333,333 shares authorized; 20,898,889 and 19,949,012 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively	28	20
Additional paid-in capital	762,576	661,850
Accumulated other comprehensive income	3,652	4,903
Accumulated deficit	(428,001)	(429,491)
Total stockholders' equity attributable to Ligand Pharmaceuticals	338,255	237,282

Total liabilities and stockholders' equity	$ 600,865	$503,061

See accompanying notes.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015 restated	2016	2015 restated
Revenues:				
Royalties	$15,698	$9,755	$39,842	$26,648
Material sales	4,219	6,046	13,445	20,456
License fees, milestones and other revenues	1,702	1,900	17,500	3,618
Total revenues	21,619	17,701	70,787	50,722
Operating costs and expenses:				
Cost of sales [1]	999	1,250	2,674	4,923
Amortization of intangibles	2,706	593	7,912	1,780
Research and development	5,898	1,945	14,813	8,730
General and administrative	6,305	4,971	19,995	18,190
Lease exit and termination costs	245	345	863	786
Total operating costs and expenses	16,153	9,104	46,257	34,409
Income from operations	5,466	8,597	24,530	16,313
Other (expense) income:				
Interest expense, net	(3,116)	(2,930)	(9,172)	(8,875)
Increase (decrease) in contingent liabilities	(958)	2,301	(2,595)	(4,976)
Gain on deconsolidation of Viking Therapeutics	—	—	—	28,190
Loss from Viking Therapeutics	(1,396)	(2,169)	(14,139)	(3,040)
Other income, net	1,215	1,485	2,107	1,889
Total other (expense) income, net	(4,255)	(1,313)	(23,799)	13,188
Income before income taxes	1,211	7,284	731	29,501
Income tax benefit (expense)	(160)	191,881	28	191,602
Income from operations	1,051	199,165	759	221,103
Discontinued operations:				
Gain on sale of Oncology Product Line before income taxes	—	—	1,139	—
Income tax expense on discontinued operations	—	—	(408)	—
Income from discontinued operations	—	—	731	—
Net income including noncontrolling interests:	1,051	199,165	1,490	221,103
Less: Net loss attributable to noncontrolling interests	—	—	—	(2,380)
Net income	$1,051	$199,165	$1,490	$223,483
Per share amounts attributable to Ligand common shareholders:				
Basic earnings per share data[2]				
Income from continuing operations	$0.05	$10.01	$0.04	$11.32
Income from discontinued operations	—	—	0.04	—
Net income	$0.05	$10.01	$0.07	$11.32
Diluted earnings per share data [2]				
Income from continuing operations	$0.05	$9.28	$0.03	$10.58
Income from discontinued operations	—	—	0.03	—
Net (loss) income	$0.05	$9.28	$0.07	$10.58

Shares used for computation (in thousands)				
Basic	20,887	19,887	20,806	19,741
Diluted	22,997	21,460	22,742	21,122

(1) Excludes amortization of intangibles.

Table of Contents

(2) The sum of net income per share amounts may not equal the totals due to rounding

See accompanying notes.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015 restated	2016	2015 restated
Net income:	$1,051	$199,165	$1,490	$223,483
Unrealized net gain on available-for-sale securities, net of tax	978	(3,059)	367	1,978
Less: Reclassification of net realized gains included in net income, net of tax	(1,071)	(606)	(1,670)	(1,591)
Comprehensive income	$958	$195,500	$187	$223,870

(a) See restatement discussion in footnote 1
See accompanying notes.

Table of Contents

LIGAND PHARMACEUTICAL INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Nine months ended September 30,	
	2016	2015 Restated
Operating activities		
Net income including noncontrolling interests	$1,490	$221,103
Less: income from discontinued operations	731	—
Income from continuing operations	759	221,103
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:		
Non-cash change in estimated fair value of contingent liabilities	2,595	4,976
Realized gain on sale of short-term investment	(1,776)	(1,988)
Gain on disposal of assets	183	—
Depreciation and amortization	8,322	1,940
Amortization of discount on investments, net	510	73
Amortization of debt discount and issuance fees	8,130	7,646
Stock-based compensation	13,690	9,511
Deferred income taxes	347	(191,615)
Accretion of note payable	—	16
Gain on deconsolidation of Viking Therapeutics	—	(28,190)
Change in fair value of the Viking convertible debt receivable and warrants	(464)	—
Loss from Viking Therapeutics	14,139	3,040
Changes in operating assets and liabilities:		
Accounts receivable	(411)	7,142
Inventory	(2,394)	(158)
Other current assets	(9)	(438)
Other long-term assets	(31)	(546)
Accounts payable and accrued liabilities	(3,079)	(4,993)
Restricted investments	—	661
Deferred revenue	1,497	(118)
Net cash provided by operating activities	42,008	28,062
Investing activities		
Purchase of commercial license rights	(17,695)	(4,030)
Payments to CVR holders and other contingency payments	(7,055)	(4,941)
Purchases of property and equipment	(1,783)	(27)
Cash paid for acquisition, net of cash acquired	(92,504)	—
Purchase of short-term investments	(73,109)	(111,788)
Purchase of common stock in equity method investment	(1,000)	—
Purchase of Viking common stock and warrants	(700)	(9,000)
Proceeds from sale of property and equipment	—	1
Proceeds received from repayment of Viking note receivable	300	—

Reduction of cash due to deconsolidation of Viking	—	(247)
Proceeds from sale of short-term investments	23,387	5,680
Proceeds from maturity of short-term investments	113,694	22,967
Net cash used in investing activities	(56,465)	(101,385)
Financing activities		
Net proceeds from stock option exercises and ESPP	4,608	7,379
Taxes paid related to net share settlement of equity awards	(999)	—
Share repurchase		(489)
Net cash provided by financing activities	3,609	6,890
Net decrease in cash and cash equivalents	(10,848)	(66,433)
Cash and cash equivalents at beginning of period	97,428	160,203
Cash and cash equivalents at end of period	$86,580	$93,770

Table of Contents

Supplemental disclosure of cash flow information		
Interest paid	$1,838	$1,822
Taxes paid	36	19
Supplemental schedule of non-cash activity		
Stock issued for acquisition, net of issuance cost	(77,330)	—
Unsettled repurchase of common stock	(1,554)	—
Stock and warrant received for repayment of Viking notes receiveable	1,200	—
Accrued inventory purchases	—	—
Unrealized gain (loss) on AFS investments	(271)	3,082

(a) See restatement discussion in footnote 1

See accompanying notes

Table of Contents

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

1. Basis of Presentation and Summary of Significant Accounting Policies

Business

Ligand is a biopharmaceutical company with a business model based on developing or acquiring assets which generate royalty, milestone or other passive revenue for the Company and using a lean corporate cost structure. We operate in one business segment: development and licensing of biopharmaceutical assets.

Principles of Consolidation

The accompanying condensed consolidated financial statements include Ligand and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Basis of Presentation

The Company’s accompanying unaudited condensed consolidated financial statements have been prepared in accordance with GAAP for interim financial information. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the financial position and results of operations of the Company and its subsidiaries, have been included. Interim financial results are not necessarily indicative of the results that may be expected for the full year. These financial statements should be read in conjunction with the consolidated financial statements and notes therein included in the Company’s annual report on Form 10-K for the year ended December 31, 2015 filed on November 14, 2016.

Upon the occurrence of certain circumstances, holders of the 2019 Convertible Senior Notes may require us to purchase all or a portion of their notes for cash, which may require the use of a substantial amount of cash. If such cash is not available, we may be required to sell other assets or enter into alternate financing arrangements at terms that may or may not be desirable. The existence of the 2019 Convertible Senior Notes and the obligations that we incurred by issuing them may restrict our ability to take advantage of certain future opportunities, such as engaging in future debt or equity financing activities.

Restatement

The Company is restating its previously issued consolidated financial statements as of and for the year ended December 31, 2015 and the condensed consolidated financial statements as of and for the three and nine months ended September 30, 2015 to correct errors relating to the Company's net operating loss (NOL) carryforward benefits in the United States which resulted in an overstatement of deferred tax assets (DTA). In connection with three acquisitions that were completed prior to February 2010, the Company recognized DTAs for a portion of the NOLs, which included capitalized research and development expenses, obtained from the acquired businesses. From the time of the acquisitions until September 2015, there was a full valuation allowance against all of the Company’s NOLs, including those obtained from the entities acquired. In September 2015, the Company concluded that it was more likely than not that a substantial portion of it deferred tax assets would be realized through future taxable income. As a result, the Company released the majority of its DTA valuation allowance, including $27.5 million related to NOLs recognized as part of the businesses acquired prior to February of 2010.

During the quarter ended September 30, 2016, the Company concluded that for accounting purposes the approximately $27.5 million of DTAs that were obtained upon acquiring the businesses prior to February of 2010 did not meet the more likely-than-not criterion for recognition in 2015 and that the related valuation allowance should not have been reversed.
As a result, the Company's income tax benefit and net income for the year ended December 31, 2015 and the three and nine month periods ended September 30, 2015 were overstated by $27.5 million each.

The Company also recorded adjustments to the consolidated financial statements as part of this restatement relating to the classification of our 2019 Convertible Senior Notes. As of December 31, 2015, the Company's last reported sale price exceeded the 130% threshold described in Note 5 - "Financing Arrangements" and accordingly the 2019 Convertible Senior Notes have been reclassified as a current liability as of December 31, 2015. As a result, the related unamortized discount of

Table of Contents

$39.6 million previously classified within stockholders' equity was reclassified as temporary equity component of currently redeemable convertible notes on our Consolidated Balance Sheet.

The account balances labeled As Reported in the following tables as of December 31, 2015 and as of and for the three and nine months ended September 30, 2015 represent the previously reported amounts as presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 and the Quarterly Report on Form 10-Q for the three months ended September 30, 2015, respectively.

The effects of these prior period corrections on the statement of operations and comprehensive income are as follows (in thousands except for per share data):

	Nine months ended September 30, 2015		
	As Reported	Adjustments	As Restated
Income tax benefit	$219,083	$ (27,481)	$191,602
Net income	250,964	(27,481)	223,483
Comprehensive income	251,351	(27,481)	223,870
Basic earnings per share	12.71	(1.39)	11.32
Diluted earnings per share data	11.88	(1.30)	10.58
Basic	19,741	—	19,741
Diluted	21,122	—	21,122

	Three months ended September 30, 2015		
	As Reported	Adjustments	As Restated
Income tax benefit (expense)	$219,362	$ (27,481)	$191,881
Net income	226,646	(27,481)	199,165
Comprehensive income	222,981	(27,481)	195,500
Basic earnings per share	11.40	(1.39)	10.01
Diluted earnings per share data	10.56	(1.28)	9.28

The effects of these prior period corrections on the consolidated balance sheet is as follows:

	As of December 31, 2015		
	As Reported	Adjustments	As Restated
Deferred income taxes	$216,564	$ (27,481)	$189,083
Total assets[1]	530,542	(27,481)	503,061
2019 convertible senior notes, net - current	—	201,985	201,985
Total current liabilities	20,836	201,985	222,821
2019 convertible senior notes, net - long term[1]	201,985	(201,985)	—
Equity component of currently redeemable convertible notes (Note 5)	—	39,628	39,628
Additional paid-in capital	701,478	(39,628)	661,850
Accumulated deficit	(402,010)	(27,481)	(429,491)
Total stockholders' equity	304,391	(67,109)	237,282
Total liabilities and stockholders' equity[1]	530,542	(27,481)	503,061

(1) $3.4 million of unamortized issuance cost was reclassified to debt discount in the concurrently filed 2015 10-K/A form that it is filed after the Company's retrospective adoption of ASU 2015-03, Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs in Q1 2016.

The effects of these prior period corrections on the condensed consolidated balance sheet is as follows:

Table of Contents

	As of September 30, 2015		
	As Reported	Adjustments	As Restated
Deferred income taxes	$208,530	$ (27,481)	$181,049
Total assets	523,807	(27,481)	496,326
Accumulated deficit	(408,351)	(27,481)	(435,832)
Total stockholders' equity	294,288	(27,481)	266,807
Total liabilities and stockholders' equity	523,807	(27,481)	496,326

The corrections did not have any impact on the company's cash flow statements for any period.

Significant Accounting Policies

We describe our significant accounting policies in Note 1 to the financial statements in Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2015. There have been no changes to our significant accounting policies during the first nine months of fiscal 2016.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with GAAP requires the use of estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and the accompanying notes. Actual results may differ from those estimates.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.
Recent Accounting Pronouncements

During the first quarter of 2016, we adopted a new accounting standard, ASU 2015-03, Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs that amends the presentation for debt issuance costs. see Note 5 for details.

In May 2014, the Financial Accounting Standards Board (FASB) issued a new accounting standard that amends the guidance for the recognition of revenue from contracts with customers to transfer goods and services. The FASB has subsequently issued additional clarifying standards to address issues arising from implementation of the new revenue recognition standard. The new revenue recognition standard and clarifying standards are effective for interim and annual periods beginning January 1, 2018, and may be adopted earlier, but not before January 1, 2017. The revenue standards are required to be adopted by taking either a full retrospective or a modified retrospective approach. We are currently evaluating the impact that the revenue standards will have on our consolidated financial statements and determining the transition method that we will apply.

In February 2016, the FASB issued a new accounting standard that amends the guidance for the accounting and disclosure of leases. This new standard requires that lessees recognize the assets and liabilities that arise from leases on the balance sheet and disclose qualitative and quantitative information about their leasing arrangements. The new standard is effective for interim and annual periods beginning on January 1, 2019. We are currently evaluating the impact that this new standard will have on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation – Stock Compensation, which identifies areas for simplification involving several aspects of accounting for stock-based payment transactions, including the income tax

consequences, classification of awards as either equity or liabilities, an option to recognize gross stock compensation expense with actual forfeitures recognized as they occur, as well as certain classifications on the statement of cash flows. ASU No. 2016-09 is effective for reporting periods beginning after December 31, 2016. Early adoption is permitted. We are currently assessing the potential impact that the adoption of ASU No. 2016-09 will have in our condensed consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments which requires that expected credit losses relating to financial assets measured on an amortized cost basis and available-for-sale debt securities be recorded through an allowance for credit losses. ASU 2016-13

Table of Contents

limits the amount of credit losses to be recognized for available-for-sale debt securities to the amount by which carrying value exceeds fair value and also requires the reversal of previously recognized credit losses if fair value increases. The new standard will be effective for us on January 1, 2020. Early adoption will be available on January 1, 2019. We are currently evaluating the effect that the updated standard will have on our consolidated financial statements.

In August 2016 the FASB issued ASU No. 2016-15 Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments. The guidance addresses the classification of cash flows related to (1) debt prepayment or extinguishment costs, (2) settlement of zero-coupon debt instruments or other debt instruments with coupon rates that are insignificant in relation to the effective interest rate of the borrowing, (3) contingent consideration payments made after a business combination, (4) proceeds from the settlement of insurance claims, (5) proceeds from the settlement of corporate-owned life insurance, including bank-owned life insurance, (6) distributions received from equity method investees and (7) beneficial interests in securitization transactions. The guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The new guidance will be effective for fiscal years beginning after 15 December 2017, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the effect that the updated standard will have on our consolidated financial statements.

Income (Loss) Per Share

Basic income (loss) per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted income (loss) per share is computed based on the sum of the weighted average number of common shares and potentially dilutive common shares outstanding during the period.

Potentially dilutive common shares consist of shares issuable under 2019 convertible senior notes, stock options and restricted stock. 2019 convertible senior notes have a dilutive impact when the average market price of the Company’s common stock exceeds the applicable conversion price of the respective notes. Potentially dilutive common shares from stock options and restricted stock are determined using the average share price for each period under the treasury stock method. In addition, the following amounts are assumed to be used to repurchase shares: proceeds from exercise of stock options; the average amount of unrecognized compensation expense for restricted stock; and estimated tax benefits that will be recorded in additional paid-in capital when expenses related to equity awards become deductible. In loss periods, basic net loss per share and diluted net loss per share are identical because the otherwise dilutive potential common shares become anti-dilutive and are therefore excluded.

The following table presents the calculation of weighted average shares used to calculate basic and diluted earnings per share (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Weighted average shares outstanding:	20,886,705	19,886,877	20,805,604	19,741,081
Dilutive potential common shares:				
Restricted stock	134,008	63,324	102,282	55,899
Stock options	792,474	763,856	788,106	922,051
2019 convertible senior notes	1,184,092	745,591	1,046,257	402,941
Shares used to compute diluted income per share	22,997,279	21,459,648	22,742,249	21,121,972
	3,540,806	3,343,719	3,522,063	3,803,007

Potentially dilutive shares excluded from calculation due to anti-dilutive effect

Subsequent to September 30, 2016, the Company repurchased 20,000 shares of its common stock for $1.9 million in the aggregate.

Cash Equivalents

Table of Contents

Cash equivalents consist of all investments with maturities of three months or less from the date of acquisition.

Short-term Investments

Short-term investments primarily consist of investments in debt securities that have effective maturities greater than three months and less than twelve months from the date of acquisition. The Company classifies its short-term investments as "available-for-sale". Such investments are carried at fair value, with unrealized gains and losses included in the statement of comprehensive income (loss). The Company determines the cost of investments based on the specific identification method.

The following table summarizes the various investment categories at September 30, 2016 and December 31, 2015 (in thousands):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
September 30, 2016				
Short-term investments				
Bank deposits	$ 11,999	$ 9	$ (2)	$ 12,006
Corporate bonds	6,014	31	—	6,045
Commercial paper	13,096	4	(9)	13,091
Asset backed securities	63	—	—	63
Municipal Bonds	1,778	13	—	1,791
Corporate equity securities	1,578	2,961	—	4,539
	$ 34,528	$ 3,018	$ (11)	$ 37,535
December 31, 2015				
Short-term investments				
Bank deposits	$ 43,043	$ —	$ (4)	$ 43,039
Corporate bonds	41,238	—	(35)	41,203
Commercial paper	1,747	—	—	1,747
Asset backed securities	10,020	—	(5)	10,015
Corporate equity securities	1,843	4,944	—	6,787
	$ 97,891	$ 4,944	$ (44)	$ 102,791

Inventory

Inventory, which consists of finished goods, is stated at the lower of cost or market value. The Company determines cost using the first-in, first-out method. Inventory levels are analyzed periodically and written down to net realizable value if it has become obsolete, has a cost basis in excess of its expected net realizable value or is in excess of expected requirements. There were no write downs related to obsolete inventory recorded for the three and nine months ended September 30, 2016 and 2015.

Table of Contents

Goodwill and Other Identifiable Intangible Assets

Goodwill and other identifiable intangible assets consist of the following (in thousands):

	September 30, 2016	December 31, 2015
Indefinite lived intangible assets		
Acquired IPR&D	$12,246	$12,556
Goodwill	72,359	12,238
Definite lived intangible assets		
Complete technology	182,577	15,267
Less: Accumulated amortization	(10,465)	(3,762)
Trade name	2,642	2,642
Less: Accumulated amortization	(751)	(652)
Customer relationships	29,600	29,600
Less: Accumulated amortization	(8,414)	(7,304)
Total goodwill and other identifiable intangible assets, net	$279,794	$60,585

The Company tests the carrying value of goodwill in accordance with accounting rules on impairment of goodwill, which require that the Company estimate the fair value of the reporting unit annually, or when impairment indicators exist, and compare such amounts to their respective carrying values to determine if an impairment is required. The Company performed its annual assessment for goodwill impairment for the year ended December 31, 2015, noting no impairment.

Commercial License Rights

Commercial License Rights consist of the following (in thousands):

	September 30, 2016	December 31, 2015
CorMatrix	$17,696	$—
Selexis	8,601	8,602
	26,297	8,602
Less: accumulated amortization	(312)	(48)
Total commercial rights, net	$25,985	$8,554

Commercial license rights represent a portfolio of future milestone and royalty payment rights acquired from Selexis in April 2013 and April 2015 and CorMatrix in May 2016. Individual commercial license rights acquired are carried at allocated cost and approximate fair value. The carrying value of the license rights will be reduced on a pro-rata basis as revenue is realized over the term of the agreement. Declines in the fair value of individual license rights below their carrying value that are deemed to be other than temporary are reflected in earnings in the period such determination is made. As of September 30, 2016, management does not believe there have been any events or circumstances indicating that the carrying amount of its commercial license rights may not be recoverable.

Relationships between the CorMatrix Parties

As previously disclosed in Ligand's filings, Jason Aryeh is a director of both Ligand and CorMatrix. Mr. Aryeh beneficially owns equity of CorMatrix representing less than 1% of CorMatrix's outstanding equity. Mr. Aryeh recused himself from all of the board's consideration of the purchase agreement between the Company and CorMatrix, including any financial analysis, the terms of the purchase agreement and the vote to approve the Purchase Agreement and the related transactions.

Table of Contents

Property and Equipment

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

	September 30, 2016	December 31, 2015
Lab and office equipment	$ 1,068	$ 2,248
Leasehold improvements	1,686	273
Computer equipment and software	568	632
	3,322	3,153
Less accumulated depreciation and amortization	(1,496)	(2,781)
Total property and equipment, net	$ 1,826	$ 372

Depreciation of equipment is computed using the straight-line method over the estimated useful lives of the assets, which range from three to ten years. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful lives or the related lease term. Depreciation expense of $0.1 million was recognized for each of the nine months ended September 30, 2016 and 2015, which is included in operating expenses.

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	September 30, 2016	December 31, 2015
Compensation	$ 2,150	$ 1,711
Professional fees	640	726
Amounts owed to former licensees	980	915
Royalties owed to third parties	1,028	823
Other	1,877	1,222
Total accrued liabilities	$ 6,675	$ 5,397

Contingent Liabilities

In connection with the Company’s acquisition of CyDex in January 2011, the Company recorded a contingent liability, for amounts potentially due to holders of the CyDex CVRs and former license holders. The liability is periodically assessed based on events and circumstances related to the underlying milestones, royalties and material sales. Any change in fair value is recorded in the Company’s consolidated statement of operations. The carrying amount of the liability may fluctuate significantly and actual amounts paid under the CVR agreements may be materially different than the carrying amount of the liability. The fair value of the liability at September 30, 2016 and December 31, 2015 was $6.7 million and $9.5 million, respectively. The Company recorded a fair-value adjustment to increase the liability by $1.2 million and $1.6 million for the three and nine months ended September 30, 2016, respectively. The Company paid CyDex CVR holders $1.4 million and $4.4 million for the three and nine months ended September 30, 2016. The Company recorded a fair-value adjustment to increase the liability by $0.9 million and $3.1 million for the three and nine months ended September 30, 2015, respectively. The Company paid CyDex CVR holders $0.8 million and $3.9 million during the three and nine months ended September 30, 2015, respectively.

In connection with the Company’s acquisition of Metabasis in January 2010, the Company issued to Metabasis stockholders four tradable CVRs, one CVR from each of four respective series of CVR, for each Metabasis share. The

CVRs will entitle Metabasis stockholders to potential cash payments as frequently as every six months as cash is received by the Company from proceeds from the sale or partnering of any of the Metabasis drug development programs, among other triggering events. The fair values of the CVRs are remeasured at each reporting date through the term of the related agreement. Any change in fair value is recorded in the Company's consolidated statement of operations. The carrying amount of the liability may fluctuate significantly based upon quoted market prices and actual amounts paid under the agreements may be

Table of Contents

materially different than the carrying amount of the liability. The fair value of the liability was estimated to be $2.3 million and $4.0 million as of September 30, 2016 and December 31, 2015, respectively. The Company recorded a decrease in the liability for Metabasis-related CVRs of $0.2 million and an increase of $1 million for the three and nine months ended September 30, 2016. The Company paid Metabasis CVR holders $2.6 million for the nine months ended September 30, 2016. No payments were made to Metabasis CVR holders for the three months ended September 30, 2016. The Company recorded a decrease in the liability of Metabasis-related CVRs of $3.2 million and an increase of $1.9 million for the three and nine months ended September 30, 2015, respectively. The Company paid Metabasis CVR holders $0.5 million and $0.8 million during the three and nine months ended September 30, 2015.

Stock-Based Compensation

Stock-based compensation expense for awards to employees and non-employee directors is recognized on a straight-line basis over the vesting period until the last tranche vests. The following table summarizes stock-based compensation expense recorded as components of research and development expenses and general and administrative expenses for the periods indicated (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Stock-based compensation expense as a component of:				
Research and development expenses	$2,845	$957	$6,112	$3,131
General and administrative expenses	2,486	1,879	7,578	6,380
	$5,331	$2,836	$13,690	$9,511

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,	
	2016	2015	2016	2015
Risk-free interest rate	1.3%	2%	1.5%	1.7%-2.0%
Dividend yield	—	—	—	—
Expected volatility	49%	50%	50%	50%-58%
Expected term	6.7	6.5	6.6	6.6
Forfeiture rate	5.0%	8.5%	5.0%	8.5%

Lease Obligations

We describe our operating lease obligations in Note 4 to the financial statements in Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2015. As of December 31, 2015, the Company had lease exit obligations of $0.9 million. As of September 30, 2016, the Company no longer records a lease obligation with respect to it's vacated space expiring in June of 2019 as the sublease proceeds offset the estimated lease exist obligation. There were no other significant changes in our operating lease commitments during the first nine months of 2016.

16

Table of Contents

Convertible Debt

In August 2014, the Company completed a $245.0 million offering of 2019 Convertible Senior Notes, which bear interest at 0.75%. The Company accounted for the 2019 Convertible Senior Notes by separating the liability and equity components of the instrument in a manner that reflects the Company's nonconvertible debt borrowing rate. As a result, the Company assigned a value to the debt component of the 2019 Convertible Senior Notes equal to the estimated fair value of similar debt instruments without the conversion feature, which resulted in the Company recording the debt instrument at a discount. The Company is amortizing the debt discount over the life of the 2019 Convertible Senior Notes as additional non-cash interest expense utilizing the effective interest method.

2. Business Combination

On January 8, 2016, the Company acquired substantially all of the assets and liabilities of OMT. OMT is a biotechnology company engaged in the genetic engineering of animals for the generation of human therapeutic antibodies through its OmniAb® technology, which currently offers three transgenic animal platforms for license, including OmniRat®, OmniMouse® and OmniFlic®. The transaction, which was accounted for as a business combination, initially added 16 partnerships to the Company's portfolio and provides the Company with opportunities for further licensing and collaborations in the area.

The aggregate acquisition consideration was $173.4 million, consisting of (in thousands, except per share amounts):

Cash consideration	$96,006
Total share consideration:	
Actual number of shares issued	790
Multiplied by: Ligand closing share price on January 8, 2016	$97.92
Total share consideration	77,373
Total consideration	$173,379

The acquisition consideration is subject to certain customary post-closing adjustments up to 15 months from January 8, 2016, in accordance with the terms and subject to the conditions contained in the merger agreement between the Company and OMT.

The acquisition consideration was preliminarily allocated to the acquisition date fair values of acquired assets and assumed liabilities as follows (in thousands):

Cash and cash equivalents	$3,504
Accounts receivable	5
Income tax receivable	140
Prepaid expenses and other current assets	2
Deferred tax liabilities, net	(56,114)
Intangible asset with finite life - core technology	167,000
Liabilities assumed	(1,279)
Goodwill	60,121
Total consideration	$173,379

The fair value of the core technology, or OMT's OmniAb technology, was based on the discounted cash flow method that estimated the present value of a hypothetical royalty stream derived from the licensing of the OmniAb

technology. These projected cash flows were discounted to present value using a discount rate of 15.5%. The fair value of the core technology is being amortized on a straight-line basis over the estimated useful life of 20 years.

Table of Contents

The excess of the acquisition date consideration over the fair values assigned to the assets acquired and the liabilities assumed was $60.1 million and was recorded as goodwill, which is not deductible for tax purposes and is primarily attributable to OMT's potential revenue growth from combining the OMT and Ligand businesses and workforce, as well as the benefits of access to different markets and customers.

The purchase price allocations were prepared on a preliminary basis and are subject to change as additional information becomes available concerning the fair value and tax basis of the assets acquired and liabilities assumed. Any measurement period adjustments to the OMT purchase price allocation will be made as soon as practicable but no later than one year from the date of acquisition.

The following table presents supplemental pro forma information for the three and nine months ended September 30, 2016 and September 30, 2015, as if the acquisition of OMT had occurred on January 1, 2015 (in thousands except for income per share):

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Revenue	$21,619	$18,824	$73,263	$55,795
Net (loss) income	$1,051	196,354	$3,759	$216,900
Basic (loss) income per share:	$0.05	$9.87	$0.18	$10.99
Diluted (loss) income per share:	$0.05	$9.15	$0.17	$10.27

The unaudited pro forma consolidated results include pro forma adjustments that assume the acquisition occurred on January 1, 2015. The primary adjustments include: (i) the $0.3 million and $0.9 million for the three and nine months ended September 30, 2015, respectively, for share based compensation expenses related to the stock awards issued to the retained OMT employees after the acquisition, (ii) additional intangible amortization expense of $2.1 million and $6.3 million was included in the three and nine months ended September 30, 2015, respectively and (iii) a platform license fee of $3.0 million paid by OMT during the nine months ended September 30, 2015. The license agreement was terminated upon acquisition by Ligand. The adjustments also include $2.5 million license revenue recognized by OMT from January 1, 2016 to the acquisition date. The unaudited pro forma consolidated results are not necessarily indicative of what our consolidated results of operations actually would have been had we completed the acquisition on January 1, 2015. In addition, the unaudited pro forma consolidated results do not purport to project the future results of operations of the combined company nor do they reflect the expected realization of any cost savings associated with the acquisition.

3. Fair Value Measurements

The Company measures certain financial assets and liabilities at fair value on a recurring basis. Fair value is a market-based measurement that should be determined using assumptions that market participants would use in pricing an asset or liability. The Company establishes a three-level hierarchy to prioritize the inputs used in measuring fair value. The levels are described below with level 1 having the highest level input that is significant to the measurement and level 3 having the lowest:
Level 1 - Quoted prices in active markets;
Level 2 - Quoted prices for similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active, or Inputs other than the quoted prices in active markets that are observable either directly or indirectly; and

Level 3 - Unobservable inputs in which there is little or no market data, which require the Company to develop its own assumptions.

Table of Contents

The following table provides a summary of the carrying value of assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2016 (in thousands). There were no transfers between Level 1 and Level 2 securities during the nine months ended September 30, 2016:

	Fair Value Measurements at Reporting Date Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Short-term investments [2]	$37,535	$ 4,539	$ 32,996	$ —
Note receivable Viking [3]	3,207	—	—	3,207
Investment in warrants [4]	684	684	—	—
Total assets	$41,426	$ 5,223	$ 32,996	$ 3,207
Liabilities:				
Current contingent liabilities-CyDex [5]	$5,079	$ —	$ —	$ 5,079
Long-term contingent liabilities-CyDex [5]	1,634	—	—	1,634
Long-term contingent liabilities-Metabasis [6]	2,299	—	2,299	—
Liability for amounts owed to former licensees [7]	536	536	—	—
Total liabilities	$9,548	$ 536	$ 2,299	$ 6,713

The following table provides a summary of the assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2015 (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs * (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents [1]	$3,015	$ —	$ 3,015	$ —
Short-term investments [2]	92,775	6,786	85,989	—
Viking note receivable [3]	4,782	—	—	4,782
Total assets	$100,572	$ 6,786	$ 89,004	$ 4,782
Liabilities:				
Current contingent liabilities-CyDex [5]	$7,812	$ —	$ —	$ 7,812
Current contingent liabilities-Metabasis [6]	2,602	—	2,602	—
Long-term contingent liabilities-Metabasis [6]	1,355	—	1,355	—
Long-term contingent liabilities-CyDex [5]	1,678	—	—	1,678
Liability for amounts owed to former licensees [7]	794	794	—	—
Total liabilities	$14,241	$ 794	$ 3,957	$ 9,490

(1) Highly liquid investments with maturities less than 90 days from the purchase date are recorded as cash equivalents that are classified as Level 2 of the fair value hierarchy, as these investment securities are valued based upon quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

(2) Investments in equity securities, which the Company received as a result of event-based and upfront payments from licensees, are classified as level 1 as the fair value is determined using quoted market prices in active markets for the same securities. Short-term investments in marketable securities with maturities greater than 90 days are classified as level 2 of the fair value hierarchy, as these investment securities are valued based upon quoted prices for identical or

Table of Contents

similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

(3) The fair value of the convertible note receivable from Viking was determined using a probability weighted option pricing model using a lattice methodology. The fair value is subjective and is affected by certain significant input to the valuation model such as the estimated volatility of the common stock, which was estimated to be 75% at September 30, 2016. Changes in these assumptions may materially affect the fair value estimate.

(4) Investment in warrants, which the Company received as a result of Viking's partial repayment of the Viking note receivable and the Company's purchase of Viking common stock and warrants in April 2016, are classified as level 1 as the fair value is determined using quoted market prices in active markets for the same securities.

(5) The fair value of the liabilities for CyDex contingent liabilities were determined based on the income approach. To the extent the estimated future income may vary significantly given the long-term nature of the estimate, the Company utilizes a Monte Carlo model. The fair value is subjective and is affected by changes in inputs to the valuation model including management's estimates of timing and probability of achievement of certain revenue thresholds and developmental and regulatory milestones which may be achieved and affect amounts owed to former license holders and CVR holders. Changes in these assumptions can materially affect the fair value estimate.

(6) The liability for CVRs for Metabasis are determined using quoted prices in an market that is not active for the underlying CVR.

(7) The liability for amounts owed to former licensees are determined using quoted market prices in active markets for the underlying investment received from a partner, a portion of which is owed to former licensees.

The following table represents significant unobservable inputs used in determining the fair value of contingent liabilities assumed in the acquisition of CyDex:

	September 30, 2016	December 31, 2015
Annual revenue subject to revenue sharing [1]	$28.0 million	$22.5 million
Revenue volatility	25%	25%
Average probability	92%	73%
Sales beta	0.30	0.40
Credit rating	BB	BB
Equity risk premium	6%	6%

(1) Revenue subject to revenue sharing represent management's estimate of the total annual revenue subject to revenue sharing (i.e. annual revenues in excess of $15 million) through December 31, 2016, which is the term of the CVR agreement.

A reconciliation of the level 3 financial instruments as of September 30, 2016 is as follows (in thousands):

Assets:	
Fair value of level 3 financial instrument assets as of December 31, 2015	$4,782
Viking note receivable fair market value adjustment	(215)
Cash payment received as partial repayment of note receivable	(300)
Fair market value of stock received as partial repayment of note receivable	(1,060)
Fair value of level 3 financial instrument assets as of September 30, 2016	$3,207
Liabilities:	
Fair value of level 3 financial instrument liabilities as of December 31, 2015	$9,490
Payments to CVR and other former license holders	(4,413)
Fair value adjustments to contingent liabilities	1,636
Fair value of level 3 financial instrument liabilities as of September 30, 2016	$6,713

20

Table of Contents

Other Fair Value Measurements

2019 Convertible Senior Notes

In August 2014, the Company issued $245.0 million aggregate principal amount of its 2019 Convertible Senior Notes. The Company uses a quoted rate in a market that is not active, which is classified as a Level 2 input, to estimate the current fair value of its 2019 Convertible Senior Notes. The estimated fair value of the 2019 Senior Convertible Notes was $357.6 million as of September 30, 2016. The carrying value of the notes does not reflect the market rate. See Note 5 Financing Arrangements for additional information.

Viking Therapeutics

The Company records its investment in Viking under the equity method of accounting. The investment is subsequently adjusted for the Company’s share of Viking's operating results, and if applicable, cash contributions and distributions. See Note 4 Investment in Viking Therapeutics for additional information. The market value of the Company's investment in Viking was $8.8 million as of September 30, 2016. The carrying value of the investment in Viking does not reflect the market value.

4. Investment in Viking Therapeutics

In 2014, the Company entered into a MLA with Viking to license the rights to five of the Company's programs to Viking. Under the terms of the MLA, no consideration was exchanged upon execution, but rather Viking agreed to issue shares of Viking common stock with an aggregate value of approximately $29.2 million upon consummation of Viking's IPO. As part of this transaction, the Company also extended a $2.5 million convertible loan to Viking under a LSA. As a result of these transactions, the Company determined it held a variable interest in Viking. The Company considered certain criteria in the accounting guidance for VIEs, and determined that Viking was a VIE and Ligand was the primary beneficiary of Viking. As a result, the Company consolidated Viking on its financial statements from May 2014 through May 2015, the effective date of Viking's IPO. The Company recorded 100% of the losses incurred as net loss attributable to noncontrolling interest because it was the primary beneficiary with no equity interest in the VIE.

In May 2015, Viking completed the Viking IPO and issued the Company approximately 3.7 million shares of Viking common stock with an aggregate value of $29.2 million based on the IPO price of $8.00 per share. In connection with the Viking IPO, the Company purchased 1.1 million shares of Viking common stock for an aggregate price of $9.0 million at the initial public offering price. Upon completion of Viking’s IPO, the Company determined that Viking was no longer a VIE and the Company did not have any other element of control that would require consolidation of Viking. In May 2015, the Company deconsolidated Viking and began to account for its equity investment in Viking under the equity method and records its proportional share of Viking gains and losses in Loss from Viking Therapeutics in the Company's consolidated statement of operations. The Company owned an aggregate of 31.4% of the outstanding common stock of Viking at September 30, 2016.

In January 2016, the Company entered into an amendment to the LSA with Viking to extend the maturity of the convertible loan to May 2017, reduce the interest rate from 5.0% to 2.5%, and extend the lock up period by one year such that the Company may not sell, transfer, or dispose of any Viking securities prior to January 23, 2017. Additionally, upon the consummation of a subsequent capital financing transaction, Viking will be required to repay $1.5 million of the Viking Note obligation to the Company, with at least $0.3 million to be paid in cash and the remaining amount to be paid in the form and at the price of the Viking equity securities sold in the financing

transaction. Upon maturity or further payments, the Company may elect to receive equity of Viking common stock or cash equal to 200% of the principal amount plus accrued and unpaid interest. The Company has opted to account for the Viking convertible note receivable at fair value.

In April 2016, Viking closed its underwritten public offering of 7.5 million shares of common stock and warrants to purchase up to 7.5 million shares of its common stock at a price of $1.25 per share of its common stock and related warrants. The warrant has an exercise price of $1.50 per share, immediately exercisable and will expire on April 13, 2021. As part of this public offering, the Company purchased 560,000 shares of common stock and warrants to purchase 560,000 shares of Viking's common stock for a total purchase price of $0.7 million. The purchased shares of common stock and warrants are subject to the same terms as the shares issued in this offering. In addition, on April 13, 2016, pursuant to the terms of the amendment to the LSA that was entered in January 2016 between Ligand and Viking, Viking repaid $0.3 million of the convertible notes in cash, and issued the Company 960,000 shares of its common stock and warrants to purchase 960,000 shares of its common stock as

Table of Contents

repayment of $1.2 million of the convertible notes. The shares received as part of the repayment, like all Viking securities held by the Company, are subject to a lock-up period that ends on January 23, 2017 in accordance with the amended LSA. A gain of $0.2 million representing the fair market value of the warrants is included within other income for the quarter ended September 30, 2016. As of September 30, 2016, the aggregate fair value of the note receivable was $3.2 million. The Company recorded a $0.2 million decrease in the fair value of the Viking convertible note in "Other Income" on its Condensed and Consolidated Statement of Operations for the nine months ended September 30, 2016. See Note 3, Fair Value Measurements for additional details.

The Company's ownership in Viking decreased to 32.7% after the public offering and the repayment of the convertible notes. Accordingly, the book value of the Company's equity method investment in Viking decreased by $10.0 million. The resulting net loss was recognized in Loss from Viking Therapeutics in the Company's consolidated statement of operations for the nine months ended September 30, 2016. The Company's ownership in Viking decreased to 31.4% during the third quarter of 2016 resulting in a loss of $0.3 million which was recognized in Loss from Viking Therapeutics in the Company's consolidated statement of operations for the three months ended September 30, 2016.

The Company reviews its investment in Viking on a regular basis and assesses whether events, changes in circumstances or the passage of time, in management's judgment, indicate that a loss in the market value of the investment may be other than temporary. This might include, but would not necessarily be limited to, the period of time during which the carrying value of our investment is significantly above the observed market value, a deterioration in Viking's financial condition, or an adverse event relating to its lead clinical programs. The Company has the ability to hold its investment in Viking at the current market value, and we do not believe there was an other-than-temporary impairment for the periods ended September 30, 2016 or December 31, 2015.

5. Financing Arrangements

0.75% Convertible Senior Notes Due 2019

In August 2014, the Company issued $245.0 million aggregate principal amount of its 2019 Convertible Senior Notes, resulting in net proceeds of $239.3 million. The 2019 Convertible Senior Notes are convertible into common stock at an initial conversion rate of 13.3251 shares per $1,000 principal amount of convertible notes, subject to adjustment upon certain events, which is equivalent to an initial conversion price of approximately $75.05 per share of common stock. The notes bear cash interest at a rate of 0.75% per year, payable semi-annually.

Holders of the 2019 Convertible Senior Notes may convert the notes at any time prior to the close of business on the business day immediately preceding May 15, 2019, under any of the following circumstances:

(1) during any fiscal quarter (and only during such fiscal quarter) commencing after December 31, 2014, if, for at least 20 trading days (whether or not consecutive) during the 30 consecutive trading day period ending on the last trading day of the immediately preceding fiscal quarter, the last reported sale price of the Company's common stock on such trading day is greater than 130% of the conversion price on such trading day;

(2) during the five business day period immediately following any ten consecutive trading day period, in which the trading price per $1,000 principal amount of notes was less than 98% of the product of the last reported sale price of the Company's common stock on such trading day and the conversion rate on each such trading day; or

(3) upon the occurrence of certain specified corporate events as specified in the indenture governing the notes.

As of September 30, 2016, the Company's last reported sale price has exceeded the 130% threshold described above and accordingly the Convertible Notes have been classified as a current liability as of September 30, 2016. As a result, the related unamortized discount of $32.1 million was classified as temporary equity component of currently redeemable convertible notes on our Condensed Consolidated Balance Sheet. The determination of whether or not the Convertible Notes are convertible as described above is made each quarter until maturity, conversion or repurchase. It is possible that the Convertible Notes may not be convertible in future periods, in which case the Convertible Notes would be classified as long-term debt, unless one of the other conversion events described above were to occur.

Table of Contents

On or after May 15, 2019 until the close of business on the second scheduled trading day immediately preceding August 15, 2019, holders of the notes may convert all or a portion of their notes at any time, regardless of the foregoing circumstances. Upon conversion, Ligand must deliver cash to settle the principal and may deliver cash or shares of common stock, at the option of the Company, to settle any premium due upon conversion.

In accordance with accounting guidance for debt related to conversion and other options, the Company separately accounted for the debt and equity components of the 2019 Convertible Senior Notes by allocating the $245.0 million total proceeds between the debt component and the embedded conversion option, or equity component, due to Ligand's ability to settle the 2019 Convertible Senior Notes in cash for the principal portion and to settle any premium in cash or common stock, at the Company's election. The debt allocation was performed in a manner that reflected the Company's non-convertible borrowing rate for similar debt of 5.83% derived from independent valuation analysis. The initial debt value of $192.5 million accretes at 5.83% to reach $245.0 million at the maturity date. The equity component of the 2019 Convertible Senior Notes was recognized as a debt discount and represents the difference between the $245.0 million proceeds at issuance of the 2019 Convertible Senior Notes and the fair value of the debt allocation on their respective issuance dates. The debt discount is amortized to interest expense using the effective interest method over the expected life of a similar liability without an equity component. The notes will have a dilutive effect to the extent the average market price per share of common stock for a given reporting period exceeds the conversion price of $75.05 per share. As of September 30, 2016, the “if-converted value” exceeded the principal amount of the 2019 Convertible Senior Notes by $88.2 million.

In connection with the issuance of the 2019 Convertible Senior Notes, the Company incurred $5.7 million of issuance costs, which primarily consisted of underwriting, legal and other professional fees. The portions of these costs allocated to the equity components totaling $1.2 million were recorded as a reduction to additional paid-in capital. The portions of these costs allocated to the liability components totaling $4.5 million are recorded net of the liability component on the balance sheet beginning in 2016 in accordance with ASU 2015-03, Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs. The portions allocated to the liability components are amortized to interest expense using the effective interest method over the expected life of the 2019 Convertible Senior Notes.

The Company determined the expected life of the debt discount for the 2019 Convertible Senior Notes to be equal to the original five-year term of the notes. The carrying value of the equity component related to the 2019 Convertible Senior Notes as of September 30, 2016 and December 31, 2015, net of issuance costs, was $51.3 million.

Table of Contents

Convertible Bond Hedge and Warrant Transactions

In August 2014, in connection with the issuance of the 2019 Convertible Senior Notes, to minimize the impact of potential dilution to the Company's common stock upon conversion of such notes, the Company entered into convertible bond hedges and sold warrants covering approximately 3,264,643 shares of its common stock. The convertible bond hedges have an exercise price of $75.05 per share and are exercisable when and if the 2019 Convertible Senior Notes are converted. If upon conversion of the 2019 Convertible Senior Notes, the price of the Company's common stock is above the exercise price of the convertible bond hedges, the counterparties will deliver shares of common stock and/or cash with an aggregate value approximately equal to the difference between the price of common stock at the conversion date and the exercise price, multiplied by the number of shares of common stock related to the convertible bond hedge transaction being exercised. The convertible bond hedges and warrants described below are separate transactions entered into by the Company and are not part of the terms of the 2019 Convertible Senior Notes. Holders of the 2019 Convertible Senior Notes and warrants will not have any rights with respect to the convertible bond hedges. The Company paid $48.1 million for these convertible bond hedges and recorded the amount as a reduction to additional paid-in capital.

Concurrently with the convertible bond hedge transactions, the Company entered into warrant transactions whereby it sold warrants to acquire, approximately 3,264,643 shares of common stock with an exercise price of approximately $125.08 per share, subject to certain adjustments. The warrants have various expiration dates ranging from November 13, 2019 to April 22, 2020. The warrants will have a dilutive effect to the extent the market price per share of common stock exceeds the applicable exercise price of the warrants, as measured under the terms of the warrant transactions. The Company received $11.6 million for these warrants and recorded this amount to additional paid-in capital. The common stock issuable upon exercise of the warrants will be in unregistered shares, and the Company does not have the obligation and does not intend to file any registration statement with the SEC registering the issuance of the shares under the warrants.

The carrying values and the fixed contractual coupon rates of the Company's financing arrangements as of September 30, 2016 and December 31, 2015 were as follows (in thousands):

	September 30, 2016	December 31, 2015
2019 Convertible Senior Notes		
Principal amount outstanding	$ 245,000	$245,000
Unamortized discount	(34,885)	(43,015)
Total notes payable	$ 210,115	$201,985

6. Income Tax

As of September 30, 2015, the Company concluded that it was more likely than not that a substantial portion of its deferred tax assets would be realized through future taxable income. The Company's income tax provision of $191.9 million and $191.6 million for the three and nine months ended September 30, 2015, respectively, included income tax expense and a discrete income tax benefit related to the release of a majority of the Company’s valuation allowance and various adjustments to its deferred tax assets, including studies validating the Company’s tax attributes and adjustments resulting from the tax return filings during the quarter.

The Company's income tax expense from continuing operations for the three months ended September 30, 2016 was $0.2 million, or $0.01 per diluted share. The Company recorded an income tax benefit of $28.0 thousand for the nine months ended September 30, 2016. The Company's income tax expense from discontinued operations for the nine months ended September 30, 2016 was $0.4 million.

The Company estimates its annual effective income tax rate for continuing operations to be approximately 42% for 2016, compared to the 509.5% effective income tax rate for 2015. The estimated effective tax rate for 2016 is different from the federal statutory rate primarily as a result of significant permanent book-to-tax differences and state taxes. The permanent differences include non-taxable contingent consideration income (expense) recorded related to the change in market value of contingent liabilities. Any significant contingent consideration expense or income will result in a significantly higher or lower effective tax rate because contingent consideration expense is largely not deductible for tax purposes and contingent consideration income is not taxable. Other permanent differences between financial statement income and taxable income relate to items such as stock compensation, meals and entertainment charges, and compensation of officers. The primary

Table of Contents

difference in the estimated effective tax rate in 2016 compared to 2015 relates to the release of the Company's valuation allowance in 2015.

The Company maintains a valuation allowance in the amount of $8.9 million against certain U.S. state NOLs, federal NOLs arising from Pre-ASC 718 excess stock compensation benefits and federal research and development tax credits. Each reporting period, the Company evaluates the need for a valuation allowance on our deferred tax assets by jurisdiction and adjusts our estimates as more information becomes available. The Company will reassess the ability to realize the deferred tax assets on a quarterly basis. If it is more likely than not that it will not realize the recognized deferred tax assets, then all or a portion of the valuation allowance may need to be re-established, which would result in a charge to tax expense. Conversely if new events indicate that it is more likely than not that we will realize additional deferred tax assets, then all or a portion of the remaining valuation allowance may be released, which would result in a tax benefit.

As of September 30, 2016, the Company had unrecognized tax benefits of approximately $33.5 million related to uncertain tax positions that, if recognized, would result in adjustments to the related deferred tax assets and reduce our annual effective tax rate, subject to the remaining valuation allowance.

The Company files income tax returns in the U.S. and in various state jurisdictions with varying statutes of limitations. The Company is no longer subject to income tax examination by tax authorities for years prior to 2011; however, its net operating loss and research credit carry-forwards arising prior to that year are subject to adjustment. It is the Company's policy to recognize interest expense and penalties related to income tax matters as a component of income tax expense. As of September 30, 2016, there was no material accrued interest related to uncertain tax positions.

7. Stockholders' Equity

The Company grants options and awards to employees and non-employee directors pursuant to a stockholder approved stock incentive plan, which is described in further detail in Note 8, Stockholders' Equity, of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

The following is a summary of the Company's stock option and restricted stock activity and related information:

	Stock Options		Restricted Stock Award	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Grant Date Fair Value
Balance as of December 31, 2015	1,683,341	$ 34.23	130,749	$ 60.36
Granted	263,489	92.09	234,855	95.31
Exercised	(130,185)	34.65	(53,121)	93.49
Forfeited	(30,115)	60.17	(2,183)	71.03
Balance as of September 30, 2016	1,786,530	$ 42.29	310,300	$ 76.02

Net cash received from options exercised during the nine months ended September 30, 2016 and 2015 was approximately $4.5 million and $7.3 million, respectively. Tax deductions for stock options and restricted stock which have exceeded stock based compensation expense in previous years have not been recognized by the Company. The Company will monitor the utilization of the net operating losses and recognize the excess tax deduction when that deduction reduces taxes payable.

As of September 30, 2016, 951,526 shares were available for future option grants or direct issuance under the Company's 2002 Stock Incentive Plan, as amended.

Employee Stock Purchase Plan

The Company's Amended ESPP allows participating employees to purchase up to 1,250 shares of Ligand common stock during each offering period, but in no event may a participant purchase more than 1,250 shares of common stock during any calendar year. The length of each offering period is six months, and employees are eligible to participate in the first

Table of Contents

offering period beginning after their hire date. This plan is described in further detail in Note 8, Stockholders' Equity, of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

There were 1,241 shares of common stock issued under the amended ESPP during the nine months ended September 30, 2016. There were no shares of common stock issued under the amended ESPP plan during the nine months ended September 30, 2015. As of September 30, 2016, 71,126 shares were available for future purchases under the Amended ESPP.

Issuance of common stock

In conjunction with the acquisition of OMT, the Company issued 790,163 shares of its common stock.

8. Litigation

The Company records an estimate of a loss when the loss is considered probable and estimable. Where a liability is probable and there is a range of estimated loss and no amount in the range is more likely than any other number in the range, the Company records the minimum estimated liability related to the claim in accordance with FASB ASC Topic 450 Contingencies. As additional information becomes available, the Company assesses the potential liability related to its pending litigation and revises its estimates. Revisions in the Company's estimates of potential liability could materially impact its results of operations.

Securities Litigation

In 2012, a federal securities class action and shareholder derivative lawsuit was filed in Pennsylvania alleging that the Company and its CEO assisted various breaches of fiduciary duties based on the Company’s purchase of a licensing interest in a development-stage pharmaceutical program from the Genaera Liquidating Trust in 2010 and the Company’s subsequent sale of half of its interest in the transaction to Biotechnology Value Fund, Inc. Plaintiff filed a second amended complaint in February 2015, which the Company moved to dismiss in March 2015. The district court granted the motion to dismiss on November 11, 2015. The plaintiff has appealed that ruling to the Third Circuit. The Company intends to continue to vigorously defend against the claims against the Company and its CEO. The outcome of the matter is not presently determinable.

Paragraph IV Certification by Par Pharmaceuticals

On January 7, 2016, the Company received a paragraph IV certification from Par Sterile Products, LLC, a subsidiary of Par Pharmaceuticals, Inc., or Par, advising us that it had filed an ANDA with the FDA seeking approval to market a generic version of Merck’s NOXAFIL-IV product. On October 31, 2016, the parties entered into a consent judgment dismissing all claims, counterclaims, affirmative defenses and demands. The parties have reported to the court that they entered into a confidential settlement agreement, and that they submitted the agreement to the Federal Trade Commission and the United States Department of Justice pursuant to Section 112(a) of the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Caution: This discussion and analysis may contain predictions, estimates and other forward-looking statements that involve a number of risks and uncertainties, including those discussed in Part II, Item 1A:"Risk Factors." This outlook represents our current judgment on the future direction of our business. These statements include those related to our Captisol-related revenues, our Promacta, Kyprolis, and other product royalty revenues, product returns, and product development. Actual events or results may differ materially from our expectations. For example, there can be no assurance that our revenues or expenses will meet any expectations or follow any trend(s), that we will be able to retain our key employees or that we will be able to enter into any strategic partnerships or other transactions. We cannot assure you that we will receive expected Promacta, Kyprolis, Captisol and other product revenues to support our ongoing business or that our internal or partnered pipeline products will progress in their development, gain marketing approval or achieve success in the market. In addition, ongoing or future arbitration, or litigation or disputes with third parties may have a material adverse effect on us. Such risks and uncertainties, and others, could cause actual results to differ materially from any future performance suggested. We

Table of Contents

undertake no obligation to make any revisions to these forward-looking statements to reflect events or circumstances arising after the date of this quarterly report. This caution is made under the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act.

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

References to "Ligand Pharmaceuticals Incorporated," "Ligand," the "Company," "we" or "our" include Ligand Pharmaceuticals Incorporated and our wholly owned subsidiaries.

Overview

We are a biotechnology company with a business model based on developing or acquiring assets which generate royalty, milestone or other passive revenue for Ligand and using a lean corporate cost structure. By diversifying our portfolio of assets across numerous technology types, therapeutic areas, drug targets, and industry partners, we offer investors an opportunity for broad exposure to multiple pharmaceutical and biotechnology assets without the risk associated with developing only one or a limited number of drugs. These therapies address the unmet medical needs of patients for a broad spectrum of diseases including thrombocytopenia, multiple myeloma, hepatitis, ventricular fibrilation, muscle wasting, Alzheimer’s disease, dyslipidemia, diabetes, anemia, asthma, FSGS, menopausal symptoms and osteoporosis. Our partners include several of the world’s leading pharmaceutical companies such as Novartis, Amgen, Merck, Pfizer, Baxter, and Eli Lilly.

Significant Developments

Portfolio Program Progress

Promacta®/Revolade®

- Novartis announced Q3 2016 net sales of Promacta® of $168 million, a $51 million or 44% increase over Q3 2015. Novartis also announced that Promacta is now approved in more than 100 countries.

Kyprolis® (carfilzomib), an Amgen Product Utilizing Captisol

- On September 27, 2016, Amgen announced top-line results of the Phase 3 CLARION trial, which evaluated an investigational regimen of Kyprolis® (carfilzomib), melphalan and prednisone (KMP) versus Velcade® (bortezomib), melphalan and prednisone (VMP) for 54 weeks in patients with newly diagnosed multiple myeloma who were ineligible for hematopoietic stem-cell transplant. The trial did not meet the primary endpoint of superiority in progression-free survival (PFS). A Phase 3 study evaluating Kyprolis in combination with lenalidomide plus dexamethasone (KRd) versus Velcade in combination with lenalidomide plus dexamethasone (VRd) in newly diagnosed multiple myeloma patients, called ENDURANCE, is underway independently by the ECOG-ACRIN Cancer Research Group.
- On July 3, 2016, Amgen announced that the European Commission approved an expanded indication for Kyprolis®, to be used in combination with dexamethasone alone, for adult patients with multiple myeloma who have received at least one prior therapy.
- Also, Ono Pharmaceuticals, holder of Kyprolis® marketing rights in Japan, announced approval in Japan for treatment of patients with relapsed or refractory multiple myeloma.

Additional Pipeline and Partner Developments

- Retrophin announced positive top-line results from the Phase 2 DUET study of sparsentan for the treatment of focal segmental glomerulosclerosis. The study achieved statistical significance in the primary efficacy endpoint for the overall sparsentan treatment group, demonstrating a greater than two-fold reduction of proteinuria compared to irbesartan after the eight-week, double-blind treatment period.
- Additional data from the Phase 2 DUET study of sparsentan for the treatment of focal segmental glomerulosclerosis will be presented at the late-breaking High-Impact Clinical Trials oral session at the American Society of Nephrology (ASN) Kidney Week 2016.

Table of Contents

- Lundbeck announced FDA approval of Carnexiv™ (carbamazepine) injection as a short-term replacement therapy for oral carbamazepine formulations in adults with certain seizure types when oral administration is temporarily not feasible. Ligand earned a $1.25 million milestone payment upon approval and is entitled to receive a royalty of 2.75% on net sales of Carnexiv.
- Melinta Therapeutics announced that it has submitted NDAs to the FDA for approval of IV and oral Baxdela™ (delafloxacin) for the treatment of patients with acute bacterial skin and skin structure infections (ABSSSI). With the submission, Ligand earned a $1.5 million milestone payment. If approved, Ligand is entitled to receive a 2.5% royalty on net sales of the IV formulation of Baxdela and an additional $1.5 million approval milestone payment.
- Baxdela was the subject of several poster presentations at IDWeek 2016, held October 26-30 at the New Orleans Ernest N. Morial Convention Center.
- The FDA granted orphan designation to Merck’s Noxafil for treatment of invasive aspergillosis.
- Viking Therapeutics announced first patient dosed in the company's Phase 2 clinical trial of VK2809 in patients with primary hypercholesterolemia and non-alcoholic fatty liver disease.
- Viking Therapeutics announced positive top-line results from a proof-of-concept study of VK0214 in a mouse model of X-linked adrenoleukodystrophy (X-ALD), showing VK0214 rapidly reduced plasma very long chain fatty acid levels by more than 25% in treated animals compared with vehicle controls ($p<0.01$). Detailed study results were presented at the 86th Annual Meeting of the American Thyroid Association.
- Aldeyra Therapeutics announced plans for ADX-102 (formerly NS2) for the first-ever vehicle-controlled Phase 3 clinical trial in noninfectious anterior uveitis, as well as a Phase 3 clinical trial in Sjögren-Larsson Syndrome. Aldeyra also announced the expected advancement of ADX-102 to a Phase 2b clinical trial in allergic conjunctivitis and the addition of a clinical program in dry eye syndrome.
- Eli Lilly presented data on Prexasertib (LY2606368) demonstrating activity in patients with BRCA wild type sporadic high-grade serous ovarian cancer at the European Society for Medical Oncology 2016 Congress.
- Merrimack Pharmaceuticals announced the FDA granted seribantumab (MM-121) Fast Track designation for development in patients with heregulin-positive, locally advanced or metastatic non-small cell lung cancer whose disease has progressed following immunotherapy.
- Lubris BioPharma announced positive results of a clinical trial that showed recombinant human lubricin demonstrated significant improvement in both signs and symptoms of dry eye disease compared to sodium hyaluronate (HA). Results were published in the September issue of The Ocular Surface.
- Opthea announced that the Phase 1 dose-escalation study of OPT-302 met its primary objective demonstrating safety and tolerability as monotherapy and in combination with the current wet AMD standard of care Lucentis®. Opthea is recruiting patients for its Phase 2a dose-expansion trial and expects data by the end of 2016.

New Licensing Deals

- Ligand announced worldwide license agreements with Gilead Sciences, F-Star Biotechnology Limited and TeneoBio to use certain or all of the OmniAb platform technologies to discover fully human antibodies. Ligand is eligible to receive annual access payments, sublicensing fees, milestone payments and royalties on future net sales of any antibodies discovered under these licenses.
- Ligand announced licensing rights to four programs to Seelos Therapeutics including aplindore for the treatment of various CNS disorders, a CRTH2 antagonist for the treatment of respiratory disorders, a Captisol-enabled™ acetaminophen program for pain and fever management and an H3 receptor antagonist program for the treatment of narcolepsy. Ligand is entitled to receive milestones and net sales royalties ranging from 4% to 10% for the various programs licensed.
- Ligand announced a license agreement for its LTP technology with Nucorion Pharmaceuticals, a venture-funded biotechnology company focused on developing anti-cancer and anti-viral agents initially directed to China, of which Ligand is a minority shareholder. Three initial programs fall under the license: NUC-202, a targeted anticancer analog for the treatment of hepatocellular carcinoma; NUC-404, a targeted nucleotide analog for the treatment of hepatitis B; and NUC-101, a targeted nucleotide analog for the treatment of hepatitis C. Ligand is eligible to receive milestones in

addition to royalties ranging from 5% to 9% on future net sales of any approved program.

Internal Glucagon Receptor Antagonist (GRA) Program

Ligand announced initiation of a Phase 2 clinical trial with LGD-6972 for the treatment of type 2 diabetes mellitus (T2DM). The randomized, double-blind, placebo-controlled study will evaluate the safety and efficacy of LGD-6972, as an adjunct to diet and exercise, in subjects with T2DM whose blood glucose levels are inadequately controlled with metformin.

Table of Contents

- Results from two Phase 1 clinical trials with LGD-6972 were published in the August issue of the journal Diabetes, Obesity and Metabolism.

Results of Operations

QTD 2016 vs QTD 2015 and YTD 2016 vs YTD 2015

Revenue

(Dollars in thousands)	Q3 2016	Q3 2015	Change	% Change	YTD 2016	YTD 2015	Change	% Change
Royalty Revenue	$15,698	$9,755	$5,943	61 %	$39,842	$26,648	$13,194	50 %
Material Sales	4,219	6,046	(1,827)	(30)%	13,445	20,456	(7,011)	(34)%
License fees, milestones and other revenue	1,702	1,900	(198)	(10)%	17,500	3,618	13,882	384 %
Total revenue	$21,619	$17,701	$3,918	22 %	$			