

PHARMION CORP  
Form 10-Q  
August 09, 2006

**Table of Contents**

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

**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**

**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: 000-50447**

**Pharmion Corporation**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**84-1521333**

*(I.R.S. Employer  
Identification No.)*

**2525 28th Street, Suite 200,  
Boulder, Colorado**

*(Address of principal executive offices)*

**80301**

*(Zip Code)*

**720-564-9100**

*(Registrant's telephone number, including area code)*

**None**

*(Former name, former address and former fiscal year, if changed since last report)*

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  No   
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.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at August 7, 2006
Common Stock, \$.001 par value per share	32,051,664 shares

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>Part I Financial Information</u></b>	
<u>Item 1.</u>	3
<u>Consolidated Financial Statements</u>	3
<u>Consolidated Balance Sheets as of June 30, 2006 (Unaudited) and December 31, 2005</u>	3
<u>Consolidated Statements of Operations for the three and six months ended June 30, 2006</u>	4
<u>(Unaudited) and 2005 (Unaudited)</u>	4
<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2006</u>	5
<u>(Unaudited) and 2005 (Unaudited)</u>	5
<u>Notes to Unaudited Consolidated Financial Statements</u>	6
<u>Item 2.</u>	16
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 3.</u>	24
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	24
<u>Item 4.</u>	24
<u>Controls and Procedures</u>	24
<b><u>Part II Other Information</u></b>	
<u>Item 1.</u>	24
<u>Legal Proceedings</u>	24
<u>Item</u>	
<u>1A.</u>	24
<u>Risk Factors</u>	24
<u>Item 2.</u>	25
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	25
<u>Item 3.</u>	26
<u>Defaults Upon Senior Securities</u>	26
<u>Item 4.</u>	26
<u>Submission of Matters to a Vote of Security Holders</u>	26
<u>Item 5.</u>	26
<u>Other Information</u>	26
<u>Item 6.</u>	27
<u>Exhibits</u>	27
<u>Certification of CEO Pursuant to Section 302</u>	
<u>Certification of CFO Pursuant to Section 302</u>	
<u>Certification of CEO and CFO Pursuant to Section 906</u>	

**Table of Contents**

**PART I**  
**FINANCIAL INFORMATION**

**Item 1. Consolidated Financial Statements**

**PHARMION CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

(In thousands, except for share amounts)

	<b>June 30, 2006 (Unaudited)</b>	<b>December 31, 2005</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 93,270	\$ 90,443
Short-term investments	95,189	152,963
Accounts receivable, net of allowances of \$3,840 and \$3,573, respectively	34,625	32,213
Inventories	13,178	11,472
Prepaid research and development costs	10,734	16,020
Other current assets	4,900	5,779
 Total current assets	 251,896	 308,890
Product rights, net	99,874	104,045
Goodwill	13,691	12,920
Property and equipment, net	6,312	6,606
Other assets	5,036	169
 Total assets	 \$ 376,809	 \$ 432,630
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 7,703	\$ 8,456
Accrued liabilities	35,401	73,813
 Total current liabilities	 43,104	 82,269
Deferred tax liability	2,965	2,797
Other long-term liabilities	24	940
 Total liabilities	 46,093	 86,006
 Stockholders' equity:		
Common stock, \$0.001 par value; 100,000,000 shares authorized and 32,051,240 and 31,912,751 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively	32	32
Preferred stock, \$0.001, 10,000,000 shares authorized, no shares issued and outstanding at June 30, 2006 and December 31, 2005		
Additional paid-in capital	484,742	482,893
Deferred compensation		(227)
Other comprehensive income (loss)	5,019	(247)
Accumulated deficit	(159,077)	(135,827)

Total stockholders' equity	330,716	346,624
Total liabilities and stockholders' equity	\$ 376,809	\$ 432,630

The accompanying notes are an integral part of these consolidated financial statements

3

---

**Table of Contents**

**PHARMION CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands, except for per share amounts)  
(Unaudited)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net sales	\$60,366	\$56,257	\$116,960	\$107,994
Operating expenses:				
Cost of sales, inclusive of royalties, exclusive of product rights amortization shown separately below	16,672	15,120	31,885	29,067
Research and development	18,386	9,800	33,519	19,263
Acquired in-process research			20,480	
Selling, general and administrative	25,986	22,618	48,498	43,298
Product rights amortization	2,451	2,227	4,890	4,466
Total operating expenses	63,495	49,765	139,272	96,094
Operating income (loss)	(3,129)	6,492	(22,312)	11,900
Interest and other income, net	1,755	1,215	3,416	2,994
Income (loss) before taxes	(1,374)	7,707	(18,896)	14,894
Income tax expense	2,140	2,153	4,354	5,071
Net income (loss)	\$ (3,514)	\$ 5,554	\$ (23,250)	\$ 9,823
Net income (loss) per common share:				
Basic	\$ (0.11)	\$ 0.17	\$ (0.73)	\$ 0.31
Diluted	\$ (0.11)	\$ 0.17	\$ (0.73)	\$ 0.30
Weighted average number of common and common equivalent shares used to calculate net income (loss) per common share:				
Basic	32,007	31,822	31,963	31,814
Diluted	32,007	32,856	31,963	32,946

The accompanying notes are an integral part of these consolidated financial statements

**Table of Contents**

**PHARMION CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)  
(Unaudited)

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Operating activities</b>		
Net income (loss)	\$ (23,250)	\$ 9,823
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	6,079	5,678
Share-based compensation expense	1,562	108
Other	(171)	82
Changes in operating assets and liabilities:		
Accounts receivable, net	(1,102)	1
Inventories	(1,241)	(2,738)
Other current assets	7,160	(335)
Other long-term assets	4	21
Accounts payable	(985)	(2,306)
Accrued liabilities	(39,226)	(3,494)
Net cash provided by (used in) operating activities	(51,170)	6,840
<b>Investing activities</b>		
Purchases of property and equipment	(660)	(4,148)
Addition to product rights		(5,000)
Acquisition of business, net of cash acquired		(10,072)
Purchase of available-for-sale investments	(52,141)	(111,996)
Sale and maturity of available-for-sale investments	105,682	64,732
Net cash provided by (used in) investing activities	52,881	(66,484)
<b>Financing activities</b>		
Proceeds from exercise of common stock options	514	243
Payment of debt obligations	(1,073)	(2,108)
Net cash used in financing activities	(559)	(1,865)
Effect of exchange rate changes on cash and cash equivalents	1,675	(3,980)
Net increase (decrease) in cash and cash equivalents	2,827	(65,489)
Cash and cash equivalents at beginning of period	90,443	119,658
Cash and cash equivalents at end of period	\$ 93,270	\$ 54,169
<b>Non cash items</b>		
Financed addition to product rights		1,870

The accompanying notes are an integral part of these consolidated financial statements

**Table of Contents**

**PHARMION CORPORATION**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. BUSINESS OPERATIONS**

Pharmion Corporation (the Company) is engaged in the acquisition, development and commercialization of pharmaceutical products for the treatment of oncology and hematology patients. The Company's product acquisition and licensing efforts are focused on both development stage products as well as those approved for marketing. In exchange for distribution and marketing rights, the Company generally grants the licensor royalties on future sales and, in some cases, up front cash payments. The Company has acquired the rights to six products, including four that are currently marketed or sold on a compassionate use or named patient basis, and two products that are in varying stages of clinical development. The Company has established operations in the United States, Europe and Australia. Through a distributor network, the Company can reach the hematology and oncology community in additional countries in the Middle East and Asia.

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

The accompanying unaudited consolidated financial statements of the Company and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the SEC pertaining to Form 10-Q. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain disclosures required for complete financial statements are not included herein. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2005 Annual Report on Form 10-K, which has been filed with the SEC.

In the opinion of management, the unaudited interim financial statements reflect all adjustments, which include all normal, recurring adjustments necessary to present fairly the Company's financial position at June 30, 2006, results of operations for the three and six months ended June 30, 2006 and 2005 and cash flows for the six months ended June 30, 2006 and 2005. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the year ending December 31, 2006 or for any other interim period or for any other future year.

*Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of net sales and expenses during the reporting period. Actual results could differ from those estimates or assumptions.

*Cash and Cash Equivalents*

Cash and cash equivalents consist of money market accounts and overnight deposits. The Company also considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents. Interest income was \$3.6 million and \$3.0 million for the six months ended June 30, 2006 and 2005, respectively.

The Company has entered into domestic and international standby letters of credit to guarantee both current and future commitments of office lease agreements. The aggregate amount outstanding under the letters of credit was approximately \$1.7 million at June 30, 2006 and is secured by an equivalent amount of restricted cash held in U.S. cash accounts.

*Short-term Investments*

Short-term investments consist of investment grade government agency auction rate and corporate debt securities due within one year. Investments with maturities beyond one year are classified as short-term based on their highly liquid nature and because such investments represent the investment of cash that is available for current operations. All investments are classified as available-for-sale and are recorded at market value. Unrealized gains and losses are reflected in other comprehensive income (loss).

**Table of Contents***Inventories*

Inventories consist of raw materials and finished goods and are stated at the lower of cost or market, cost being determined under the first-in, first-out method. The Company periodically reviews inventories and any items considered outdated or obsolete are reduced to their estimated net realizable value. The Company estimates reserves for excess and obsolete inventories based on inventory levels on hand, future purchase commitments, product expiration dates and current and forecasted product demand. If an estimate of future product demand suggests that inventory levels are excessive, then inventories are reduced to their estimated net realizable value.

Inventories at June 30, 2006 and December 31, 2005 consisted of the following (in thousands):

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
Raw materials	\$ 4,529	\$ 3,444
Finished goods	8,649	8,028
Total inventories	\$ 13,178	\$ 11,472

*Long-Lived Assets*

Our long-lived assets consist primarily of product rights and property and equipment. In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 144 , Accounting for the Impairment or Disposal of Long-Lived Assets, we evaluate our ability to recover the carrying value of long-lived assets used in our business, considering changes in the business environment or other facts and circumstances that suggest their value may be impaired. If this evaluation indicates the carrying value will not be recoverable, based on the undiscounted expected future cash flows estimated to be generated by these assets, we reduce the carrying amount to the estimated fair value.

*Goodwill*

In association with a business acquisition in 2003 and related contingent payments that were made in 2004 and 2005, goodwill was created. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, the Company does not amortize goodwill. SFAS No. 142 requires the Company to perform an impairment review of goodwill at least annually. If it is determined that the value of goodwill is impaired, the Company will record the impairment charge in the statement of operations in the period it is discovered.

*Property and Equipment*

Property and equipment are stated at cost. Repairs and maintenance are charged to operations as incurred, and significant expenditures for additions and improvements are capitalized. Leasehold improvements are amortized over the economic life of the asset or the lease term, whichever is shorter. Depreciation and amortization of property and equipment are computed using the straight-line method based on the following estimated useful lives:

	<b>Estimated Useful Life</b>
Computer hardware and software	3 years
Leasehold improvements	3-5 years
Equipment	7 years
Furniture and fixtures	10 years

*Revenue Recognition*

The Company sells its products to wholesale distributors and, for certain products, directly to hospitals and clinics. Revenue from product sales is recognized when ownership of the product is transferred to the customer, the sales price is fixed and determinable, and collectibility is reasonably assured. Within the U.S. and certain foreign countries, revenue is recognized upon shipment (freight on board shipping point) since title to the product passes and the customers have assumed the risks and rewards of ownership. In certain other foreign countries, it is common practice that ownership transfers upon receipt of product and, accordingly, in these circumstances revenue is recognized upon

delivery (freight on board destination) when title to the product effectively transfers.

**Table of Contents**

The Company records allowances for product returns, chargebacks, rebates and prompt pay discounts at the time of sale, and reports revenue net of such amounts. In determining allowances for product returns, chargebacks and rebates, the Company must make significant judgments and estimates. For example, in determining these amounts, the Company estimates end-customer demand, buying patterns by end-customers and group purchasing organizations from wholesalers and the levels of inventory held by wholesalers. Making these determinations involves estimating whether trends in past buying patterns will predict future product sales.

A description of the Company's allowances requiring accounting estimates, and the specific considerations the Company uses in estimating these amounts, is as follows:

*Product returns.* The Company's customers have the right to return any unopened product during the 18-month period beginning 6 months prior to the labeled expiration date and ending 12 months past the labeled expiration date. As a result, in calculating the allowance for product returns, the Company must estimate the likelihood that product sold to wholesalers might remain in its inventory or in end-customers' inventories to within 6 months of expiration and analyze the likelihood that such product will be returned within 12 months after expiration.

To estimate the likelihood of product remaining in wholesalers' inventory to within six months of its expiration, the Company relies on information from its wholesalers regarding their inventory levels, measured end-customer demand as reported by third party sources, and on internal sales data. The Company believes the information from its wholesalers and third party sources is a reliable indicator of trends, but the Company is unable to verify the accuracy of such data independently. The Company also considers its wholesalers' past buying patterns, estimated remaining shelf life of product previously shipped and the expiration dates of product currently being shipped.

Since the Company does not have the ability to track a specific returned product back to its period of sale, the product returns allowance is primarily based on estimates of future product returns over the period during which customers have a right of return, which is in turn based in part on estimates of the remaining shelf life of products when sold to customers. Future product returns are estimated primarily based on historical sales and return rates.

At June 30, 2006 and December 31, 2005, the allowance for returns was \$0.7 million and \$0.6 million, respectively.

*Chargebacks and rebates.* Although the Company sells its products in the U.S. primarily to wholesale distributors, the Company typically enters into agreements with certain governmental health insurance providers, hospitals, clinics, and physicians, either directly or through group purchasing organizations acting on behalf of their members, to allow purchase of Company products at a discounted price and/or to receive a volume-based rebate. The Company provides a credit, or chargeback, to the wholesaler representing the difference between the wholesaler's acquisition list price and the discounted price paid to the wholesaler by the end-customer. Rebates are paid directly to the end-customer, group purchasing organization or government insurer.

As a result of these contracts, at the time of product shipment the Company must estimate the likelihood that product sold to wholesalers might be ultimately sold by the wholesaler to a contracting entity or group purchasing organization. For certain end-customers, the Company must also estimate the contracting entity's or group purchasing organization's volume of purchases.

The Company estimates its chargeback allowance based on its estimate of the inventory levels of its products in the wholesaler distribution channel that remain subject to chargebacks, and specific contractual and historical chargeback rates. The Company estimates its Medicaid rebate and commercial contractual rebate accruals based on estimates of usage by rebate-eligible customers, estimates of the level of inventory of its products in the distribution channel that remain potentially subject to those rebates, and terms of its contractual and regulatory obligations.

At June 30, 2006 and December 31, 2005, the allowance/accrual for chargebacks and rebates was \$2.9 million and \$2.6 million, respectively.

*Prompt pay discounts.* As incentive to expedite cash flow, the Company offers some customers a prompt pay discount whereby if they pay their accounts within 30 days of product shipment, they may take a 2% discount. As a result, the Company must estimate the likelihood that its customers will take the discount at the time of product shipment. In estimating the allowance for prompt pay discounts, the Company relies on past history of its customers payment patterns to determine the likelihood that future prompt pay discounts will be taken and for those customers that historically take advantage of the prompt pay discount, the Company increases the allowance accordingly.

At June 30, 2006 and December 31, 2005, the allowance for prompt pay discounts was \$0.4 million and \$0.5 million, respectively.

**Table of Contents**

The Company has adjusted the allowances for product returns, chargebacks and rebates and prompt pay discounts in the past based on differences between its estimates and its actual experience, and the Company will likely be required to make adjustments to these allowances in the future. The Company continually monitors the allowances and makes adjustments when the Company believes actual experience may differ from estimates.

*Cost of Sales*

Cost of sales includes the cost of product sold, royalties due on the sales of the products and the distribution and logistics costs related to selling the products. Cost of sales does not include product rights amortization expense as it is disclosed separately.

*Risks and Uncertainties*

The Company is subject to risks common to companies in the pharmaceutical industry including, but not limited to, uncertainties related to regulatory approvals, dependence on key products, dependence on key customers and suppliers, and protection of proprietary rights.

*Translation of Foreign Currencies*

The functional currencies of the Company's foreign subsidiaries are the local currencies, primarily the British pound sterling, euro and Swiss franc. In accordance with SFAS No. 52, Foreign Currency Translation, assets and liabilities are translated using the current exchange rate as of the balance sheet date. Income and expenses are translated using a weighted average exchange rate over the period ending on the balance sheet date. Adjustments resulting from the translation of the financial statements of the Company's foreign subsidiaries into U.S. dollars are excluded from the determination of net income (loss) and are accumulated in a separate component of stockholders equity. Foreign exchange transaction gains and losses, which to date have not been significant, are included in the results of operations.

*Research and Development*

Research and development costs include salaries, benefits and other personnel related expenses as well as fees paid to third parties for clinical development and regulatory services. Such costs are expensed as incurred.

*Acquired In-Process Research*

In January 2006, the Company entered into a license and collaboration agreement for the research, development and commercialization of MethylGene Inc.'s HDAC inhibitors, including its lead compound MGCD0103, in North America, Europe, the Middle East and certain other markets. Under the terms of the agreement, the Company made up front payments to MethylGene totaling \$25.0 million, including \$20.5 million for a license fee and the remainder as an equity investment in MethylGene common shares. The \$20.5 million license fee was immediately expensed as acquired in-process research as MGCD0103 has not yet achieved regulatory approval for marketing and, absent obtaining such approval, has no alternative future use.

*Concentration of Credit Risk*

Financial instruments which potentially subject the Company to concentrations of credit risk are primarily cash and cash equivalents, short-term investments and accounts receivable. The Company maintains its cash and investment balances in the form of money market accounts, debt and equity securities and overnight deposits with financial institutions that management believes are creditworthy. The Company has no financial instruments with off-balance-sheet risk of accounting loss.

The Company's products are sold both to wholesale distributors and directly to hospitals and clinics. Ongoing credit evaluations of customers are performed and collateral is generally not required. The Company maintains a reserve for potential credit losses, and such losses have been within management's expectations. Net revenues generated as a percent of total consolidated net revenues, for three largest customers in the U.S. were as follows for the six months ended June 30, 2006 and 2005:

**Table of Contents**

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Oncology Supply	19%	16%
Cardinal Health	12%	15%
McKesson Corporation	11%	15%

Net sales generated from international customers were individually less than 5% of consolidated net sales.

*Share-Based Compensation*

On January 1, 2006, the Company adopted SFAS No. 123R, Share-Based Payment which establishes accounting for share-based awards exchanged for employee services and requires companies to expense the estimated fair value of these awards over the requisite employee service period. Under SFAS No. 123R, share-based compensation cost is determined at the grant date using an option pricing model. The value of the award that is ultimately expected to vest is recognized as expense on a straight line basis over the employee's requisite service period. The Company adopted SFAS No. 123R using the modified prospective method. Under this method, prior periods are not restated for comparative purposes. Rather, compensation for awards outstanding, but not vested, at the date of adoption using the grant date value determined under SFAS No. 123, Accounting for Share-Based Compensation, as well as new awards granted after the date of adoption using the grant date value under SFAS No. 123R will be recognized as expense in the statement of operations over the remaining service period of the award.

The Company has estimated the fair value of each award using the Black-Scholes option pricing model, which was developed for use in estimating the value of traded options that have no vesting restrictions and that are freely transferable. The Black-Scholes model considers, among other factors, the expected life of the award and the expected volatility of the Company's stock price.

On November 10, 2005 the Financial Accounting Standards Board issued Staff Position No. FAS 123R-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards ( FAS 123R-3 ). The Company has elected to adopt the alternative transition method provided in FAS 123R-3 for calculating the tax effects of stock-based compensation pursuant to SFAS No. 123R. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee stock-based compensation expense, which is available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123R.

Prior to the adoption of SFAS No. 123R, the Company accounted for share-based payment awards to employees and directors in accordance with APB 25 as allowed under SFAS No. 123. In accordance with APB 25, the Company recorded deferred compensation in connection with stock options granted in 2003 under the intrinsic value method. The amount of deferred compensation was equal to the difference between the exercise price of the stock options granted to employees and the higher fair market value of the underlying stock at the date of grant. The deferred compensation was recognized ratably over the vesting period of these options as stock-based compensation expense up to the adoption of SFAS No. 123R. Upon adoption, the unamortized deferred compensation balance was eliminated with a corresponding reduction to additional paid in capital.

*Adoption of SFAS No. 123R*

Employee share-based compensation expense recognized in 2006 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures at an expected rate of 15 percent. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The post-vesting forfeiture rate was based on the Company's historical option cancellations. There was no impact to cash flows or financial position upon adoption.

**Table of Contents**

Share-based compensation expense recognized under SFAS No. 123R was (in thousands, except for per share data):

	<b>Three Months Ended June 30, 2006</b>	<b>Six Months Ended June 30, 2006</b>
Research and development	\$ 215	\$ 440
Selling, general and administrative	572	1,122
Total share-based compensation expense	\$ 787	\$ 1,562
Share-based compensation expense, per common share:		
Basic and Diluted	\$ 0.02	\$ 0.05

*Pro Forma Information for Periods Prior to Adoption of SFAS No. 123R*

The following pro forma net income and earnings per share were determined as if we had accounted for employee share-based compensation for our employee stock plans under the fair value method prescribed by SFAS No. 123. (in thousands, except for per share data):

	<b>Three Months Ended June 30, 2005</b>	<b>Six Months Ended June 30, 2005</b>
Net income as reported	\$ 5,554	\$ 9,823
Plus: share-based compensation recognized under the intrinsic value method	52	108
Less: share-based compensation under fair value method	(1,891)	(3,872)
Pro forma net income	\$ 3,715	\$ 6,059
Net income per common share:		
Basic, as reported	\$ 0.17	\$ 0.31
Basic, pro forma	\$ 0.12	\$ 0.19
Diluted, as reported	\$ 0.17	\$ 0.30
Diluted, pro forma	\$ 0.11	\$ 0.18

*Valuation assumptions used to determine fair value of share based compensation*

The employee share-based compensation expense recognized under SFAS No. 123R and presented in the pro forma disclosure required under SFAS No. 123 was determined using the Black-Scholes option valuation model. Option valuation models require the input of subjective assumptions and these assumptions can vary over time. The weighted-average assumptions used include:

<b>Three Months Ended June 30,</b>	<b>Six Months Ended June 30,</b>
--	--------------------------------------

Edgar Filing: PHARMION CORP - Form 10-Q

	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Risk-free interest rate	4.8%	3.9%	4.7%	3.8%
Expected stock price volatility	41%	50%	41%	58%
Expected option term until exercise	4.1 years	4.0 years	4.1 years	4.0 years
Expected dividend yield	0%	0%	0%	0%

The risk free interest rate was derived from the US Treasury yield in effect at the time of grant with terms similar to the contractual life of the option. The expected life of the options was estimated using peer data of companies in the life science industry with similar equity plans.

The weighted-average fair value per share was \$6.90 and \$9.70 for stock options granted in the three months ended June 30, 2006 and 2005, respectively. The weighted-average fair value per share was \$6.72 and \$15.92 for stock options granted in the six months ended June 30, 2006 and 2005, respectively.

As of June 30, 2006, there was approximately \$6.7 million of total unrecognized compensation cost related to nonvested stock options granted under the Company's plans. This cost is expected to be recognized over a weighted average period of 2.9 years.

**Table of Contents**

A summary of the option activity for the six months ended June 30, 2006 was as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2005	3,386,858	\$ 20.60		
Granted	167,325	\$ 19.02		
Exercised	(138,576)	\$ 3.71		
Terminated	(496,417)	\$ 32.51		
Outstanding, June 30, 2006	2,919,190	\$ 19.29	5.22	\$ 11,607
Vested and expected to vest, June 30, 2006	2,378,848	\$ 19.38	5.03	\$ 10,893
Exercisable, June 30, 2006	1,714,975	\$ 19.49	4.60	\$ 10,227

On May 24, 2006, the Company completed its previously announced Offer to Exchange Outstanding Options to Purchase Common Stock (the Offer) under which the Company accepted for exchange certain outstanding options to purchase the Company's common stock for cancellation and issued new options to purchase a lesser number of shares of common stock at an exercise price per share equal to the fair market value on the closing date of the Offer. The Company's executive officers and directors were not eligible to participate in the Offer. As a result of the Offer, the Company accepted for cancellation, options to purchase an aggregate of 282,940 shares of common stock, versus 286,950 shares as reported on May 24, 2006. The Company issued new options to purchase an aggregate of 99,825 shares of common stock, versus 101,425 shares previously reported on May 24, 2006.

The intrinsic value of options exercised during the six months ended June 30, 2006 and 2005 was \$2.1 million and \$1.6 million, respectively.

The following table summarizes the options that are outstanding and exercisable at June 30, 2006:

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number of Shares Outstanding	Weighted Average Remaining Contractual Term (years)	Weighted Average Exercise Price	Number of Shares Outstanding	Weighted Average Remaining Contractual Term (years)	Weighted Average Exercise Price
\$0.40 to 2.40	705,339	3.42	\$ 1.94	638,742	3.41	\$ 1.91
\$2.41 to 18.20	412,936	4.94	\$ 14.80	189,486	4.44	\$ 14.04
\$18.21 to 18.49	485,000	6.44	\$ 18.49			\$
\$18.50 to 21.54	424,270	5.91	\$ 20.98	290,453	5.35	\$ 21.36
\$21.55 to 35.15	461,927	5.87	\$ 27.57	179,076	5.43	\$ 31.91

Edgar Filing: PHARMION CORP - Form 10-Q

\$35.16 to 52.27	429,718	5.68	\$ 42.43	417,218	5.60	\$ 42.25
Total	2,919,190	5.22	\$ 19.29	1,714,975	4.60	\$ 19.49

The following table presents a summary of the Company's non-vested shares of restricted stock granted as of June 30, 2006:

	<b>Number of Shares</b>	<b>Weighted Average Fair Value at Grant Date</b>
Non-vested at December 31, 2005		\$
Granted	50,850	\$ 17.90
Vested		\$
Terminated		\$
Non-vested, June 30, 2006	50,850	\$ 17.90

The restricted stock grants vest over a four year period, with 25% of the award vesting on the first year anniversary date. Thereafter, the award vests in equal installments of 6.25% on a quarterly basis. Expense of approximately \$55,000 was recognized in the six months ended June 30, 2006 with the remaining expense of approximately \$0.9 million to be recognized over a weighted average period of 3.8 years.

**Table of Contents****NOTE 3. NET INCOME (LOSS) PER COMMON SHARE**

The Company applies SFAS No. 128, Earnings per Share, which establishes standards for computing and presenting earnings per share. Basic net income (loss) per common share is calculated by dividing net income (loss) applicable to common stockholders by the weighted average number of unrestricted common shares outstanding for the period. Diluted net loss per common share is the same as basic net loss per common share for the three and six months ended June 30, 2006, since the effects of potentially dilutive securities were antidilutive for that period. Diluted net income per common share is calculated by dividing net income applicable to common stockholders by the weighted average number of common shares outstanding for the period increased to include all additional common shares that would have been outstanding assuming the issuance of potentially dilutive common shares. Potential incremental common shares include shares of common stock issuable upon exercise of stock options outstanding during the periods presented.

A reconciliation of the weighted average number of shares used to calculate basic and diluted net income (loss) per common share is as follows (in thousands):

	<b>Three Months Ended June</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Basic	32,007	31,822	31,963	31,814
Effect of dilutive securities:				
Stock options		1,034		1,132
Diluted	32,007	32,856	31,963	32,946

The total number of potential common shares excluded from diluted earnings per share computation because they were anti-dilutive was 1,740,136 and 1,048,356 for the three months ended June 30, 2006 and 2005, respectively, and 1,967,549 and 921,929 for the six months ended June 30, 2006 and 2005, respectively.

**NOTE 4. LICENSE AGREEMENTS AND PRODUCT RIGHTS**

The cost value and accumulated amortization associated with the Company's product rights was as follows (in thousands):

	<b>As of June 30, 2006</b>		<b>As of December 31, 2005</b>	
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>
Amortized product rights:				
Thalidomide	\$ 102,731	\$ (13,831)	\$ 101,837	\$ (9,690)
Refludan	12,208	(4,234)	12,208	(3,560)
Innohep	5,000	(2,000)	5,000	(1,750)
Total product rights	\$ 119,939	\$ (20,065)	\$ 119,045	\$ (15,000)

***Thalidomide***

In 2001, the Company licensed rights relating to the development and commercial use of thalidomide from Celgene Corporation and separately entered into an exclusive supply agreement for thalidomide with Celgene U.K. Manufacturing II Limited (formerly known as Penn T Limited), or CUK, which was acquired by Celgene in 2004. Under the agreements, as amended in December 2004, the territory licensed from Celgene is for all countries other than the United States, Canada, Mexico, Japan and all provinces of China (except Hong Kong). The Company pays (i) Celgene a royalty/license fee of 8% on the Company's net sales of thalidomide under the terms of the license agreements, and (ii) CUK product supply payments equal to 15.5% of the Company's net sales of thalidomide under

the terms of the product supply agreement. The agreements with Celgene and CUK each have a ten-year term commencing on the date of receipt of the Company's first regulatory approval for thalidomide in the United Kingdom.

**Table of Contents**

In December 2004, the Company amended its thalidomide agreements with Celgene and CUK to reduce the thalidomide product supply payment, expand the Company's licensed territory, and eliminate certain license termination rights held by Celgene. The Company paid Celgene a one-time payment of \$80 million in exchange for (i) the reduction in the cost of product supply from 28.0% of net sales to 15.5% of net sales, (ii) the addition of Korea, Hong Kong, and Taiwan to the Company's licensed territory and, (iii) elimination of Celgene's right to terminate the license agreement in the event the Company has not obtained a marketing authorization approval for thalidomide in the United Kingdom by November 2006. The \$80 million payment was capitalized as part of the thalidomide product rights and is being amortized over the remaining period the Company expects to generate significant thalidomide sales, approximately 12 years from December 31, 2005.

The Company has also committed to provide funding to support further clinical development studies of thalidomide sponsored by Celgene. Under these agreements, the Company has paid Celgene \$12.0 million through June 30, 2006 and will provide payments of \$1.3 million over the last six months of 2006 and \$2.7 million in 2007.

In connection with a third party patent dispute associated with thalidomide, the Company agreed to make a \$5.0 million payment in 2005, with two \$1.0 million payments due in 2006 and 2007. Accordingly, these amounts increased the thalidomide product rights.

In connection with the 2003 acquisition of Laphal, the Company acquired rights to Laphal's formulation of thalidomide. The portion of the purchase price allocated to thalidomide has been included in product rights, net on the accompanying balance sheet.

***Vidaza***

In 2001, the Company licensed worldwide rights to Vidaza (azacitidine) from Pharmacia & Upjohn Company, now part of Pfizer, Inc. Under terms of the license agreement, the Company is responsible for all costs to develop and market Vidaza and the Company pays Pfizer a royalty of 8% to 20% of Vidaza net sales. No up-front or milestone payments have been or will be made to Pfizer. The license has a term extending for the longer of the last to expire of valid patent claims in any given country or ten years from the first commercial sale of the product in a particular country.

***Satraplatin***

In December 2005, the Company entered into a co-development and license agreement with GPC Biotech for satraplatin, an oral platinum-based compound in advanced clinical development. Under the terms of the agreement, the Company obtained exclusive commercialization rights for Europe, Turkey, the Middle East, Australia and New Zealand, while GPC Biotech retained rights to the North American market and all other territories. In January 2006, the Company made an up front payment of \$37.1 million to GPC Biotech, including a \$21.2 million reimbursement for satraplatin clinical development costs incurred prior to the agreement and \$15.9 million for funding of ongoing and certain future clinical development to be conducted jointly by the Company and GPC Biotech. The Company and GPC Biotech will pursue a joint development plan to evaluate development activities for satraplatin in a variety of tumor types and will share global development costs, for which the Company has made an additional commitment of \$22.2 million, in addition to the \$37.1 million in initial payments. The Company could also pay GPC Biotech \$30.5 million based on the achievement of certain regulatory filing and approval milestones, and up to an additional \$75 million for up to five subsequent European approvals for additional indications. GPC Biotech will also receive royalties on sales of satraplatin in the Company's territories at rates of 26% to 30% on annual sales up to \$500 million, and 34% on annual sales over \$500 million. Finally, the Company could pay GPC Biotech sales milestones totaling up to \$105 million, based on the achievement of significant annual sales levels in its territories.

***MethylGene***

In January 2006, the Company entered into a license and collaboration agreement for the research, development and commercialization of MethylGene Inc.'s HDAC inhibitors, including its lead compound MGCD0103, in North America, Europe, the Middle East and certain other markets. Under the terms of the agreement, the Company made up front payments to MethylGene totaling \$25 million, including a \$20.5 million license fee and the remainder as an equity investment in MethylGene common shares. The common shares were purchased at a subscription price of CDN \$3.125 which represented a 25% premium over the market closing price on January 27, 2006. Subsequent to the transaction, the Company had a 7.8% ownership in MethylGene. The ownership interest was initially recorded at fair

value and is now accounted for as a long-term available-for-sale security, which is classified in other assets.

MGCD0103 is currently in Phase I/II development and has a number of clinical studies underway. Under the terms of the license agreement, MethylGene will initially fund 40% of the preclinical and clinical development for MGCD0103 (and any additional second

**Table of Contents**

generation compounds) required, to obtain marketing approval in North America, while the Company will fund 60% of such costs. MethylGene will receive royalties on net sales in North America ranging from 13% to 21%. The royalty rate paid to MethylGene will be determined based upon the level of annual net sales achieved in North America and the length of time development costs are funded by MethylGene. MethylGene will have an option, at its sole discretion, as long as it continues to fund development, to co-promote approved products and, in lieu of receiving royalties, to share the resulting net profits equally with the Company. If MethylGene exercises its right, at its sole discretion, to discontinue development funding, the Company will be responsible for 100% of development costs incurred thereafter.

In all other licensed territories, which include Europe, the Middle East, Turkey, Australia, New Zealand, South Africa and certain countries in Southeast Asia, the Company is responsible for development and commercialization costs and MethylGene will receive a royalty on net sales in those markets at a rate of 10% to 13% based on annual net sales.

**Refludan**

In May 2002, the Company entered into agreements to acquire the exclusive right to market and distribute Refludan in all countries outside the U.S. and Canada. These agreements, as amended in August 2003, transferred all marketing authorizations and product registrations for Refludan in the individual countries within the Company's territories. The Company has paid Schering an aggregate of \$13 million to date and has capitalized to product rights \$12.2 million, which is being amortized over a 10 year period during which the Company expects to generate revenue. Additional payments of up to \$7.5 million will be due Schering upon achievement of certain milestones. Because such payments are contingent upon future events, they are not reflected in the accompanying financial statements. In addition, the Company pays Schering a royalty of 14% of net sales of Refludan until the aggregate royalty payments total \$12.0 million measured from January 2004. At that time, the royalty rate will be reduced to 6%.

**Innohep**

In June 2002, the Company entered into a ten-year agreement with LEO Pharma A/S for the license of the low molecular weight heparin, Innohep. Under the terms of the agreement, the Company acquired an exclusive right and license to market and distribute Innohep in the United States. On the closing date the Company paid \$5 million for the license, which was capitalized as product rights and is being amortized over a 10 year period in which the Company expects to generate significant sales. In addition, the Company is obligated to pay LEO Pharma royalties at the rate of 30% of net sales on annual net sales of up to \$20 million and at the rate of 35% of net sales on annual net sales exceeding \$20 million, less in each case the Company's purchase price from LEO Pharma of the units of product sold. Furthermore, the agreement contains a minimum net sales clause that is effective for two consecutive two-year periods. If the Company does not achieve these minimum sales levels for two consecutive years, it has the right to pay LEO Pharma additional royalties up to the amount LEO Pharma would have received had the Company achieved these net sales levels. If the Company opts not to make the additional royalty payment, LEO Pharma has the right to terminate the license agreement. The second of the two-year terms will conclude on December 31, 2006.

**NOTE 5. OTHER COMPREHENSIVE INCOME (LOSS)**

The Company reports comprehensive income (loss) in accordance with the provisions of SFAS No. 130, Reporting Comprehensive Income. Comprehensive income (loss) includes all changes in equity for cumulative translation adjustments resulting from the consolidation of foreign subsidiaries and unrealized gains and losses on available-for-sale securities.

Total comprehensive income (loss) for the three and six months ended June 30, 2006 and 2005 was (in thousands):

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net income (loss)	\$(3,514)	\$ 5,554	\$(23,250)	\$ 9,823
Other comprehensive income (loss), net of tax:				
Foreign currency translation gain (loss)	2,962	(4,863)	4,790	(7,291)
	(1,070)	103	476	55

Unrealized gain (loss) on available-for-sale securities

Comprehensive income (loss)	\$ (1,622)	\$ 794	\$ (17,984)	\$ 2,587
-----------------------------	------------	--------	-------------	----------

**Table of Contents**

The foreign currency translation amounts relate to the operating results of our foreign subsidiaries.

**NOTE 6. INCOME TAXES**

Income taxes have been provided for using the liability method in accordance with SFAS No. 109, Accounting for Income Taxes. The provision for income taxes reflects management's estimate of the effective tax rate expected to be applicable for the full fiscal year for each country in which we do business. This estimate is re-evaluated by management each quarter based on the Company's estimated tax expense for the year. Income tax expense for the three and six months ended June 30, 2006 and 2005 resulted primarily from taxable income generated in certain foreign jurisdictions.

**NOTE 7. GEOGRAPHIC INFORMATION**

Domestic and foreign financial information for the three and six months ended June 30, 2006 and 2005 was (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
United States net sales	\$ 36,796	\$ 32,066	\$ 70,583	\$ 60,981
Foreign entities net sales	23,570	24,191	46,377	47,013
Total net sales	\$ 60,366	\$ 56,257	\$ 116,960	\$ 107,994
United States operating income (loss)	\$ 315	\$ 4,294	\$ (7,578)	\$ 8,981
Foreign entities operating income (loss)	(3,444)	2,198	(14,734)	2,919
Total operating income (loss)	\$ (3,129)	\$ 6,492	\$ (22,312)	\$ 11,900

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

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the condensed financial statements and the related notes that appear elsewhere in this document. This Quarterly Report on Form 10-Q should also be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

**FORWARD-LOOKING STATEMENTS**

All statements, trend analysis and other information contained in this Form 10-Q that are not historical in nature are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, without limitation, discussion relative to markets for our products and trends in sales, gross margins and anticipated expense levels, as well as other statements including words such as "anticipate," "believe," "plan," "estimate," "expect" and "intend" and other similar expressions. All statements regarding our expected financial position and operating results, business strategy, financing plans, forecast trends relating to our industry are forward-looking statements. These forward-looking statements are subject to business and economic risks and uncertainties, and our actual results of operations may differ materially from those contained in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those mentioned in the discussion below and the factors set forth under "Risk Factors" below and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005. As a result, you should not place undue reliance on these forward-looking statements. We undertake no obligation to revise these forward-looking statements to reflect future events or developments.

**Overview**

We are a global pharmaceutical company focused on acquiring, developing and commercializing innovative products for the treatment of hematology and oncology patients. We have established our own regulatory, development and sales and marketing organizations covering the U.S., Europe and Australia. We have also developed a distributor network to cover the hematology and oncology markets in numerous additional countries throughout

Europe, the Middle East and Asia. To date, we have acquired the rights to six products, including four that are currently marketed or sold on a compassionate use or named patient basis, and two products that are in varying stages of development.

**Table of Contents**

In May 2004, Vidaza® was approved for marketing in the U.S. and we commenced sales of the product in July 2004. Pending positive data from an ongoing Phase III/IV study, we plan to file for marketing approval in the European Union (E.U.) in 2007. Until Vidaza is approved, we intend to sell Vidaza on a compassionate use and named patient basis throughout the major markets in the E.U. We have filed for approval to market Vidaza in certain other international markets and these submissions are under review by the respective regulatory authorities.

Thalidomide Pharmion 50mg(tm) is being sold by us on a compassionate use or named patient basis in Europe and other international markets while we pursue marketing authorization in those markets. In addition, we sell Innohep® in the U.S. and Recludan® in Europe and other international markets.

In December 2005, we entered into a co-development and license agreement with GPC Biotech for satraplatin, an oral platinum-based compound in advanced clinical trials. Under the terms of the agreement, we obtained exclusive commercialization rights for Europe, Turkey, the Middle East, Australia and New Zealand. Enrollment in a Phase III study examining satraplatin as a second line treatment for hormone refractory prostate cancer was completed in the fourth quarter of 2005 and data from this study is expected to be available in late 2006.

In January 2006, we entered into a license and collaboration agreement with MethylGene for the research, development and commercialization of the oncology applications of MethylGene's histone deacetylase (HDAC) inhibitors in North America, Europe, the Middle East and certain other international markets, including MGCD0103, MethylGene's lead HDAC inhibitor, which is currently in several Phase I and Phase II clinical trials.

With our combination of regulatory, development and commercial capabilities, we intend to continue to build a balanced portfolio of approved and pipeline products targeting the hematology and oncology markets.

**Critical Accounting Policies*****Revenue Recognition***

We sell our products to wholesale distributors and, for certain products, directly to hospitals and clinics. Revenue from product sales is recognized when ownership of the product is transferred to the customer, the sales price is fixed and determinable, and collectibility is reasonably assured. Within the U.S. and certain foreign countries, revenue is recognized upon shipment (freight on board shipping point) since title to the product passes and the customers have assumed the risks and rewards of ownership. In certain other foreign countries, it is common practice that ownership transfers upon receipt of product and, accordingly, in these circumstances revenue is recognized upon delivery (freight on board destination) when title to the product effectively transfers.

We record allowances for product returns, chargebacks, rebates and prompt pay discounts at the time of sale, and report revenue net of such amounts. In determining allowances for product returns, chargebacks and rebates, we must make significant judgments and estimates. For example, in determining these amounts, we estimate end-customer demand, buying patterns by end-customers and group purchasing organizations from wholesalers and the levels of inventory held by wholesalers. Making these determinations involves estimating whether trends in past buying patterns will predict future product sales.

A description of our allowances requiring accounting estimates, and the specific considerations we use in estimating these amounts, are as follows:

*Product returns.* Our customers have the right to return any unopened product during the 18-month period beginning 6 months prior to the labeled expiration date and ending 12 months past the labeled expiration date. As a result, in calculating the allowance for product returns, we must estimate the likelihood that product sold to wholesalers might remain in its inventory or in end-customers inventories to within 6 months of expiration and analyze the likelihood that such product will be returned within 12 months after expiration.

To estimate the likelihood of product remaining in wholesalers' inventory to within six months of its expiration, we rely on information from our wholesalers regarding their inventory levels, measured end-customer demand as reported by third party sources, and on internal sales data. We believe the information from our wholesalers and third party sources is a reliable indicator of trends, but we are unable to verify the accuracy of such data independently. We also consider our wholesalers' past buying patterns, estimated remaining shelf life of product previously shipped and the expiration dates of product currently being shipped.

**Table of Contents**

Since we do not have the ability to track a specific returned product back to its period of sale, the product returns allowance is primarily based on estimates of future product returns over the period during which customers have a right of return, which is in turn based in part on estimates of the remaining shelf life of products when sold to customers. Future product returns are estimated primarily based on historical sales and return rates.

The allowance for returns was \$0.7 million at June 30, 2006 and \$0.6 million at December 31, 2005.

*Chargebacks and rebates.* Although we sell our products in the U.S. primarily to wholesale distributors, we typically enter into agreements with certain governmental health insurance providers, hospitals, clinics, and physicians, either directly or through group purchasing organizations acting on behalf of their members, to allow purchase of our products at a discounted price and/or to receive a volume-based rebate. We provide a credit to the wholesaler, or a chargeback, representing the difference between the wholesaler's acquisition list price and the discounted price paid to the wholesaler by the end-customer. Rebates are paid directly to the end-customer, group purchasing organization or government insurer.

As a result of these contracts, at the time of product shipment we must estimate the likelihood that product sold to wholesalers might be ultimately sold by the wholesaler to a contracting entity or group purchasing organization. For certain end-customers, we must also estimate the contracting entity's or group purchasing organization's volume of purchases.

We estimate our chargeback allowance based on our estimate of the inventory levels of our products in the wholesaler distribution channel that remain subject to chargebacks, and specific contractual and historical chargeback rates. We estimate our Medicaid rebate and commercial contractual rebate accruals based on estimates of usage by rebate-eligible customers, estimates of the level of inventory of our products in the distribution channel that remain potentially subject to those rebates, and terms of our contractual and regulatory obligations.

The allowance/accrual for chargebacks and rebates was \$2.9 million at June 30, 2006 and \$2.6 million at December 31, 2005.

*Prompt pay discounts.* As incentive to expedite cash flow, we offer some customers a prompt pay discount whereby if they pay their accounts within 30 days of product shipment, they may take a 2% discount. As a result, we must estimate the likelihood that our customers will take the discount at the time of product shipment. In estimating the allowance for prompt pay discounts, we rely on past history of our customers' payment patterns to determine the likelihood that future prompt pay discounts will be taken and for those customers that historically take advantage of the prompt pay discount, we increase the allowance accordingly.

The allowance for prompt pay discounts was \$0.4 million at June 30, 2006 and \$0.5 million at December 31, 2005.

We have adjusted the allowances for product returns, chargebacks and rebates and prompt pay discounts in the past based on differences between our estimates and our actual experience, and we will likely be required to make adjustments to these allowances in the future. We continually monitor the allowances and make adjustments when we believe actual experience may differ from estimates.

***Cost of sales***

Cost of sales includes the cost of product sold, royalties due on the sales of the products and the distribution and logistics costs related to selling the products. Cost of sales does not include product rights amortization expense as it is disclosed separately.

***Inventories***

Inventories are stated at the lower of cost or market, cost being determined under the first-in, first-out method. We periodically review inventories and items considered outdated or obsolete are reduced to their estimated net realizable value. We estimate reserves for excess and obsolete inventories based on inventory levels on hand, future purchase commitments, product expiration dates and current and forecasted product demand. If an estimate of future product demand suggests that inventory levels are excessive, then inventories are reduced to their estimated net realizable value.

**Table of Contents*****Long-Lived Assets***

Our long-lived assets consist primarily of product rights and property and equipment. In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we evaluate our ability to recover the carrying value of long-lived assets used in our business, considering changes in the business environment or other facts and circumstances that suggest their value may be impaired. If this evaluation indicates the carrying value will not be recoverable, based on the undiscounted expected future cash flows estimated to be generated by these assets, we reduce the carrying amount to the estimated fair value.

***Goodwill***

In association with a business acquisition in 2003 and related milestone payments that were made in 2004 and 2005, goodwill was created. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, we do not amortize goodwill. SFAS No. 142 requires us to perform an impairment review of goodwill at least annually. We perform an evaluation in the fourth quarter of each year. If it is determined that the value of goodwill is impaired, we will record the impairment charge in the statement of operations in the period it is discovered. The process of reviewing for impairment of goodwill is similar to that of long-lived assets in that expected future cash flows are calculated using estimated future events and trends such as sales, cost of sales, operating expenses and income taxes. The actual results of any of these factors could be materially different than what we estimate.

***Acquired in-process research***

In January 2006, we entered into a license and collaboration agreement for the research, development and commercialization of MethylGene Inc.'s HDAC inhibitors, including its lead compound MGCD0103, in North America, Europe, the Middle East and certain other markets. Under the terms of the agreement, we made up front payments to MethylGene totaling \$25.0 million, including \$20.5 million for a license fee and the remainder as an equity investment in MethylGene common shares. The \$20.5 million license fee was immediately expensed as acquired in-process research as MGCD0103 has not yet achieved regulatory approval for marketing and, absent obtaining such approval, has no alternative future use.

***Accounting for Share-Based Compensation***

On January 1, 2006, we adopted SFAS No. 123R, Share-Based Payment which establishes accounting for share-based awards exchanged for employee services and requires companies to expense the estimated fair value of these awards over the requisite employee service period. Under SFAS No. 123R, share-based compensation cost is determined at the grant date using an option pricing model. The value of the award that is ultimately expected to vest is recognized as expense on a straight line basis over the employee's requisite service period. We adopted SFAS No. 123R using the modified prospective method. Under this method, prior periods are not restated for comparative purposes. Rather, compensation for awards outstanding, but not vested, at the date of adoption using the grant date value determined under SFAS No. 123, Accounting for Share-Based Compensation, as well as new awards granted after the date of adoption using the grant date value under SFAS No. 123R will be recognized as expense in the statement of operations over the remaining service period of the award.

We have estimated the fair value of each award using the Black-Scholes option pricing model, which was developed for use in estimating the value of traded options that have no vesting restrictions and that are freely transferable. The Black-Scholes model considers, among other factors, the expected life of the award and the expected volatility of our stock price. Option valuation models require the input of subjective assumptions and these assumptions can vary over time.

Prior to the adoption of SFAS No. 123R, we accounted for share-based payment awards to employees and directors in accordance with APB 25 as allowed under SFAS No. 123. In accordance with APB 25, we recorded deferred compensation in connection with stock options granted in 2003 under the intrinsic value method. The amount of deferred compensation was equal to the difference between the exercise price of the stock options granted to employees and the higher fair market value of the underlying stock at the date of grant. The deferred compensation was recognized ratably over the vesting period of these options as share-based compensation expense up to the adoption of SFAS No. 123R. Upon adoption, the unamortized deferred compensation balance was eliminated with a corresponding reduction to additional paid in capital.

Employee share-based compensation expense recognized in 2006 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

**Table of Contents**

The overall impact of adopting SFAS No. 123R was an increase of \$0.8 million and \$1.6 million in operating expenses for the three and six months ended June 30, 2006. As of June 30, 2006, total compensation cost related to nonvested stock options not yet recognized in the statement of operations was \$6.7 million, which is estimated to be expensed over a weighted average period of 2.9 years.

**NET INCOME (LOSS) PER COMMON SHARE**

The total number of potential common shares excluded from diluted earnings per share computation because they were anti-dilutive was 1,740,136 and 1,048,356 for the three months ended June 30, 2006 and 2005, respectively, and 1,967,549 and 921,929 for the six months ended June 30, 2006 and 2005, respectively.

**Results of Operations****Comparison of the Company's Results for the Three Months Ended June 30, 2006 and 2005**

*Net sales.* Net sales totaled \$60.4 million for the three months ended June 30, 2006 as compared to \$56.3 million for the three months ended June 30, 2005. Net sales included \$36.8 million and \$32.1 million in the U.S. for the three months ended June 30, 2006 and 2005, respectively and \$23.6 million and \$24.2 million in Europe and other countries for the three months ended June 30, 2006 and 2005, respectively. The primary reason for the net sales increase is due to the growth of Vidaza sales in the U.S. as well as increases in compassionate use sales of Vidaza in Europe and other countries. Vidaza net sales increased to \$36.1 million for the three months ended June 30, 2006 as compared to \$31.5 million for the three months ended June 30, 2005. The increase was the result of Vidaza being a more established drug having been on the U.S. market for nearly two years, as well as having greater visibility to physicians due to increased marketing and educational efforts. In addition, we began selling Vidaza on a compassionate use basis in Europe in 2006. Such sales totaled approximately \$2 million for the three month ended June 30, 2006. The increase in Vidaza net sales was partially offset by a decrease in thalidomide sales, which totaled \$19.1 million for the three months ended June 30, 2006, as compared to \$21.4 million for the quarter ended June 30, 2005. The decrease in thalidomide sales was due primarily to the introduction of new competition, the increased availability of thalidomide from other suppliers, and reimbursement resistance in certain markets.

Reductions from gross to net sales, which include product returns, chargebacks, rebates and prompt pay discounts totaled \$4.5 million and \$4.7 million for the three months ended June 30, 2006 and 2005, respectively. As a percentage of gross sales, the reductions were 7.0% for the second quarter of 2006 versus 7.7% for the second quarter in 2005.

*Cost of sales.* Cost of sales for the three months ended June 30, 2006 totaled \$16.7 million compared to \$15.1 million for the three months ended June 30, 2005. Cost of sales reflects the cost of product sold plus royalties due on the sales of our products as well as the distribution costs related to selling our products. However, product rights amortization is excluded from cost of sales and included separately with operating expenses. The increase was the direct result of the increase in net sales. Our gross margin was 72% for the three months ended June 30, 2006 compared to 73% for the same period in 2005. We expect the gross margin for our products will remain in the low 70% range for the foreseeable future.

*Research and development expenses.* Research and development expenses totaled \$18.4 million for the three months ended June 30, 2006 as compared to \$9.8 million for the three months ended June 30, 2005. These expenses generally consist of regulatory, clinical and manufacturing development, and medical and safety monitoring costs for our products. Increased development expenses resulting from the licensing of satraplatin and the MethylGene HDAC inhibitor program resulted in \$4.2 million of the increase. Growth in clinical study costs for Vidaza and thalidomide, as well as alternative formulation and back-up manufacturer development costs for Vidaza amounted to \$3.0 million of the increase. We expect research and development expenses to continue to grow for the remainder of 2006 as the development programs for our products mature.

*Selling, general and administrative expenses.* Selling, general and administrative expenses totaled \$26.0 million for the three months ended June 30, 2006 as compared to \$22.6 million for the three months ended June 30, 2005. Sales and marketing expenses increased to \$19.4 million for the three months ended June 30, 2006 from \$15.2 million for the comparable period of 2005. The expansion of our field-based headcount in the U.S. and increased Vidaza marketing activities in response to new competitive products that were launched in 2006 increased sales and marketing expenses by \$2.7 million. Additionally, we continued to increase pre-approval marketing costs for

thalidomide, Vidaza and satraplatin in Europe and other international markets which accounted for the remaining \$1.5 million increase.

**Table of Contents**

General and administrative expenses totaled \$6.6 million for the three months ended June 30, 2006 as compared to \$7.4 million for the three months ended June 30, 2005. The decrease is the result of \$1.7 million of relocation expenses associated with the move of our European headquarters incurred in 2005. This decrease was partially offset in the current quarter by a \$0.9 million increase in personnel costs for general and administrative functions such as finance, human resources and information technology. These personnel costs were incurred to support the significant growth we have experienced as a company.

*Product rights amortization.* Product rights amortization totaled \$2.4 million for the three months ended June 30, 2006 as compared to \$2.2 million for the three months ended June 30, 2005. The increase is due to an addition to thalidomide product rights in June 2005 such that the prior year quarter only had one month of the additional amortization versus three months in the current year quarter.

*Interest and other income, net.* Interest and other income, net, totaled \$1.7 million for the three months ended June 30, 2006, compared with \$1.2 million for the second quarter of 2005. Although we experienced a decrease in cash, cash equivalents, and short-term investments as a result of the up front payments made to GPC Biotech and MethylGene in the first quarter of 2006, this has been offset by the improved investment returns due to higher interest rates for investments in the current quarter versus the comparable period in 2005.

*Income tax expense.* Income tax expense totaled \$2.1 million for the three months ended June 30, 2006 as compared to \$2.2 million for the three months ended June 30, 2005. The provision for income taxes reflects management's estimate of the effective tax rate expected to be applicable for the full fiscal year in each of our taxing jurisdictions. Although our income before taxes decreased significantly in the second quarter of 2006 as compared to 2005, this had minimal impact on our tax expense as much of the decline in pre tax income was incurred in jurisdictions where we incurred minimal tax expense in 2005.

***Comparison of the Company's Results for the Six Months Ended June 30, 2006 and 2005***

*Net sales.* Net sales totaled \$117.0 million for the six months ended June 30, 2006 as compared to \$108.0 million for the six months ended June 30, 2005. Net sales included \$70.6 million and \$61.0 million in the U.S. and \$46.4 million and \$47.0 million in Europe and other countries for the six months ended June 30, 2006 and 2005, respectively. The primary reason for the net sales increase is due to the growth of Vidaza sales in the U.S. as well as increases in compassionate use sales of Vidaza in Europe and other countries. Vidaza net sales increased to \$69.0 million for the six months ended June 30, 2006 as compared to \$59.0 million for the six months ended June 30, 2005. The increase was the result of Vidaza being a more established drug, having been on the market for more than one year, and having greater visibility to physicians due to increased marketing and educational efforts. In addition, we began selling Vidaza on a compassionate use basis in Europe in 2006. Such sales totaled approximately \$3 million for the six months ended June 30, 2006. The increase in Vidaza net sales was partially offset by a decrease in thalidomide sales, which totaled \$38.6 million for the six months ended June 30, 2006, as compared to \$41.7 million for the six months ended June 30, 2005. The decrease in thalidomide sales was due primarily to the introduction of new competition, increased availability of thalidomide from other suppliers, and reimbursement resistance in certain markets.

Reductions from gross to net sales, which include product returns, chargebacks, rebates and prompt pay discounts totaled \$9.3 million and \$8.7 million for the six months ended June 30, 2006 and 2005, respectively. As a percentage of gross sales, the reductions were 7.4% for the six months ended June 30, 2006 versus 7.5% for the six months ended June 30, 2005.

*Cost of sales.* Cost of sales for the six months ended June 30, 2006 totaled \$31.9 million compared to \$29.1 million for the six months ended June 30, 2005. Cost of sales reflects the cost of product sold plus royalties due on the sales of our products as well as the distribution costs related to selling our products. However, product rights amortization is excluded from cost of sales and included separately with operating expenses. The increase was the direct result of the increase in net sales. Our gross margins for the six months ended June 30, 2006 and 2005 remained constant at 73%. We expect the gross margin for our products will remain in the low 70% range for the foreseeable future.

*Research and development expenses.* Research and development expenses totaled \$33.5 million for the six months ended June 30, 2006 as compared to \$19.3 million for the six months ended June 30, 2005. These expenses generally consist of regulatory, clinical and manufacturing development, and medical and safety monitoring costs for our

products. Development expenses related to our licensing of satraplatin and the MethylGene HDAC inhibitor program resulted in \$7.5 million of the increase. Additional growth in clinical study costs for Vidaza and thalidomide, as well as alternative formulation and back-up manufacturer development costs for

**Table of Contents**

Vidaza amounted to \$5.9 million of the increase. We expect research and development expenses to continue to grow for the remainder of 2006 as the development programs for our products mature.

*Acquired in-process research.* In January 2006, we entered into a licensing and collaboration agreement with MethylGene for the research, development and commercialization of MethylGene's HDAC inhibitor in North America, Europe, the Middle East and certain other markets. Under terms of this agreement, we made up front payments to MethylGene of \$25.0 million, including \$20.5 million for a license fee and the remainder as an equity investment in MethylGene common shares. The \$20.5 million license fee was immediately expensed as acquired in-process research as MethylGene's HDAC inhibitor has not yet achieved regulatory approval for marketing and, absent obtaining such approval, has no alternative future use. No such expense was incurred in the first half of 2005.

*Selling, general and administrative expenses.* Selling, general and administrative expenses totaled \$48.5 million for the six months ended June 30, 2006 as compared to \$43.3 million for the six months ended June 30, 2005. Sales and marketing expenses totaled \$35.3 million for the six months ended June 30, 2006, an increase of \$5.3 million over the comparable period of 2005. The expansion of our field-based headcount in the U.S. and increased Vidaza marketing activities in response to new competitive products being launched in 2006 increased sales and marketing expenses by \$3.5 million. Increases in pre-approval marketing costs for thalidomide, Vidaza and satraplatin in Europe and other international markets accounted for the remaining \$1.8 million increase.

General and administrative expenses totaled \$13.2 million for the six months ended June 30, 2006 as compared to \$13.3 million for the six months ended June 30, 2005. The \$0.1 million decrease is the result of \$2.4 million of relocation expenses associated with the move of our European headquarters being incurred in the prior year, offset by an increase in the current year of \$2.3 million related to personnel costs for general and administrative functions such as finance, human resources and information technology. These personnel cost increases were incurred to support the significant growth we have experienced as a company.

*Product rights amortization.* Product rights amortization totaled \$4.9 million for the six months ended June 30, 2006 as compared to \$4.5 million for the six months ended June 30, 2005. The increase is due to an addition to thalidomide product rights in June 2005 such that the prior year period only had one month of the additional amortization versus six months in the current year period.

*Interest and other income, net.* Interest and other income, net, totaled \$3.4 million for the six months ended June 30, 2006, an increase of \$0.4 million over the same period in 2005. Although we have experienced a decrease in cash, cash equivalents, and short-term investments as a result of the up front payments made to GPC Biotech and MethylGene in the first quarter of 2006, this has been offset by the improved investment returns due to higher interest rates for investments in the current year versus the comparable period in 2005.

*Income tax expense.* Income tax expense totaled \$4.4 million for the six months ended June 30, 2006 as compared to \$5.1 million for the six months ended June 30, 2005. The provision for income taxes reflects management's estimate of the effective tax rate expected to be applicable for the full fiscal year in each of our taxing jurisdictions. Although our income before taxes decreased significantly in the second quarter of 2006 as compared to 2005, this had minimal impact on our tax expense as much of the decline in pre tax income was incurred in jurisdictions where we incurred minimal tax expense in 2005.

**Liquidity and Capital Resources**

We achieved profitability on a full year basis for the first time in 2005. As of June 30, 2006, we had an accumulated deficit of \$159.1 million. Although we achieved profitability during 2005, our recent product licensing transactions have and will continue to significantly increase our research and development expenses. As a result, we incurred a loss in the six months ended June 30, 2006 and expect to incur a net loss for all of 2006. To date, our operations have been funded primarily with proceeds from the sale of preferred and common stock and net sales of our products. Net proceeds from the sale of our preferred stock was \$125.0 million and our public offerings of common stock completed in November 2003 and July 2004 resulted in combined net proceeds of \$314.2 million. We began generating revenue from product sales in July 2002.

Cash, cash equivalents and short-term investments decreased from \$243.4 million at December 31, 2005 to \$188.5 million at June 30, 2006. This \$54.9 million decrease is primarily due to the \$62.1 million up front payments made to GPC Biotech and MethylGene in connection with the licensing of satraplatin and the MethylGene HDAC

products, partially offset by cash generated from operating activities less cash used for capital expenditures and repayment of debt obligations.

We expect that our cash on hand at June 30, 2006, along with cash generated from expected product sales, will be adequate to fund our operations for at least the next twelve months. However, we re-examine our cash requirements periodically in light of changes in

**Table of Contents**

our business. For example, in the event that we make additional product acquisitions, we may need to raise additional funds. Adequate funds, either from the financial markets or other sources may not be available when needed or on terms acceptable to us. Insufficient funds may cause us to delay, reduce the scope of, or eliminate one or more of our planned development, commercialization or expansion activities. Our future capital needs and the adequacy of our available funds will depend on many factors, including the effectiveness of our sales and marketing activities, the cost of clinical studies and other actions needed to obtain regulatory approval of our products in development, and the timing and cost of any product acquisitions.

**Contractual Obligations**

Our contractual obligations as of June 30, 2006 are as follows (in thousands):

<b>Contractual Obligations</b>	<b>Total</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>Thereafter</b>
Research and development	\$ 26,200	\$ 1,333	\$ 10,067	\$ 7,400	\$ 7,400	\$	\$
Operating leases	13,244	1,944	3,669	2,648	2,367	843	1,773
Inventory purchase commitments	7,577	7,577					
Product royalty payments	2,012	2,012					
Product acquisition payments	1,000		1,000				
Long-term debt obligations	70	36	34				
<b>Total fixed contractual obligations</b>	<b>\$ 50,103</b>	<b>\$ 12,902</b>	<b>\$ 14,770</b>	<b>\$ 10,048</b>	<b>\$ 9,767</b>	<b>\$ 843</b>	<b>\$ 1,773</b>

*Research and development funding.* In December 2005, we entered into a co-development and licensing agreement for satraplatin with GPC Biotech. Pursuant to that agreement, we made an up front payment of \$37.1 million to GPC Biotech in January 2006. Of that amount, \$21.2 million was allocated to acquired in-process research and charged to expenses in 2005. The remaining amount of \$15.9 million represents a prepayment of future clinical development costs. The licensing agreement also stipulates we provide an additional \$22.2 million for similar future development costs. This amount is reflected in the schedule above in equal annual amounts for 2007-2009.

We previously entered into two agreements with Celgene to provide funding to support clinical development studies sponsored by Celgene studying thalidomide as a treatment for various types of cancers. Under these agreements, we will pay \$2.7 million in each of 2006 and 2007.

*Operating leases.* Our commitment for operating leases relates primarily to our corporate and sales offices located in the U.S., Europe, Thailand and Australia. These lease commitments expire on various dates through 2013.

*Inventory purchase commitments.* The contractual summary above includes contractual obligations related to our product supply contracts. Under these contracts, we provide our suppliers with rolling 12-24 month supply forecasts, with the initial 3-6 month periods representing binding purchase commitments.

*Product royalty payments.* Pursuant to our thalidomide product license agreements with Celgene, we are required to make additional quarterly payments to the extent that the royalty and license payments due under those agreements do not meet certain minimums. These minimum royalty and license payment obligations expire the earlier of 2006 or the date we obtain regulatory approval to market thalidomide in the E.U. The amounts reflected in the summary above represent the minimum amounts due under these agreements. In addition, our Innohep license agreement with LEO Pharma requires annual minimum royalty payments through 2006.

*Product acquisition payments.* We have future payment obligations associated with the June 2005 addition to thalidomide product rights. We paid \$5.0 million in June 2005, with additional \$1.0 million payments due in each of 2006 and 2007.

*Contingent product acquisition payments.* The contractual summary above reflects only payment obligations for product and company acquisitions that are fixed and determinable. We also have contractual payment obligations, the

amount and timing of which are contingent upon future events. In accordance with U.S. generally accepted accounting principles, contingent payment obligations are not recorded on our balance sheet until the amount due can be reasonably determined. Under the terms of the agreement with GPC Biotech, we will pay them up to an additional \$30.5 million based on the achievement of certain regulatory filing and approval milestones, up to an additional \$75 million for up to five subsequent E.U. approvals for additional indications and we will pay them sales milestones totaling up to \$105 million, based on the achievement of significant annual sales levels in our territories. Similarly, under the agreement with MethylGene, our milestone payments for MGCD0103 could reach \$145 million, based on the achievement

**Table of Contents**

of significant development, regulatory and sales goals, with the nearest milestone of \$4 million to be paid upon enrollment of the first patient in a Phase II trial. Furthermore, up to \$100 million for each additional HDAC inhibitor may be paid, also based on the achievement of significant development, regulatory and sales milestones. Also, under the agreements with Schering AG, payments totaling up to \$7.5 million are due if milestones relating to sales and gross margin targets for Refludan are achieved.

**Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

We have no material changes to the disclosure on this Item made in our Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

**Item 4. *Controls and Procedures******Evaluation of Disclosure Controls and Procedures***

We carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15(d)-15(e) of the Securities Exchange Act of 1934, as amended ( Exchange Act ), as of the end of the period covered by this report. Based on that evaluation, the CEO and CFO have concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by us in our periodic reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and can therefore only provide reasonable, not absolute, assurance that the design will succeed in achieving its stated goals.

***Changes in Internal Controls***

There were no changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II OTHER INFORMATION

**Item 1. *Legal Proceedings***

For a description of the Company's outstanding legal proceedings, please see our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, filed with the SEC on March 16, 2006. No material changes have occurred during the period covered by this report.

**Item 1A. *Risk Factors***

The Risk Factors included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 have not materially changed other than as set forth below.

***Our existing commercial business is largely dependent on the success of Vidaza.***

Sales of Vidaza account for a significant portion of our total product sales. For the three months ended June 30, 2006 and for the year ended December 31, 2005, Vidaza net sales represented 60% and 57%, respectively, of our total net sales. Vidaza now faces competition from two approved therapies in the United States: Revlimid<sup>®</sup>, manufactured by Celgene Corporation, which was approved for marketing by the FDA in late 2005 as a treatment for a subset of low-risk MDS patients, and Dacogen<sup>®</sup>, manufactured by MGI Pharma, Inc., which was approved by the FDA in May 2006 for the treatment of all sub-types of MDS. Although Vidaza sales increased during the period covered by this report as compared with the same period a year ago and over the prior quarter, we are unable to fully assess the impact these relatively recent competitive product launches will have on future Vidaza sales. We may also face competition from any other new therapeutics for treating MDS that may be under development by our competitors. The commercial success of Vidaza and future growth in Vidaza sales will depend, among other things, upon:

**Table of Contents**

continued acceptance by regulators, physicians, patients and other key decision-makers as a safe, superior therapeutic as compared to currently existing or future treatments for MDS;

the success of our current survival clinical trial for Vidaza in MDS;

our ability to achieve a marketing authorization for Vidaza in Europe and in other countries; and

our ability to expand the indications for which we can market Vidaza.

As a consequence, we cannot make assurances that Vidaza will gain increased market acceptance from members of the medical community or that the acceptance of Vidaza we have observed thus far will be maintained. Even if Vidaza does gain increased market acceptance, we may not be able to maintain that market acceptance over time if the competitive products recently introduced to the marketplace are more favorably received than Vidaza or render Vidaza obsolete.

Regulatory authorities in our markets subject approved products and manufacturers of approved products to continual regulatory review. Previously unknown problems, such as unacceptable toxicities or side effects, may only be discovered after a product has been approved and used in an increasing number of patients. If this occurs, regulatory authorities may impose labeling restrictions on the product that could affect its commercial viability or could require withdrawal of the product from the market. Accordingly, there is a risk that we will discover such previously unknown problems associated with the use of Vidaza in patients, which could limit sales growth or cause sales of Vidaza to decline.

***We face substantial competition, which may result in others commercializing competing products before or more successfully than we do.***

Our industry is highly competitive. Our success will depend on our ability to acquire, develop and commercialize products and our ability to establish and maintain markets for our products. Potential competitors in North America, Europe and elsewhere include major pharmaceutical companies, specialized pharmaceutical companies and biotechnology firms, universities and other research institutions. Many of our competitors have substantially greater research and development capabilities and experience, and greater manufacturing, marketing and financial resources, than we do. Accordingly, our competitors may develop or license products or other novel technologies that are more effective, safer or less costly than our existing products or products that are being developed by us, or may obtain regulatory approval for products before we do. Clinical development by others may render our products or product candidates noncompetitive.

Other pharmaceutical companies may develop generic versions of our products that are not subject to patent protection or otherwise subject to orphan drug exclusivity or other proprietary rights. In particular, because we have only limited patent protection for thalidomide, we face substantial competition from generic versions of thalidomide throughout Europe and other territories in which we sell thalidomide without orphan drug exclusivity. Governmental and other pressures to reduce pharmaceutical costs may result in physicians writing prescriptions for these generic products. Increased competition from the sale of competing generic pharmaceutical products could cause a material decrease in sales of our products.

Vidaza faces competition from two products that have been approved by the FDA and launched in 2006: Dacogen, approved by the FDA for the treatment of all MDS sub-types and launched in May 2006, and Revlimid, approved by the FDA as a treatment for certain low risk MDS patients and launched early in the first quarter of 2006. Vidaza also competes with traditional therapies for the treatment of MDS, including the use of blood transfusions and growth factors, such as erythropoietin and granulocyte colony stimulating factor. Thalidomide faces competition from sales of other versions of thalidomide sold in generic or unlicensed forms in Europe, including compounding of thalidomide by pharmacists, and Velcade® from Millenium Pharmaceuticals Inc. and Johnson & Johnson Pharmaceutical Research & Development LLC, approved as a second-line treatment for multiple myeloma in Europe. Thalidomide also faces potential competition from Revlimid from Celgene Corporation, which is currently under review for regulatory approval by the EMEA as a second-line treatment of multiple myeloma.

**Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds***

Not applicable.

**Table of Contents**

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Submission of Matters to a Vote of Security Holders**

At our 2006 Annual Meeting of Shareholders held on June 8, 2006 (the Annual Meeting ), our shareholders: (i) elected two Class III Directors, each to serve for a term to expire in 2009 (Item No. 1); (ii) ratified the appointment of Ernst & Young LLP as independent registered public accounting firm for the fiscal year ending December 31, 2003 (Item No. 2); and (iii) approved the adoption of the Pharmion Corporation 2006 Employee Stock Purchase Plan (Item No. 3). The tabulation of votes for each of the Items is set forth below:

**Item No. 1**

Election of two Class III Directors for a three-year term:

<b>Directors Class II</b>	<b>Votes For</b>	<b>Votes Withheld</b>
Dr. Thorlef Spickschen	25,128,930	1,572,844
Dr. John C. Reed	26,676,620	25,154

The terms of office for the Class I Directors and Class II Directors of the Company, Brian G. Atwood; M. James Barrett, Ph.D; James Blair, Ph.D; Cam L. Garner; Patrick J. Mahaffy and Edward McKinley, continued after the Annual Meeting.

**Item No. 2**

Ratification of the appointment of Ernst & Young LLP as independent auditors of the Company for the 2005 fiscal year:

<b>FOR</b>	<b>AGAINST</b>	<b>ABSTAIN</b>
26,455,048	4,907	7,092

**Item No. 3**

Approval of the adoption of the Pharmion Corporation 2006 Employee Stock Purchase Plan:

<b>FOR</b>	<b>AGAINST</b>	<b>ABSTAIN</b>	<b>Broker Non-Vote</b>
21,101,948	138,406	6,205	5,502,715

**Item 5. Other Information**

None.

**Table of Contents**

**Item 6. Exhibits**

The following documents are being filed as part of this report:

<b>Exhibit Number</b>	<b>Description of Document</b>
31.1	Sarbanes-Oxley Act of 2002, Section 302 Certification for President and Chief Executive Officer.
31.2	Sarbanes-Oxley Act of 2002, Section 302 Certification for Chief Financial Officer.
32.1	Sarbanes-Oxley Act of 2002, Section 906 Certifications for President and Chief Executive Officer and Chief Financial Officer.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PHARMION CORPORATION

By: /s/ Patrick J. Mahaffy

*President and Chief Executive Officer*  
(Principal Executive Officer)

Date: August 9, 2006

PHARMION CORPORATION

By: /s/ Erle T. Mast

Chief Financial Officer  
(Principal Financial and Accounting Officer)

Date: August 9, 2006

**Table of Contents**

**Exhibit Index**

<b>Exhibit Number</b>	<b>Description of Document</b>
31.1	Sarbanes-Oxley Act of 2002, Section 302 Certification for President and Chief Executive Officer.
31.2	Sarbanes-Oxley Act of 2002, Section 302 Certification for Chief Financial Officer.
32.1	Sarbanes-Oxley Act of 2002, Section 906 Certifications for President and Chief Executive Officer and Chief Financial Officer.