

Update: Lemelson Capital Further Increases Short Stake in Ligand Pharmaceuticals (NASDAQ: LGND) as LGND EPS Plunges 76 percent in Q2 2014

Lemelson Capital further increases short stake and reaffirms 100 percent downside risk in Ligand Pharmaceuticals (NASDAQ: LGND), revenue and earnings down across the board, while liabilities and dilution continue to rise dramatically.

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Overview

- Despite a significant downward correction in the share price of Ligand Pharmaceuticals (NASDAQ: LGND) since the June 16, 2014 publication of its original research report on LGND, Lemelson Capital Management has since continued to increase its short position in the Company.
 - Lemelson Capital’s original June 16, 2014 report can be found [here](#).
 - Lemelson Capital’s appended 12-page update published on July 3, 2014, can be found [here](#).

- Between June 16, 2014 and August 1, 2014, a period of approximately six weeks, shares in Ligand Pharmaceuticals have plunged roughly 35 percent, losing approximately \$490 million in market capitalization.
- Q2 2014 EPS plunged 76% from Q2 2013.
- Collaborative Research and Development continue a multi-year slide with the release of the company's Q2 earnings report, dropping ~80% in just a matter of four years.
- When non-cash items are excluded, Q2 2014 revenue actually declined year over year.
- Ligand's press releases and communications with investors continue to paint an exceedingly and deceptively optimistic picture, including in its Q2 2014 earnings release this morning. Yet, the firm's SEC filings reveal a business whose key revenue streams and earnings continue to decline, or are likely to diminish entirely. Revenue and earnings are down 76 percent year over year, contingent liabilities are up roughly 148 percent while management continues a policy of extraordinary shareholder dilution through stock-based compensation that exceeds by a significant margin the company's net income from continuing operations.
- Once intangibles are removed from balance sheet, company shareholder equity is just \$21,000 to shield the common shareholder from the litany of growing liabilities and severe competitive threats the company faces.
- Promacta sales have not yet been impaired by new Hep C regimens that address multiple genotypes, but will be. Kyprolis, the company's other major royalty generating program also faces severe competitive threats.
- The financial condition of the company continues to erode rapidly offering essentially zero margin of safety to common shareholders.

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Q2 2014 EPS Plunges 76 Percent

Q2 2014 EPS has plunged 76 percent year over year. Net income attributable to common shareholders for the second quarter of 2014 was just \$1.6 million, or \$0.07 per diluted share, compared with net income attributable to common shareholders for the second quarter of 2013 of \$6.1 million, or \$0.30 per diluted share.

Net income attributable to common shareholders for the first six months of 2014 was \$3.7 million, or \$0.17 per diluted share, compared with net income attributable to common shareholders of \$7.6 million, or \$0.37 per diluted share, for the same period in 2013, representing a decrease of 54.1 percent.

Collaborative Research and Development Revenue Continues to Plummet

Collaborative research and development and other revenues declined to just ~\$4.3 million from ~\$5.0 million for the same period in 2013, a decrease of 14 percent year over year and continuing a multi-year trend.

Once the TG Therapeutics non-cash licensing agreement is backed out of revenue, collaborative research and development revenue declined even further, to just \$3 million for all of 1H 2014, or a decline of some 38 percent over the same period in 2013.

Collaborative R & D revenues (a substantial part of Ligand's overall sales and business model), have already declined 79 percent in just the last four years, continuing to further concentrate the Company's business into just two precariously fragile revenue streams.

When Non-Cash Items are Removed, Q2 2014 Revenue Has Decreased

The company reported in the Q2 earnings release that revenues for the second quarter of 2014 were \$10.6 million, an increase of 11 percent compared with \$9.6 million for the same period in 2013. However, this presentation of the data is potentially misleading.

An upfront, non-cash license fee was received by Ligand from TG Therapeutics for the licensing of IRAK-4 in the second quarter of 2014. Under the terms of the agreement, Ligand received 125,000 shares of TG common stock, valued at approximately \$1.2 million at signing. As of the close of market on August 1, 2014, the 125,000 shares had a value of just \$917,500, a decrease in value to the company of some \$300,000.

Once this non-cash licensing fee is removed from the Q2 revenue figures, the company's revenue was only \$9.4 million, which is 2.1 percent less than the \$9.6 million of revenue the company had in Q2 2013.

A statement of cash flows would have revealed this, but cash flow reporting was oddly omitted from the company's Q2 2014 earnings release.

Material sales decreased approximately \$500,000, or 13 percent, to \$3.5 million from \$4.0 million for the same period in 2013, representing a drop of some 13 percent.

Press Release vs. SEC filings: Net Income, Contingent Liabilities and Stock-based Compensation

Net income from continuing operations dropped from \$3,694,000 in Q2 of 2013 to just \$1,592,000 in Q2 2014, representing a drop of approximately 57 percent (a decline of approximately 76 percent in EPS when accounting for continued dilution).

Contingent liabilities to the company increased an extraordinary 147 percent during the same time period from \$-2,741,000 to \$1,312,000, while mark-to-market adjustments for investments would have taken another \$797,000 off the income statement had the company reported the more correct and accurate GAAP figures.

Despite the drop in revenues and the plunge in EPS, management continued to siphon off shareholder value through an extraordinary increase of approximately 100 percent in stock-based compensation during the first six months of 2014 alone.

“...Ligand which has only speculative value and virtually no perceptible insight into future revenue or profitability, while maintaining a spectrum of significant liabilities, including from the Company itself vis-à-vis spectacular dilution.”

LIGAND PHARMACEUTICALS - SEVERE COMPETITIVE THREAT TO KEY ROYALTY PROGRAM AND “GOING CONCERN”
RISK DRIVE 100 PERCENT DOWNSIDE

JUNE 16, 2014

While net income attributable to Ligand common shareholders fell by approximately 53 percent from 1H 2013 (\$7.6 million) to 1H 2014 (\$3.7 million), management increased their awards by more than 100 percent, to approximately \$5.1 million, or 27 percent greater than the company's entire 1H 2014 earnings, with the lions share likely going to the company's top two executives, validating the original research report that one of the greatest risk to Ligand earnings is from management itself.

Competitive Threat to Promacta and Kyprolis Not Yet Realized

Promacta revenues (as was previously reported) from Hepatitis C patients are dependent on the use of interferon in Hepatitis C therapeutic regimens, which Lemelson Capital's industry sources expect to be reduced significantly, if not entirely, in the future due to approvals of the new oral Hepatitis C treatments including but not limited to Gilead's blockbuster therapy, Sovaldi.

In its first two industry record shattering quarters on the market, Sovaldi has racked up sales of \$5.8 billion despite reports that thousands of patients are still waiting for Gilead's two drugs in one pill combination treatment expected to gain U.S. approval in October.

UPDATE 2-GILEAD HEPATITIS C DRUG SOVALDI RACKS UP \$3.5 BLN IN QUARTER

REUTERS – JULY 23, 2014

It was only last December 2013 that the U.S. Food and Drug Administration (FDA) approved Sovaldi, an oral treatment for chronic Hepatitis C, for use with Ribavirin and interferon. Sovaldi also appears to be used "off label" with Johnson and Johnson's (NYSE:JNJ) Olysio. These new oral combination regimens present a severe competitive threat to future Promacta sales as outlined in the original June 16, research report. However, this has not yet shown up in GlaxoSmithKline's (NASDAQ: GSK) Promacta sales figures since prescribing physicians, as part of the initial regimens, have continued to prescribe the new treatments in combination with interferon (a point also outlined in the original June 16 report), a practice set to change.

Further, Sovaldi will gain additional future competition from drugs in development by AbbVie Inc. (NASDAQ:ABBV) and Merck & Company (NYSE:MRK), creating a more competitive market for the oral Hepatitis C drug market that will undoubtedly drive future promotional efforts, price points and parenthetically further pressure legacy indications such as Promacta, which without interferon have no commercially viable application in Hepatitis C treatment.

The key point is that doctors will eliminate interferon (an expensive indication) in the future when prescribing Sovaldi and other oral combination regimens.

Further clouding the issue is the fact that at least one vocal analyst has repeatedly promoted the idea that interferon will continue to be a mainstay of Hepatitis C treatment for certain genotypes outside of the U.S. However, prescribing information for Sovaldi contradicts and invalidates such a suggestion.

Solvaldi Indications HCV Mono-infected and HCV/HIV-1 Co-infected	Treatment	Duration
Genotype 1 or 4	SOVALDI + peg-interferon alfa + ribavirin	12 weeks
Genotype 2	SOVALDI + ribavirin	12 weeks
Genotype 3	SOVALDI + ribavirin	24 weeks

SOURCE: SOLVALDI PRESCRIBING INFORMATION

Like Promacta, Kyprolis also faces an extraordinary competitive threat from two entrenched multiple myeloma (MM) indications, Celgene's (NASDAQ:CELG) Revlimid and Takeda Pharmaceutical Company Limited's (OTC:TKPYY) Velcade. Celgene also markets Pomalyst (Pomalidomide), another thalidomide analogue, which was approved in 2013 for the treatment of MM patients who have received at least two prior therapies including Revlimid and Velcade and have demonstrated disease progression on or within 60 days of completion of the last therapy.

Although Kyprolis has U.S. Orphan Drug designation with exclusivity through July 2019 and U.S. patents that extend until at least 2025, Velcade patent expires in the U.S. in 2017 and 2019 in the E.U, opening the door for much less expensive generics. Kyprolis' future competition may also include Amgen's pipeline product, Oprozomib, that is in Phase II development.

Summary: Financials Continue Eroding while Liabilities Continue Increasing. 100 Percent Downside Risk Reaffirmed

EPS has plunged 76 percent year-over year through Q2 2014 without explanation from management.

Collaborative research and development revenue has fallen 38 percent year-over-year (when non-cash items are backed out), continuing a multi-year trend.

The company has awarded its executives 47.4 percent more in stock-based compensation than the company has earned in Q2 2014, and ~27 more than the company earned in 1H 2014.

The company's tangible equity is just \$21,000 against a comparatively monstrous market capitalization of approximately \$1.1 billion, while the company's net earnings were just \$1.59 million in Q2 2014.

Liabilities continue to grow at a fast pace, while all of the company's insipid earnings continue to be entirely eliminated by ever-increasing stock-based compensation.

The Company's business model as a "broker" of obscure, third-line, unknown and largely untested indications is inherently flawed and filled with extraordinary risk. It is worth considering why so much time, energy and resources are invested by the company in extraordinarily complex transactions that are often presented to the public in a different light than they are to the SEC.

A common shareholder is distinct from bond-holders or other forms of secured securities holders. Shares of Ligand have already lost approximately 35 percent since the publication of the original LCM report on June 16, 2014 through the close of market on August 1, 2014 (a loss of some \$490 million in market capitalization in slightly over six weeks).

Common shareholders of Ligand now have just \$21,000 in tangible equity to shield them from the slightest bad news which could send the company's \$1.1 billion market capitalization tumbling substantially further. Indeed the company's intangible and contingent liabilities could easily exceed \$21,000 in a day.

For this reason, as well as those enumerated in LCM's previous reports, the intrinsic value of Ligand shares must be reaffirmed as \$0 with downside risk justifiably calculated at 100 percent.

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