RIGEL PHARMACEUTICALS INC
Form 10-Q
August 02, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006.

OR

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

FOR THE TRANSITION PERIOD FROM TO

Commission File Number 0-29889

Rigel Pharmaceuticals, Inc.

(Exact name of registrant as specified in its charter)

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

(650) 624-1100

(Registrant s telephone number, including area code)

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

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

Large accelerated filer o Accelerated filer ý Non-accelerated filer o

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

As of July 28, 2006, there were 24,938,377 shares of the registrant s common stock outstanding.

RIGEL PHARMACEUTICALS, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

RIGEL PHARMACEUTICALS, INC.

BALANCE SHEETS

(in thousands, except share amounts)

	June 30, 2006 (unaudited)	December 31, 2005(1)
Assets		
Current assets:		
Cash and cash equivalents	$ 62,228	$ 76,779
Available-for-sale securities	60,012	61,417
Accounts receivable	1,050	1,050
Other receivables	850	777
Prepaid expenses and other current assets	2,186	2,573
Total current assets	126,326	142,596
Property and equipment, net	3,378	3,457
Other assets	1,520	1,615
	$ 131,224	$ 147,668
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 1,544	$ 2,497
Accrued compensation	1,145	2,189
Other accrued liabilities	1,631	2,324
Deferred revenue	7,221	15,567
Capital lease obligations	1,257	1,070
Total current liabilities	12,798	23,647
Long-term portion of capital lease obligations	1,539	1,132
Long-term portion of deferred revenue		2,771
Long-term portion of deferred rent	11,208	11,121
Other long-term liabilities	386	409
Commitments		
Stockholders equity:		
Common stock, $0.001 par value; 100,000,000 shares authorized; 24,928,469 and 24,814,671 shares issued and outstanding on June 30, 2006 and December 31, 2005, respectively	25	25
Additional paid-in capital	373,710	366,203
Deferred stock compensation		(26)
Accumulated other comprehensive loss	(121)	(92)
Accumulated deficit	(268,321)	(257,522)
Total stockholders equity	105,293	108,588
	$ 131,224	$ 147,668

Note (1) The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date included in Rigel s Annual Report on Form 10-K for the year ended December 31, 2005.

See accompanying notes.

RIGEL PHARMACEUTICALS, INC.

CONDENSED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Contract revenues from collaborations	$ 14,321	$ 4,606	$ 24,218	$ 7,224
Costs and expenses:				
Research and development	13,205	13,807	27,916	24,980
General and administrative	4,725	3,429	9,728	6,303
	17,930	17,236	37,644	31,283
Loss from operations	(3,609)	(12,630)	(13,426)	(24,059)
Interest income	1,426	402	2,840	732
Interest expense	(147)	(65)	(213)	(130)
Net loss	(2,330)	(12,293)	(10,799)	(23,457)
Net loss per common share, basic and diluted	$ (0.09)	$ (0.62)	$ (0.43)	$ (1.18)
Weighted average shares used in computing net loss per common share, basic and diluted	24,842	19,887	24,829	19,801

See accompanying notes.

RIGEL PHARMACEUTICALS, INC.

CONDENSED STATEMENTS OF CASH FLOWS
(in thousands)

(unaudited)

	Six Months Ended June 30, 2006	2005
Operating activities		
Net loss	$ (10,799)	$ (23,457)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	664	587
Amortization of deferred stock compensation, net		11
Non-cash stock compensation expense (recovery)	6,688	(657)
Changes in assets and liabilities:		
Accounts receivable		(1,181)
Other receivables	(73)	111
Prepaid expenses and other current assets	387	(187)
Other assets	95	81
Accounts payable	(953)	1,240
Accrued compensation	(1,044)	(697)
Other accrued liabilities	(307)	513
Deferred revenue	(11,117)	7,132
Deferred rent and other long-term liabilities	(322)	(402)
Net cash used in operating activities	(16,781)	(16,906)
Investing activities		
Purchases of available-for-sale securities	(27,792)	(31,887)
Maturities of available-for-sale securities	29,168	43,160
Capital expenditures	(585)	(554)
Net cash provided by investing activities	791	10,719
Financing activities		
Proceeds from capital lease financing	1,257	1,191
Payments on capital lease obligations	(663)	(1,025)
Net proceeds from issuances of common stock	845	5,850
Net cash provided by financing activities	1,439	6,016
Net decrease in cash and cash equivalents	(14,551)	(171)
Cash and cash equivalents at beginning of period	76,779	10,495
Cash and cash equivalents at end of period	$ 62,228	$ 10,324

See accompanying notes.

Rigel Pharmaceuticals, Inc.

Notes to Condensed Financial Statements

(unaudited)

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

1. Nature of Operations

We were incorporated in the state of Delaware on June 14, 1996. We are engaged in the discovery and development of novel, small-molecule drugs for the treatment of inflammatory diseases, cancer and viral diseases.

2. Basis of Presentation

Our accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In our opinion, these unaudited condensed financial statements include all adjustments, consisting only of normal recurring adjustments, which we consider necessary to fairly state our financial position and the results of our operations and cash flows. Interim-period results are not necessarily indicative of results of operations or cash flows for a full-year period. The balance sheet at December 31, 2005 has been derived from audited financial statements at that date, but does not include all disclosures required by generally accepted accounting principles for complete financial statements. These unaudited condensed financial statements and the notes accompanying them should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2005.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Comprehensive net loss did not differ materially from the net loss as reported.

3. Basic and Diluted Net Loss Per Share

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

4. Stock Award Plans

We have two stock option plans, the 2000 Equity Incentive Plan and 2000 Non-Employee Directors Stock Option Plan, that provide for granting to officers, directors, all other employees and other non-employees options to purchase shares of our common stock. Under the plans, we may issue non-qualified options or incentive stock options. We also have an employee stock purchase plan, or ESPP, where eligible employees can purchase shares of our common stock at a price per share equal to 85% of the lower of the fair market value on the first and last day of each six-month purchase period. The benefits provided under these plans are share-based payments subject to the provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (Revised 2004) , or SFAS 123(R).

Effective January 1, 2006, we adopted the provisions of SFAS 123(R) using the modified prospective application transition method. Under this method, the share-based compensation cost recognized beginning January 1, 2006 includes compensation cost for (i) all share-based payments granted prior to, but not vested as of January 1, 2006, based on the grant date fair value originally estimated in accordance with the provisions of SFAS No. 123, Accounting for Stock-Based Compensation , or SFAS 123, and calculated for pro forma disclosures under SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure , or SFAS 148, and (ii) all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). Compensation cost under SFAS 123(R) for awards granted prior to January 1, 2006 is recognized using an accelerated method pursuant to the Financial Accounting Standards Board, or FASB, Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans , or FIN 28. For awards granted after January 1, 2006, we have adopted the use of the straight-line attribution method over the requisite service period for the entire award. Results of prior periods do not reflect any restated amounts, and we had no cumulative effect adjustment upon adoption of SFAS No. 123(R) under the modified prospective method.

Impact of the Adoption of FAS 123(R)

Total stock-based compensation expense, related to all of the Company s share-based awards, recognized for the three and six months ended June 30, 2006 and 2005 was comprised as follows (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Research and development	$ 1,543	$ 566	$ 3,464	$ (461)
General and administrative	1,584	256	3,224	(185)
Stock-based compensation expense/(recovery)	$ 3,127	$ 822	$ 6,688	$ (646)
Stock-based compensation expense/(recovery) per share				
Basic and diluted	$ 0.13	$ 0.04	$ 0.27	$ (0.03)

We recorded approximately $3.1 million in stock-based compensation expense for the three months ended June 30, 2006, consisting of approximately $3.2 million in stock-based awards granted to officers, directors and all other employees from our stock option plans and ESPP, offset by a recovery of approximately $93,000 in options originally granted to consultants, which is discussed below. We recorded approximately $6.7 million in stock-based compensation expense for the six months ended June 30, 2006, consisting of approximately $6.5 million in stock-based awards granted to officers, directors and all other employees from our stock option plans and ESPP and approximately $184,000 in options granted to consultants. Pursuant to SFAS 123(R), we are required to estimate the amount of expected forfeitures when calculating the compensation costs, instead of accounting for forfeitures as incurred, which was our previous method. Our annual weighted average forfeiture rate was 7.6% as of June 30, 2006 as compared to 4.7% as of March 31, 2006. The increase in the forfeiture rate was due to the forfeiture of an executive officer s unvested options resulting from his departure from the company. We will record actual forfeitures as they occur, and we will review our forfeiture rates each quarter and make changes to our estimate.

For the three months ended June 30, 2006, we recorded a recovery of approximately $93,000, and for the six months ended June 30, 2006, we recorded an expense of approximately $184,000, associated with options granted to consultants, reflecting the fair value and periodic fair value remeasurement of outstanding consultant options under Emerging Issues Task Force No. 96-18, Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services , or EITF 96-18. The valuation is based upon the current market value of our common stock and other assumptions, including the expected future volatility of our stock price, risk-free interest rate and expected term. For consultant options granted in 2006, we amortized stock-based compensation using a straight-line attribution method consistent with the method used for employees and with the attribution election we made upon adoption of FAS 123(R). For options granted prior to January 1, 2006, we used the accelerated method for expensing stock-based compensation, which was the method we used prior to adoption. We recorded stock-based compensation expense of approximately $92,000 for the three months ended June 30, 2005 and a recovery of approximately $115,000 for the six months ended June 30, 2005 relating to consultant options. We expect to see continued fluctuations in the future as a portion of these options are remeasured based on the changes in the current market price of our common stock.

In 2005, we recorded charges associated with the stock options that were eligible for re-pricing under a tender offer initiated in June 2003. All replacement options, as well as the eligible options that were not surrendered under the original offer to exchange, were treated for financial reporting purposes as variable awards. Therefore, for the period prior to adoption of FAS 123(R), we recorded a non-cash charge, generally for the intrinsic value of the options as they vested under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, or APB 25, utilizing the accelerated vesting method, reflecting increases and decreases (down to, but not below, the exercise price) in the price of our common stock as compensation expense (recovery) in connection with the replacement options and the eligible options that were not exchanged. For the three months ended June 30, 2005, we recorded stock-based compensation expense of approximately $715,000 related to all employee options eligible for replacement options. The expense resulted from the increase in the market price of our common stock during the period. For the six months ended June 30, 2005, we recorded stock-based compensation recovery of approximately $551,000 related to all employee options eligible for replacement options. The recovery resulted from the decrease in the market price of our common stock during the period. For periods after the adoption of FAS 123(R), we account for the vested portion of the options repriced prior to the adoption of SFAS 123(R) in accordance with provisions of SFAS 123. In May 2006, our board of directors approved a plan to grant new options in August 2006 to employees who hold repriced options that expire in the same period. We will record stock-based compensation expense relating to the new options in the third quarter of 2006.

Under FAS 123(R), the fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. We have segregated option awards into three homogenous groups (i.e., Officers and Directors, All Other Employees and Non-employees or Consultants) for purposes of determining fair values of options.

We determined weighted-average valuation assumptions separately for the groups as follows:

Volatility - We estimated volatility using the historical share price performance over the expected life of the option up to the point where we have historical market data. As our publicly listed options are not actively traded, implied volatility was not representative of our current volatility. We also considered other factors such as our current clinical trials and other company activities that may affect volatility of our stock in the future but determined that at this time, the historical volatility was more indicative of our expected future stock performance.

Expected term - We worked with various data points to determine the most applicable expected term for each option group. The data points included: (1) expected term of the options from option date to exercise date; (2) cancellation term of options from grant date to cancellation date and excluding unvested option forfeitures from the determination; and (3) term of options that remain outstanding from grant date to the end of the reporting period. The analysis of the above data points gave us a range of expected terms to consider; however, we also considered the vesting schedules of the options granted and factors surrounding exercise behavior of our groups, our current market price and company activity that may affect our market price. In addition, we also considered the vesting schedules of the options, the optionee type (i.e., officers and directors and all other employees) and other factors that may affect the expected term of the option. For non-employee options, we use the contractual term of the option, which is generally ten years, for the initial valuation of the option and the remaining contractual term of the option for the succeeding years.

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

Forfeiture rate - We estimated the forfeiture rate using our historical experience with pre-vesting options. Our annual weighted-average forfeiture rate was approximately 7.6% as of June 30, 2006 as compared to 4.7% as of March 31, 2006. The increase in the forfeiture rate was due to the forfeiture of an executive officer s unvested options resulting from his departure from the company. We review our forfeiture rates each quarter and make changes as factors affecting our forfeiture rate calculations and assumptions change.

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

The following table summarizes the weighted-average assumptions relating to our employee options for the three and six months ended June 30, 2006 and 2005 as permitted under FAS 123(R) for 2006 and FAS 123 for 2005:

	Stock Option Plans Three Months Ended June 30,		Stock Option Plans Six Months Ended June 30,	
	2006	2005	2006	2005
Risk-free interest rate	5.0%	3.7%	4.6%	4.1%
Expected life (in years)	4.9	3.1	4.6	2.4
Dividend yield	0.0%	0.0%	0.0%	0.0%
Expected volatility	94.0%	75.0%	98.2%	75.0%

Option prices are not less than the market price of our common stock on the date of grant, become exercisable at varying dates and generally expire ten years from the date of grant. At June 30, 2006, options to purchase 1,543,293 shares of common stock were available for grant under our stock option plans.

Employee Stock Purchase Plan

The fair value of each option element of our employee stock purchase plan (ESPP) is estimated on the date of grant using the Black-Scholes option pricing model that uses weighted-average assumptions in the table below. Our ESPP provides for a twenty-four month offering period comprised of four six-month purchase periods with a look-back option. A look-back option is a provision in an ESPP that establishes the purchase price as an amount based on the lesser of the stock s market price at the grant date or its market price at the exercise or purchase date. The plan also includes a reset feature whereby participants reset to a new offering when the market price of the stock falls below the market price on the first day of a twenty-four month offering period. Expected volatilities are based on historical volatility of our stock. Expected term represents the purchase periods within our offering period. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury of constant maturity rates. Stock-based compensation expense relating to our employee stock purchase plan is recognized according to the FASB Technical Bulletin No. 97-1, Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-back Option , or FTB 97-1. As of June 30, 2006, there were approximately 56,000 shares in reserve for future issuance under the plan. The following table summarizes the weighted-average assumptions relating to our employee stock purchase plan for the six months ended June 30, 2006 and 2005:

	Employee Stock Purchase Plan Six Months Ended June 30,	
	2006	2005
Risk-free interest rate	4.6%	4.1%
Expected life (in years)	1.2	0.5
Dividend yield	0.0%	0.0%
Expected volatility	110.3%	75.0%

Stock-based Compensation Award Activity

The following table summarizes activity under our equity incentive and stock option plans as of June 30, 2006 (in thousands, except per share amounts):

	Shares		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)		Aggregate Intrinsic Value
Outstanding at December 31, 2005	3,893,219	$	15.98			
Granted	841,685	$	8.16			
Exercised	(31,668)	$	8.04			
Forfeited/Expired/Cancelled	(190,144)	$	17.34			
Outstanding at June 30, 2006	4,513,092	$	14.52	7.82	$	4,106,597
Vested and expected to vest at June 30, 2006	4,356,604	$	15.05			
Exercisable at June 30, 2006	2,440,405	$	13.25	7.02	$	2,706,408

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the options to acquire 2.2 million shares that were in-the-money at June 30, 2006. During the six months ended June 30, 2006 and 2005, the aggregate intrinsic values of options exercised under our stock option plans were approximately $88,000 and $612,332, respectively, determined as of the date of option exercise. As of June 30, 2006, there were approximately $13.3 million of total unrecognized compensation cost, net of forfeitures, related to unvested share-based compensation arrangements granted under our stock option plans and $833,000 of total unamortized compensation cost related to our ESPP. That cost is expected to be recognized over a weighted-average period of 1.45 years. We also had approximately 2.1 million of unvested stock options at June 30, 2006. Future option grants and their valuation will increase our compensation cost in the future as the options are granted, valued and expensed ratably according to their vesting periods. The weighted average grant-date fair values of options granted in the six months ended June 30, 2006 and 2005 were $6.01 and $9.30, respectively.

Pro Forma Information under FAS 123 for Periods Prior to Fiscal 2006

Prior to adopting SFAS 123(R) on January 1, 2006, we accounted for equity-based employee compensation costs under the recognition and measurement principles of APB 25. Under APB 25, the intrinsic value method of accounting, no compensation expense is recognized, because the exercise price of our employee stock options equals the market price of the underlying stock on the date of grant. Pro forma information regarding net loss and net loss per share was determined as if we had accounted for our employee stock options and employee stock purchase plan under the fair value method prescribed by FAS 123, as amended by FAS No. 148. The fair value for these options was estimated at the date of grant using the Black-Scholes model. See the weighted-average assumptions discussed above.

For purposes of pro forma disclosures, the estimated fair value of the options was amortized to expense over the vesting period of the options prior to adopting SFAS 123(R). Our pro forma information was as follows (in thousands, except per share amounts):

	Three Months Ended,	Six Months Ended,

		June 30, 2005		June 30, 2005
Net loss as reported:	$	(12,293)	$	(23,457)
Add (Deduct): Total stock-based employee compensation expense/(recovery) determined under APB 25		730		(531)
Add: Total stock-based employee compensation expense determined under the fair value based method of all awards		2,048		3,862
Pro forma net loss	$	(13,611)	$	(27,850)
Basic and diluted net loss per common share:				
As reported	$	(0.62)	$	(1.18)
Pro forma	$	(0.68)	$	(1.41)

5. Revenue Recognition

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

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

Revenues related to collaborative research with our corporate collaborators are recognized as research services are performed over the related development funding periods for each contract. Under these agreements, we are required to perform research and development activities as specified in each respective agreement. The payments received are not refundable and are generally based on a contractual cost per full-time equivalent employee working on the project. Research and development expenses under the collaborative research agreements, except for the Merck collaboration signed in November 2004 related to ubiquitin ligases, approximate or exceed the revenue recognized under such agreements over the term of the respective agreements. For the Merck collaboration, we are recognizing a pro-rata portion of the invoiced amounts for funding of our research scientists based on the headcount dedicated to the project. It is our policy to recognize revenue based on our level of effort expended, however, revenue recognized will not exceed amounts billable under the arrangement which corresponds to cash receipts.

Milestones are recognized pursuant to collaborative agreements upon the achievement of these at risk milestones.

Royalties will be recognized as earned in accordance with the contract terms when the third party results are reliably measurable and collectibility is reasonably assured.

6. Cash, Cash Equivalents and Available-For-Sale Securities

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

	June 30, 2006	December 31, 2005
Checking account	$ 154	$ 742
Money market funds	10,057	3,421
Federal agency securities	17,917	21,067
Corporate bonds and notes	94,112	112,966

	$	122,240	$	138,196
Reported as:				
Cash and cash equivalents	$	62,228	$	76,779
Available-for-sale securities		60,012		61,417
	$	122,240	$	138,196

June 30, 2006		**Amortized Cost**		**Gross Unrealized Gains**		**Gross Unrealized Losses**		**Fair Value**
Federal agency securities	$	17,975	$		$	(57)	$	17,918
Corporate bonds and note		42,158		4		(68)		42,094
Total	$	60,133	$	4	$	(125)	$	60,012

December 31, 2005	**Amortized Cost**	**Gross Unrealized**	**Gross Unrealized**