

PHARMION CORP  
Form 10-Q  
November 09, 2007

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 September 30, 2007

**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 November 6, 2007
Common Stock, \$.001 par value per share	37,250,223 shares

TABLE OF CONTENTS

	<b>Page</b>
<b><u>Part I Financial Information</u></b>	
<u>Item 1. Consolidated Financial Statements</u>	3
<u>Consolidated Balance Sheets (Unaudited) as of September 30, 2007 and December 31, 2006</u>	3
<u>Consolidated Statements of Operations (Unaudited) for the three and nine months ended September 30, 2007 and 2006</u>	4
<u>Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2007 and 2006</u>	5
<u>Notes to Unaudited Consolidated Financial Statements</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	12
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	22
<u>Item 4. Controls and Procedures</u>	22
<b><u>Part II Other Information</u></b>	
<u>Item 1. Legal Proceedings</u>	23
<u>Item 1A. Risk Factors</u>	23
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	24
<u>Item 3. Defaults Upon Senior Securities</u>	24
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	24
<u>Item 5. Other Information</u>	24
<u>Item 6. Exhibits</u>	24
<u>Section 302 Certification of the President and CEO</u>	
<u>Section 302 Certification of the Chief Financial Officer</u>	
<u>Section 906 Certification of the President and CEO and CFO</u>	

**Table of Contents**

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

**Item 1. Consolidated Financial Statements**

**PHARMION CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
**(In thousands, except for share amounts)**  
**(Unaudited)**

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 135,047	\$ 59,903
Short-term investments	122,585	76,310
Accounts receivable, net of allowances of \$3,799 and \$4,711, respectively	45,407	40,299
Inventories	12,986	12,411
Other current assets	13,968	14,045
Total current assets	329,993	202,968
Product rights, net	89,145	95,591
Goodwill	15,568	14,402
Property and equipment, net	10,979	7,121
Other assets	5,825	6,650
Total assets	\$ 451,510	\$ 326,732
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 10,075	\$ 11,612
Accrued and other current liabilities	57,463	38,359
Total current liabilities	67,538	49,971
Deferred tax liability	2,955	2,734
Other long-term liabilities	984	945
Total liabilities	71,477	53,650
Stockholders equity:		
Common stock, \$0.001 par value; 100,000,000 shares authorized and 37,172,286 and 32,102,520 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively	37	32
Preferred stock, \$0.001, 10,000,000 shares authorized, no shares issued and outstanding at September 30, 2007 and December 31, 2006		
Additional paid-in capital	627,492	488,553
Other comprehensive income	15,727	11,336
Accumulated deficit	(263,223)	(226,839)
Total stockholders equity	380,033	273,082

Total liabilities and stockholders' equity	\$	451,510	\$	326,732
--	----	---------	----	---------

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>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net sales	\$ 67,315	\$ 61,636	\$ 195,834	\$ 178,596
Operating expenses:				
Cost of sales, inclusive of royalties, exclusive of product rights amortization shown separately below	18,236	16,629	53,341	48,514
Research and development	29,118	16,675	71,992	50,194
Acquired in-process research	8,000	4,000	8,000	24,480
Selling, general and administrative	32,522	24,465	93,174	72,963
Product rights amortization	2,475	2,454	7,407	7,344
Total operating expenses	90,351	64,223	233,914	203,495
Operating loss	(23,036)	(2,587)	(38,080)	(24,899)
Interest and other income, net	2,991	1,870	6,448	5,286
Loss before taxes	(20,045)	(717)	(31,632)	(19,613)
Income tax expense	1,395	2,834	4,752	7,188
Net loss	\$ (21,440)	\$ (3,551)	\$ (36,384)	\$ (26,801)
Net loss per common share:				
Basic and Diluted	\$ (0.58)	\$ (0.11)	\$ (1.05)	\$ (0.84)
Weighted average number of common and common equivalent shares used to calculate net loss per common share:				
Basic and Diluted	36,996	32,053	34,506	31,993

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>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Operating activities</b>		
Net loss	\$ (36,384)	\$ (26,801)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	9,307	9,140
Share-based compensation expense	4,130	2,410
Amortization of discounts and premiums on short-term investments, net	(1,279)	(337)
Other	38	64
Changes in operating assets and liabilities:		
Accounts receivable, net	(2,993)	(5,629)
Inventories	413	(950)
Other current assets	640	10,601
Other long-term assets	(80)	(6)
Accounts payable	(1,842)	(3,481)
Accrued liabilities	17,157	(36,912)
Net cash used in operating activities	(10,893)	(51,901)
<b>Investing activities</b>		
Purchases of property and equipment	(5,411)	(1,197)
Purchase of available-for-sale investments	(168,077)	(80,129)
Sale and maturity of available-for-sale investments	123,126	140,255
Net cash provided by (used in) investing activities	(50,362)	58,929
<b>Financing activities</b>		
Proceeds from sale of common stock, net of issuance costs	129,566	
Proceeds from exercise of common stock options and employee stock purchase plan	5,418	547
Payment of debt obligations	(920)	(1,092)
Net cash provided by (used in) financing activities	134,064	(545)
Effect of exchange rate changes on cash and cash equivalents	2,335	1,899
Net increase in cash and cash equivalents	75,144	8,382
Cash and cash equivalents at beginning of period	59,903	90,443
Cash and cash equivalents at end of period	\$ 135,047	\$ 98,825

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) was incorporated in Delaware on August 26, 1999 and commenced operations in January 2000. 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 some combination of royalties on future sales, up front and/or milestone cash payments, and development funding. The Company has acquired the rights to or developed eight products, including four that are currently marketed or sold on a compassionate use or named patient basis, and four products that are in varying stages of clinical development. The Company has established drug development, regulatory, and commercial capabilities in the United States, Europe and Australia. Through its distributor network, the Company can reach the hematology and oncology markets in additional countries in Asia, Latin America, and the Middle East.

**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 2006 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 fairly present the Company's financial position at September 30, 2007, results of operations for the three and nine months ended September 30, 2007 and 2006 and cash flows for the nine months ended September 30, 2007 and 2006. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the year ending December 31, 2007 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 \$6.6 million and \$5.7 million for the nine months ended September 30, 2007 and 2006, respectively.

The Company has entered into several standby letters of credit to guarantee both current and future commitments with office and equipment lease agreements and customer supply public tender commitments. The aggregate amount outstanding under the letters of credit was approximately \$2.4 million and \$2.2 million at September 30, 2007 and December 31, 2006, respectively. The letters of credit are secured by an equivalent amount of restricted cash held in U.S. and foreign cash accounts.



**Table of Contents***Short-term Investments*

Short-term investments consist of investment grade government agency and corporate debt securities due within one year. Investments with maturities beyond one year are also 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. The estimated fair value of the available-for-sale securities is determined based on quoted market prices or rates for similar instruments.

*Inventories*

Inventories consist of Vidaza, Innohep, Refludan and thalidomide. Vidaza is sold commercially in the U.S. and, to a lesser extent, on a compassionate use basis within Europe and other international markets. Innohep is sold exclusively in the U.S. market, and Refludan and thalidomide are both sold within Europe and the other international markets. All of the products are manufactured by third-party manufacturers and delivered to the Company as finished goods. The Company purchases the active ingredient for Vidaza which is supplied to the third-party manufacturer. Inventories 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 items considered outdated or obsolete are reduced to their estimated net realizable value.

Inventories at September 30, 2007 and December 31, 2006 consisted of the following (in thousands):

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
Raw materials	\$ 2,948	\$ 3,709
Finished goods	10,038	8,702
Total inventories	\$ 12,986	\$ 12,411

*Product Rights*

The cost of acquiring the distribution and marketing rights of the Company's products that are approved for commercial use were capitalized and are being amortized on a straight-line basis over the estimated benefit period of 10-15 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.

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 include:

*Product returns.* The Company's customers have the right to return any unopened product during the 18-month period beginning six months prior to the labeled expiration date and ending twelve 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 six months of expiration and analyze the likelihood that such product will be returned within twelve months after expiration.

7

---

**Table of Contents**

To estimate the likelihood of product remaining in wholesalers' inventory to within six months of its expiration, the Company relies on its internal estimate of wholesalers' inventory levels, measured end-customer demand as reported by third party sources, and on internal sales data. The Company believes the information from 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 September 30, 2007 and December 31, 2006, the allowance for returns was \$0.8 million and \$1.0 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 September 30, 2007 and December 31, 2006, the allowance/accrual for chargebacks and rebates was \$3.1 million and \$4.0 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 September 30, 2007 and December 31, 2006, the allowance for prompt pay discounts was \$0.3 million and \$0.4 million, respectively.

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.

**Table of Contents***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*

The Company has acquired and will continue to acquire the rights to develop and commercialize new drug opportunities. The upfront payment to acquire the new drug candidate as well as future milestone payments will be immediately expensed as acquired in-process research provided that the new drug has not 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, investments and accounts receivable. The Company maintains its cash, cash equivalent 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 an allowance 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 our three largest customers in the U.S. were as follows for the nine months ended September 30, 2007 and 2006:

	<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
Oncology Supply	18%	19%
Cardinal Health	10%	11%
Oncology Therapeutics Network	7%	6%

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

*Share-Based Compensation*

The Company recognizes compensation for share based awards to employees and non-employee directors under Statement of Financial Accounting Standard (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. 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.

Employee share-based compensation expense recognized in the three and nine months ended September 30, 2007 and 2006 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures at a rate of 15 percent, based on the Company's historical option cancellations. 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.

Share-based compensation expense recognized under SFAS No. 123R for the three and nine months ended September 30, 2007 and 2006 was (in thousands):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Research and development	\$ 411	\$ 230	\$ 1,071	\$ 670
Selling, general and administrative	1,078	617	3,059	1,740

Edgar Filing: PHARMION CORP - Form 10-Q

Total share-based compensation expense	\$ 1,489	\$ 847	\$ 4,130	\$ 2,410
--	----------	--------	----------	----------

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

The employee share-based compensation expense recognized under SFAS No. 123R 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</b>		<b>Nine Months</b>	
	<b>Ended September 30, 2007</b>	<b>2006</b>	<b>Ended September 30, 2007</b>	<b>2006</b>
Risk-free interest rate	4.5%	4.9%	4.6%	4.9%
Expected stock price volatility	48%	42%	43%	42%
Expected option term until exercise	4.5	4.3	4.4	4.2
	years	years	years	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 option was \$11.79 and \$7.34 for stock options granted in the three months ended September 30, 2007 and 2006, respectively. The weighted-average fair value per option was \$11.95 and \$7.17 for stock options granted in the nine months ended September 30, 2007 and 2006, respectively.

As of September 30, 2007, there was approximately \$8.0 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 2.5 years.

A summary of the option activity for the nine months ended September 30, 2007 was as follows:

	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (years)</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Outstanding at January 1, 2007	3,287,559	\$ 19.26		
Granted	179,832	\$ 28.97		
Exercised	(421,821)	\$ 11.38		
Terminated	(63,173)	\$ 24.77		
Outstanding, September 30, 2007	2,982,397	\$ 20.85	4.79	\$ 75,594
Vested and expected to vest, September 30, 2007	2,691,771	\$ 20.62	4.65	\$ 68,857
Exercisable, September 30, 2007	1,777,408	\$ 19.55	3.94	\$ 47,409

The following table presents a summary of the Company's non-vested shares of restricted stock unit awards as of September 30, 2007:

**Weighted Average**

	<b>Number of Shares</b>		<b>Fair Value at Grant  Date</b>
Non-vested at December 31, 2006	229,878	\$	23.38
Granted	130,800	\$	29.32
Vested	(20,983)	\$	17.82
Terminated	(22,540)	\$	21.07
Non-vested, September 30, 2007	317,155	\$	24.67

The restricted stock units 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.

**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 nine months ended September 30, 2007 and 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.

The total number of potential common shares excluded from diluted earnings per share computation because they were anti-dilutive was 3.4 million and 1.6 million for the three months ended September 30, 2007 and 2006, respectively, and 3.5 million and 1.9 million for the nine months ended September 30, 2007 and 2006, respectively.

**NOTE 4. LICENSE AGREEMENTS AND PRODUCT RIGHTS*****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. The Company currently owns approximately 5.0% of the outstanding common shares of MethylGene Inc. The investment in MethylGene common stock is classified in other assets and is accounted for as a long-term available-for-sale security with changes in fair value recorded to other comprehensive income (loss).

**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 nine months ended September 30, 2007 and 2006 was (in thousands):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net loss	\$ (21,440)	\$ (3,551)	\$ (36,384)	\$ (26,801)
Other comprehensive loss, net of tax:				
Foreign currency translation gain	4,674	949	5,265	5,739
Unrealized gain (loss) on available-for-sale securities	(1,187)	1,657	(874)	2,133
Comprehensive loss	\$ (17,953)	\$ (945)	\$ (31,993)	\$ (18,929)

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 nine months ended September 30, 2007 and 2006 resulted primarily from taxable income generated in certain



foreign jurisdictions. The Company has generated net operating loss carryforwards in certain jurisdictions, most notably in the U.S. and Switzerland. The Company has fully reserved the potential tax benefit in its balance sheet, due to the uncertainty of realizing the asset in future periods. The Internal Revenue Code contains provisions that limit the annual utilization of U.S. net operating loss and tax credit carryforwards if there has been a change of ownership as described in Section 382 of the Code. Such an ownership change occurred for the Company in 2006.

**Table of Contents**

The Company adopted the provisions of FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109, on January 1, 2007. The Company has analyzed tax positions in all jurisdictions where we are required to file an income tax return and we have concluded that we do not have any material unrecognized tax benefits. As a result, there was no material effect on our financial position or results of operations due to the implementation of FIN 48. We file a U.S. federal income tax return as well as returns for various state and foreign jurisdictions. Most of the income tax returns filed in the U.S. and foreign jurisdictions are subject to potential examination from the date of start-up through the current year, due to net operating losses that have been generated since the commencement of operations. Income tax returns in the U.K. and Switzerland have been reviewed by local authorities through 2004 and 2005, respectively. We are not aware of any circumstances that we believe will result in any material changes in our unrecognized tax positions over the next 12 months.

The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, we did not have interest or penalties accrued for any unrecognized tax benefits and there was no significant interest expense recognized during the current year.

**NOTE 7. GEOGRAPHIC INFORMATION**

Domestic and foreign financial information for the three and nine months ended September 30, 2007 and 2006 was (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
United States net sales	\$ 36,058	\$ 36,009	\$ 105,646	\$ 106,591
Foreign entities net sales	31,257	25,627	90,188	72,005
Total net sales	\$ 67,315	\$ 61,636	\$ 195,834	\$ 178,596
United States operating loss	\$ (9,250)	\$ (653)	\$ (16,349)	\$ (8,231)
Foreign entities operating loss	(13,786)	(1,934)	(21,731)	(16,668)
Total operating loss	\$ (23,036)	\$ (2,587)	\$ (38,080)	\$ (24,899)

	<b>September</b>	<b>December</b>
	<b>30,</b>	<b>31,</b>
	<b>2007</b>	<b>2006</b>
United States total assets	\$ 249,350	\$ 129,528
Foreign entities total assets	202,160	197,204
Total assets	\$ 451,510	\$ 326,732

**NOTE 8. ACCRUED AND OTHER CURRENT LIABILITIES**

	<b>September</b>	<b>December</b>
	<b>30,</b>	<b>31,</b>
	<b>2007</b>	<b>2006</b>
(in thousands)		
Accrued and other current liabilities:		
Accrued product development expenses	\$ 19,490	\$ 6,632
Royalties payable	13,204	10,893
Accrued salaries and benefits	9,066	9,191

Income taxes payable	2,140	262
Other accrued operating expenses	13,563	11,381
Total accrued and other operating liabilities	\$ 57,463	\$ 38,359

***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, 2006.

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

All statements, trend analysis and other information contained in this Quarterly Report on 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, 2006. 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, Middle East, Asia, and Latin America. To date, we have acquired the rights to or internally developed eight products, including four that are currently marketed or sold on a compassionate use or named patient basis, and four products that are in varying stages of development.

In May 2004, Vidaza® was approved for marketing in the U.S. and we commenced sales of the product in July 2004. We plan to file for marketing approval in the European Union (E.U.) by the end of 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.

Thalidomide (including Thalidomide Pharmion and the Laphal thalidomide formulation) 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 territories. We also sell thalidomide on an approved basis in Australia and certain other international markets. In February 2007, the European Medicines Agency (EMA) accepted for review our Marketing Authorization Application (MAA) for Thalidomide Pharmion for the treatment of untreated multiple myeloma. We expect the results of the EMA's review to be available in late 2007 or early 2008. In addition, we sell Innohep® in the U.S. and Refludan® 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. Progression free survival data from the Phase 3 study examining satraplatin as a treatment for hormone refractory prostate cancer was presented in February 2007 and we submitted an MAA to the EMA based on this data in July 2007. In October 2007, the overall survival results from this Phase 3 trial were released. The trial did not achieve the endpoint of overall survival. We planned on submitting the overall survival results to the EMA during the review process. Over the next few months we intend to review these results with the EMA to determine the next steps for our marketing application.

In January 2006, we entered into a license and collaboration agreement with MethylGene for the research, development and commercialization 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 1 and Phase 2 clinical trials in both solid tumors and hematological disorders.

In November 2006, we acquired 100% of the outstanding common stock of Cabrellis Pharmaceuticals Corporation and gained the rights to amrubicin, a third-generation synthetic anthracycline currently in development for small cell lung cancer (SCLC) in North America and the E.U. In October, 2007, we initiated an international Phase 3 pivotal

study evaluating amrubicin in the treatment of second-line SCLC.

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

**Table of Contents****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 include:

*Product returns.* Our customers have the right to return any unopened product during the 18-month period beginning six months prior to the labeled expiration date and ending twelve 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 six months of expiration and analyze the likelihood that such product will be returned within twelve months after expiration.

To estimate the likelihood of product remaining in wholesalers' inventory to within six months of its expiration, we rely on our internal estimate of the wholesalers' inventory levels, measured end-customer demand as reported by third party sources, and on internal sales data. We believe the information from our 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.

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 \$0.8 million and \$1.0 million at September 30, 2007 and December 31, 2006, respectively.

*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.

## **Table of Contents**

The allowance/accrual for chargebacks and rebates was \$3.1 million and \$4.0 million at September 30, 2007 and December 31, 2006, respectively.

*Prompt pay discounts.* As an incentive to expedite cash flow, we offer some customers a prompt pay discount of 2% when the customer pays their balance within 30 days of product shipment. 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 \$0.3 million and \$0.4 million at September 30, 2007 and at December 31, 2006, respectively.

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.

### ***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.

### ***Acquired In-Process Research***

The Company has acquired and will continue to acquire the rights to develop and commercialize new drug opportunities. The upfront payment to acquire the new drug candidate as well as future milestone payments will be immediately expensed as acquired in-process research provided that the new drug has not achieved regulatory approval for marketing and, absent obtaining such approval, has no alternative future use.

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

We account for share-based awards exchanged for services using SFAS No. 123R, *Share-Based Payment* which 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 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.

Employee share-based compensation expense 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.

As of September 30, 2007, total compensation cost related to nonvested stock options not yet recognized in the statement of operations was approximately \$8.0 million, which is estimated to be expensed over a weighted average period of 2.5 years.

### ***Recently Issued Accounting Standards***

The Company adopted the provisions of FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes* an Interpretation of FASB Statement No. 109, on January 1, 2007. We have analyzed tax positions in all jurisdictions where



**Table of Contents**

we are required to file an income tax return and have concluded that we do not have any material unrecognized tax benefits. As a result, there was no material effect on our financial position or results of operations due to the implementation of FIN 48. We file a U.S. federal income tax return as well as returns for various state and foreign jurisdictions. Most of the income tax returns filed in the U.S. and foreign jurisdictions are subject to potential examination from the date of start-up through the current year, due to net operating losses that have been generated since the commencement of operations. Certain income tax returns in the U.K. and France for years prior to 2001 and 2003, respectively, are no longer subject to examination. We do not believe there will be any material changes in our unrecognized tax positions over the next 12 months.

The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, we did not have interest or penalties accrued for any unrecognized tax benefits and there was no significant interest expense recognized during the current year.

**Results of Operations****Comparison of the Company's Results for the Three Months Ended September 30, 2007 and 2006**

**Net Sales:** Net sales and related changes for the three months ended September 30, 2007 and 2006 were as follows (in thousands):

	Three Months Ended		Increase (Decrease)	Percent Change
	2007	September 30, 2006		
Vidaza	\$42,349	\$36,601	\$5,748	16%
Thalidomide	20,192	20,199	(7)	0%
Other	4,774	4,836	(62)	(1%)
	\$67,315	\$61,636	\$5,679	9%

	Three Months Ended		Increase (Decrease)	Percent Change
	2007	September 30, 2006		
United States	\$36,058	\$36,009	\$ 49	0%
Foreign Entities	31,257	25,627	5,630	22%
	\$67,315	\$61,636	\$5,679	9%

Net sales for the three months ended September 30, 2007 increased compared to the three months ended September 30, 2006. The primary reason for the net sales increase is due to Vidaza net sales in Europe and other international markets. Although not approved for marketing in the E.U., we sell Vidaza on a named patient or compassionate use basis within these markets. Vidaza sales in Europe and other international markets increased by \$5.7 million to \$9.0 million for the three months ended September 30, 2007 as compared to the three months ended September 30, 2006. While total net sales of Vidaza in the third quarter of 2007 have increased by \$5.7 million to \$42.3 million as compared to the same period in 2006, U.S. Vidaza sales levels remained constant at \$33.3 million for the three months ended September 30, 2007 and 2006, respectively. Sales of thalidomide in Europe and other international markets remained constant at \$20.2 million for the three months ended September 30, 2007 and 2006.

Reductions from gross to net sales, which include allowances for product returns, chargebacks, rebates and prompt pay discounts totaled \$4.6 million and \$4.5 million for the three months ended September 30, 2007 and 2006, respectively. As a percentage of gross sales, the reductions were 6.4% for the third quarter of 2007 versus 6.8% for the third quarter in 2006.



**Table of Contents**

**Operating Expenses:** Operating expenses and related changes for the three months ended September 30, 2007 and 2006 were as follows (in thousands):

	Three Months Ended September 30,		Increase (Decrease)	Percent Change
	2007	2006		
Cost of sales	\$ 18,236	\$ 16,629	\$ 1,607	9.7%
Percent of net sales	27.1%	27.0%		
Research and development	\$ 29,118	\$ 16,675	\$ 12,443	74.6%
Percent of net sales	43.3%	27.1%		
Acquired in-process research	\$ 8,000	\$ 4,000	\$ 4,000	100.0%
Percent of net sales	11.9%	6.5%		
Selling, general and administrative	\$ 32,522	\$ 24,465	\$ 8,057	32.9%
Percent of net sales	48.3%	39.7%		
Product rights amortization	\$ 2,475	\$ 2,454	\$ 21	0.9%
Percent of net sales	3.7%	4.0%		

*Cost of sales.* Cost of sales for the three months ended September 30, 2007 increased compared to the three months ended September 30, 2006. Cost of sales includes the cost of product sold, royalties due on the sales of our products and the distribution costs related to selling our products. However, product rights amortization is excluded from cost of sales and is presented separately within operating expenses. The increase in cost of sales was a direct result of the increase in net sales. Our gross margin was 73% for the three months ended September 30, 2007 and 2006. 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 for the three months ended September 30, 2007 increased compared to the three months ended September 30, 2006. These expenses generally consist of regulatory, clinical and manufacturing development, and medical and safety monitoring costs for our products. Development expenses relating to amrubicin and the MethylGene HDAC inhibitor products, which were licensed in 2006, resulted in \$5.4 million of the increase. An additional \$4.7 million of the increase is due to Phase 3 clinical studies and EMEA regulatory activities for thalidomide and expenses for oral azacitidine development and Vidaza alternative dosing studies. Additionally, personnel related costs increased \$1.5 million due to the hiring of new employees to manage the research and development programs for our products acquired during 2006. We expect research and development expenses for the remainder of 2007 to be consistent with the third quarter results.

*Acquired in-process research.* In September 2006, the Company paid a development milestone of \$4.0 million to MethylGene Inc. upon the initiation of Phase 2 clinical trials for MGCD0103. In July 2007, the European Medicines Agency (EMA) accepted our marketing authorization application for satraplatin in combination with prednisone for hormone-refractory prostate cancer. This acceptance triggered an \$8.0 million milestone payment to GPC Biotech AG. Both milestone payments were immediately expensed as acquired in-process research, as the products have not achieved regulatory approval for marketing and, absent obtaining such approval, have no alternative future use.

*Selling, general and administrative expenses.* Selling, general and administrative expenses for the three months ended September 30, 2007 increased compared to the three months ended September 30, 2006. Sales and marketing expenses totaled \$23.3 million for the three months ended September 30, 2007, an increase of \$5.7 million over the comparable period in 2006. The expansion of our field-based headcount in the U.S. and increased Vidaza marketing activities increased sales and marketing expenses by \$2.2 million. The remaining increase to sales and marketing expense was attributable to pre-approval market research and other activities undertaken to prepare for the potential approval and launch of thalidomide and Vidaza in Europe and product branding and market development for

MGCD0103 and amrubicin in the U.S.

**Table of Contents**

General and administrative expenses totaled \$9.2 million for the three months ended September 30, 2007 as compared to \$6.8 million for the three months ended September 30, 2006. The increase was due to higher personnel costs for our general and administrative functions, such as legal, finance, human resources and information technology, supporting the expansion of commercial and research and development activities. In addition, employee recruitment and relocation costs, information technology expense and communications costs were higher in 2007 due to the continued growth of the Company. We expect selling, general and administrative expenses will continue to increase for the remainder of 2007 and in 2008, as we increase our staffing and launch preparation activities for the potential European approvals of thalidomide and Vidaza.

**Product rights amortization.** Product rights amortization totaled \$2.5 million for the three months ended September 30, 2007 and 2006. There were no additions to product rights since the second quarter of 2006 and, therefore, amortization expense is expected to be consistent with the comparable quarter in the prior year.

**Interest and other income, net.** Interest and other income, net totaled \$3.0 million for the three months ended September 30, 2007, compared with \$1.9 million for the third quarter of 2006. During the second quarter of 2007, we sold 4.6 million shares of common stock in an underwritten public offering which raised \$129.6 million in net proceeds. This increase to cash and short-term investments, as well as the improved investment returns in the third quarter of 2007 in comparison to the third quarter of 2006, resulted in an increase to interest and other income, net.

**Income tax expense.** Income tax expense totaled \$1.4 million for the three months ended September 30, 2007 as compared to \$2.8 million for the three months ended September 30, 2006. 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. The decrease in income tax expense was primarily due to a reduction in the current year effective tax rate in France resulting from the utilization of net operating losses. The losses became available in the third quarter of 2007 upon completion of an organizational restructuring of two entities operating in this jurisdiction which reduced income tax expense by \$0.7 million in comparison to the third quarter of 2006. The remaining decrease in income tax expense was primarily due to a reduction in alternative minimum taxes related to operating activities in the U.S..

**Comparison of the Company's Results for the Nine Months Ended September 30, 2007 and 2006**

**Net Sales:** Net sales and related changes for the nine months ended September 30, 2007 and 2006 were as follows (in thousands):

	Nine Months Ended September 30,		Increase (Decrease)	Percent Change
	2007	2006		
Vidaza	\$ 120,511	\$ 105,614	\$ 14,897	14%
Thalidomide	60,691	58,754	1,937	3%
Other	14,632	14,228	404	3%
	\$ 195,834	\$ 178,596	\$ 17,238	10%

	Nine Months Ended September 30,		Increase (Decrease)	Percent Change
	2007	2006		
United States	\$ 105,646	\$ 106,591	\$ (945)	(1)%
Foreign Entities	90,188	72,005	18,183	25%
	\$ 195,834	\$ 178,596	\$ 17,238	10%



**Table of Contents**

Net sales for the nine months ended September 30, 2007 increased compared to the nine months ended September 30, 2006. The primary reason for the net sales increase is due to the growth of Vidaza sales. Named patient and compassionate use sales of Vidaza in Europe and other international markets continued to grow, increasing to \$23.3 million for the nine months ended September 30, 2007 as compared to \$6.9 million for the nine months ended September 30, 2006. U.S. sales of Vidaza totaled \$97.2 million for the nine months ended September 30, 2007 as compared to \$98.7 million in the comparable period of 2006. Additionally, thalidomide net sales totaled \$60.7 million for the nine months ended September 30, 2007 as compared to \$58.8 million for the nine months ended September 30, 2006.

Reductions from gross to net sales, which include allowances for product returns, chargebacks, rebates and prompt pay discounts totaled \$15.1 million and \$13.8 million for the nine months ended September 30, 2007 and 2006, respectively. As a percentage of gross sales, the reductions were 7.2% for the nine months ended September 30, 2007 and 2006, respectively.

**Operating Expenses:** Operating expenses and changes for the nine months ended September 30, 2007 and 2006 were as follows (in thousands):

	Nine Months Ended September 30,		Increase (Decrease)	Percent Change
	2007	2006		
Cost of sales	\$53,341	\$48,514	\$ 4,827	9.9%
Percent of net sales	27.2%	27.2%		
Research and development	\$71,992	\$50,194	\$ 21,798	43.4%
Percent of net sales	36.8%	28.1%		
Acquired in-process research	\$ 8,000	\$24,480	\$(16,480)	(67.3)%
Percent of net sales	4.1%	13.7%		
Selling, general and administrative	\$93,174	\$72,963	\$ 20,211	27.7%
Percent of net sales	47.6%	40.9%		
Product rights amortization	\$ 7,407	\$ 7,344	\$ 63	0.9%
Percent of net sales	3.8%	4.1%		

*Cost of sales.* Cost of sales for the nine months ended September 30, 2007 increased compared to the nine months ended September 30, 2006. 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 is presented separately within operating expenses. The increase in cost of sales of \$4.8 million was the direct result of the increase in net sales. Our gross margins for the nine months ended September 30, 2007 and 2006 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 for the nine months ended September 30, 2007 increased compared to the nine months ended September 30, 2006. These expenses generally consist of regulatory, clinical and manufacturing development, and medical and safety monitoring costs for our products. Development expenses relating to amrubicin and the MethylGene HDAC inhibitor program, which were licensed in 2006, resulted in \$9.7 million of the increase. An additional \$7.3 million of the increase was due to Phase 3 clinical studies and EMEA regulatory activities associated with thalidomide and expenses for oral azacitidine development and alternative dosing studies for Vidaza. Personnel related costs increased by \$5.5 million due to the hiring of additional employees to manage the development programs for our products, including those acquired in 2006. These increases were partially offset by a reduction in severance costs of \$0.9 million, due primarily to the

retirement of an executive officer of the Company in 2006. No such severance costs have been incurred to date in 2007. We expect research and development expenses for the remainder of 2007 to be consistent with the level of development costs incurred in the third quarter of 2007.



**Table of Contents**

*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 inhibitors, including MGCD0103, 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. In September 2006, the Company paid a development milestone of \$4.0 million to MethylGene for the initiation of Phase 2 clinical trials for MGCD0103. The total of the license fee and the milestone payment of \$24.5 million was 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.

In July 2007, the EMEA accepted our marketing authorization application for satraplatin in combination with prednisone for hormone-refractory prostate cancer. This acceptance triggered an \$8.0 million milestone payment to GPC Biotech, which was recognized as an acquired in-process research expense in the third quarter of 2007 as satraplatin has not achieved regulatory approval for marketing and, absent obtaining such approval, has no alternative future use.

*Selling, general and administrative expenses.* Selling, general and administrative expenses for the nine months ended September 30, 2007 increased compared to the nine months ended September 30, 2006. Sales and marketing expenses totaled \$67.8 million for the nine months ended September 30, 2007, an increase of \$14.8 million over the comparable period of 2006. With the continued expansion of the sales organization to support the commercial sales growth in the U.S., Europe and other international markets, personnel related costs have increased \$8.6 million. In addition, activities undertaken to prepare for the potential approval and launch of thalidomide, Vidaza and satraplatin in Europe have increased sales and marketing expenses by \$5.0 million for the nine months ended September 30, 2007 over the comparable period of 2006. U.S. sales and marketing expenses also increased by \$1.1 million primarily due to product branding and market development for MGCD0103 and amrubicin in 2007.

General and administrative expenses totaled \$25.4 million for the nine months ended September 30, 2007 as compared to \$20.0 million for the nine months ended September 30, 2006. Personnel costs for our general and administrative functions, such as legal, finance, human resources and information technology, have increased \$3.0 million for the nine months ended September 30, 2007 over the comparable period of 2006 to support the overall expansion of our commercial and research and development activities. In addition, employee recruitment costs, information technology systems support and communications costs have increased \$2.5 million in the current year due to the growth of the Company. We expect selling, general and administrative expenses will continue to increase in 2008 as we increase our staffing and launch preparation activities for the potential European approvals of thalidomide and Vidaza.

*Product rights amortization.* Product rights amortization totaled \$7.4 million and \$7.3 million for the nine months ended September 30, 2007 and 2006, respectively. No additions to product rights have occurred since the first half of 2006.

*Interest and other income, net.* Interest and other income, net, totaled \$6.4 million for the nine months ended September 30, 2007 as compared to \$5.3 million for the nine months ended September 30, 2006. The increase was due to the increase in cash and short-term investments in the second quarter of 2007 as a result of the receipt of \$129.6 million in net proceeds from the sale of common stock in an underwritten public offering completed in June 2007, as well as the improved investment returns in 2007.

*Income tax expense.* Income tax expense totaled \$4.8 million for the nine months ended September 30, 2007 as compared to \$7.2 million for the nine months ended September 30, 2006. 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. The decrease in income tax expense was partially due to a reduction in the current year effective tax rate in France resulting from the utilization of net operating losses. The losses became available in the third quarter of 2007 upon completion of an organizational restructuring of two entities operating in this jurisdiction which reduced income tax expense by \$0.7 million in comparison to the income tax expense recorded for the nine months ended September 30, 2006. The remaining decrease in income tax expense was primarily due to a reduction to U.S. taxes associated with alternative minimum tax and a reduction in taxable income in certain foreign jurisdictions.

**Liquidity and Capital Resources**

As of September 30, 2007, we had an accumulated deficit of \$263.2 million. Although we achieved profitability during 2005, our recent product acquisitions and development have significantly increased our operating expenses, resulting in net losses during 2006

**Table of Contents**

and for the nine months ended September 30, 2007. We expect to continue to incur significant net losses for 2007. To date, our operations have been funded primarily with proceeds from the sale of equity and net sales of our products.

Cash, cash equivalents and short-term investments increased from \$136.2 million at December 31, 2006 to \$257.6 million at September 30, 2007. This \$121.4 million increase is primarily related to the receipt of \$129.6 million of net proceeds from the sale of common stock through our public offering completed in June 2007, offset by a milestone payment made to GPC Biotech in the third quarter of 2007 and by cash used to purchase property and equipment and to fund operations.

We expect that our cash on hand at September 30, 2007, along with cash generated from expected product sales, will be adequate to fund our operations for at least the next twelve months. However, we reexamine our cash requirements periodically in light of changes in 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 September 30, 2007 are as follows (in thousands):

	<b>Total</b>	<b>Remainder of 2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>Thereafter</b>
			<b>(In thousands)</b>				
<b>Contractual Obligations</b>							
Operating leases	\$ 24,996	\$ 1,328	\$ 4,921	\$ 4,560	\$ 3,780	\$ 3,400	\$ 7,007
Research and development	15,007	2,517	7,400	5,090			
Inventory purchase commitments	12,767	8,559	4,208				
Product royalty payments	300	300					
Total fixed contractual obligations	\$ 53,070	\$ 12,704	\$ 16,529	\$ 9,650	\$ 3,780	\$ 3,400	\$ 7,007

*Operating leases.* Our commitment for operating leases relates primarily to our corporate, clinical, and sales offices located in the U.S., Europe, Thailand and Australia. These lease commitments expire on various dates through 2015.

*Research and development.* 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 early 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 was a prepayment of clinical development costs. The licensing agreement also stipulates we provide an additional funding commitment of \$22.2 million for similar future development costs, of which \$14.3 million of this funding commitment remains at September 30, 2007. 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 for clinical development studies sponsored by Celgene studying thalidomide as a treatment for various types of cancers. Under these agreements, we paid Celgene \$4.7 million in 2005, \$2.7 million in 2006, and \$2.7 million will be paid in 2007.

*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 on 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 and assumes that thalidomide is approved in the E.U. in the first quarter of 2008.

*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 for

**Table of Contents**

satraplatin, we will pay GPC Biotech 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 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 \$141 million, based on the achievement of significant development, regulatory and sales goals. 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. Under the terms of the Cabrellis Pharmaceuticals Corporation acquisition agreement, we will pay \$12.5 million for the initial approval of amrubicin by regulatory authorities in each of the U.S. and the E.U. Additionally, upon amrubicin's approval for a second indication in the U.S. or E.U., we will pay an additional payment of \$10 million for each market. Under the terms of our license agreement for amrubicin, we are also required to make milestone payments of \$7.0 million and \$1.0 million to Dainippon Sumitomo Pharma Co. Ltd. upon regulatory approval of amrubicin in the U.S. and the E.U., respectively, and up to \$17.5 million upon achieving certain annual sales levels in the U.S. Finally, under the agreements with Schering AG, payments totaling up to \$7.5 million are due if milestones relating to revenue 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, 2006.

**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.

**Table of Contents****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, 2006, filed with the SEC on March 15, 2007. 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, 2006 have not materially changed other than as set forth below.

***We may not receive regulatory approvals for our product candidates, or approvals may be delayed.***

Our growth prospects depend to a large extent upon our ability to obtain regulatory approval of our near-term product candidates in Europe: Thalidomide Pharmion, satraplatin and Vidaza. The regulatory review and approval process to obtain marketing approval, even for a drug that is approved in other jurisdictions, takes many years and requires the expenditure of substantial resources. This process can vary substantially based on the type, complexity, novelty and indication of the product candidate involved. Changes in the regulatory approval policy during the development period, changes in or the enactment of additional statutes or regulations, or changes in regulatory review for each submitted product application may cause delays in the approval or rejection of an application. The regulatory authorities have substantial discretion in the approval process and may refuse to accept any application or may decide that data is insufficient for approval and require additional pre-clinical, clinical or other studies, even if the clinical trials supporting the application for approval achieve their endpoints. In addition, varying interpretations of the data obtained from pre-clinical and clinical testing by regulatory authorities could delay, limit or prevent regulatory approval of a product candidate.

*Thalidomide Pharmion.* In January 2007, we submitted an MAA to the EMEA seeking a marketing authorization for Thalidomide Pharmion in the E.U. We believe that the clinical data supporting this submission provides compelling evidence of Thalidomide Pharmion's efficacy in treating multiple myeloma patients. However, our MAA is still currently under review by the EMEA and we cannot make any assurances that this review will result in a positive recommendation for approval. Thalidomide's well-known potential for causing severe birth defects and its negative historical reputation may delay or prevent an approval of our MAA, despite its proven efficacy. In addition, thalidomide continues to be widely available and, in most cases, without a comprehensive safety program. Any report of a birth defect attributed to the current use of thalidomide could compel the regulatory authorities to delay approval or elect not to grant us marketing authorization for Thalidomide Pharmion.

*Satraplatin.* In June 2007, we submitted an MAA to the EMEA seeking marketing approval for satraplatin based upon the results achieved in the SPARC Phase 3 clinical trial evaluating satraplatin in second line hormone refractory prostate cancer (HRPC). The trial met its co-primary endpoint by demonstrating a statistically significant improvement in progression-free survival, or PFS, in the satraplatin treatment arm. PFS is a composite endpoint that assesses when a patient's disease has progressed based upon a number of clinical criteria relevant to the disease state. Although both the EMEA and the FDA have accepted PFS as a suitable endpoint for some product approvals, in other cases regulatory authorities have indicated that only overall survival endpoints will be sufficient for approvals of some cancer therapy candidates. In July 2007, our partner GPC Biotech withdrew its NDA seeking approval for satraplatin in the U.S., following the unanimous recommendation of the Oncologic Drugs Advisory Committee that the FDA wait for the final overall survival data analysis before deciding whether the NDA should be approved. Previously, the EMEA had advised us and GPC Biotech, that it would accept the final analysis of PFS as a basis for an MAA submission for satraplatin, but that the submission must also include available overall survival data from the SPARC trial. In October 2007, in a joint press release with GPC Biotech, we announced that the SPARC trial failed to achieve the overall survival co-primary endpoint, with a median overall survival of 61.3 weeks in the satraplatin arm compared to 61.4 weeks for the control group. We believe this failure will have a significantly negative impact on the review of our MAA by the EMEA. We are currently performing further analysis of the results of the SPARC trial, including pre-specified subset analyses that could provide important information relevant to our MAA submission. However, given the failure of the SPARC trial to demonstrate any survival advantage in favor of satraplatin, we

cannot assure you that the EMEA will accept the final data from SPARC as a basis for marketing approval of satraplatin.

*Vidaza.* In early August 2007, we announced that our on-going clinical study of Vidaza in 358 high-risk MDS patients demonstrated a statistically-significant survival advantage for patients in the Vidaza treatment arm versus conventional care regimens. We intend to file an MAA with the EMEA seeking a marketing authorization for Vidaza in the E.U. by the end of 2007 and a supplemental NDA with the FDA seeking to include these new data in the prescribing information for Vidaza in the U.S. These results were based upon a preliminary, or top line, analysis of data from the trial and further analyses of the results from the trial are on-going. We cannot assure you that the top line results from this clinical trial will be confirmed upon full analysis of the results of the study or that negative information relating to the safety, efficacy or tolerability of Vidaza may be discovered upon further analysis of data from this study. Furthermore, even if these top line results are confirmed upon full analysis of the study, we cannot guarantee that these results or the trial design will be deemed sufficient for approval by regulatory authorities in the E.U. or that information from the study will ultimately be included in the approved prescribing information in the U.S.

The timing of our submissions, the outcome of reviews by the applicable regulatory authorities in each relevant market, and the initiation and completion of clinical trials are subject to uncertainty, change and unforeseen delays. Moreover, favorable results in later stage clinical trials do not ensure regulatory approval to commercialize a product. We will be unable to market Thalidomide Pharmion, Vidaza or satraplatin in Europe if we do not receive marketing authorization from the European Commission. Without such authorization, we will only be able to sell those products, if at all, on a compassionate use or named patient basis in Europe, which will significantly limit our revenues.

**Table of Contents**

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

Not applicable.

**Item 3. *Defaults Upon Senior Securities***

Not applicable.

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

Not applicable.

**Item 5. *Other Information***

None.

**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 of the President and Chief Executive Officer.
31.2	Sarbanes-Oxley Act of 2002, Section 302 Certification of the Chief Financial Officer.
32.1	Sarbanes-Oxley Act of 2002, Section 906 Certifications of the 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: November 9, 2007

PHARMION CORPORATION

By: /s/ Erle T. Mast  
Chief Financial Officer  
(Principal Financial and Accounting  
Officer)

Date: November 9, 2007

**Table of Contents**

**Exhibit Index**

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