LEXICON PHARMACEUTICALS, INC./DE
Form 10-Q
August 09, 2010

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2010

or

q 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: 000-30111

Lexicon Pharmaceuticals, Inc.
(Exact Name of Registrant as Specified in its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	76-0474169 (I.R.S. Employer Identification Number)

8800 Technology Forest Place
The Woodlands, Texas 77381
(Address of Principal Executive Offices and Zip Code)

(281) 863-3000
(Registrant’s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes ü No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer ü Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No ü

As of August 5, 2010, 337,404,194 shares of the registrant's common stock, par value $0.001 per share, were outstanding.

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Lexicon Pharmaceuticals, Inc.

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The Lexicon name and logo, OmniBank® and LexVision® are registered trademarks and Genome5000™ is a trademark of Lexicon Pharmaceuticals, Inc.

Factors Affecting Forward Looking Statements

This quarterly report on Form 10-Q contains forward-looking statements. These statements relate to future events or our future financial performance. We have attempted to identify forward-looking statements by terminology including "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "plan," "potential," "predict," "sl negative of these terms or other comparable terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including the risks outlined under "Part II, Item 1A. – Risk Factors," that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels or activity, performance or achievements expressed or implied by these forward-looking statements.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are not under any duty to update any of the forward-looking statements after the date of this quarterly report on Form 10-Q to conform these statements to actual results, unless required by law.

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Part I – Financial Information

Item 1. Financial Statements

Lexicon Pharmaceuticals, Inc.

Consolidated Balance Sheets
(In thousands, except par value)

Assets	As of June 30, 2010 (unaudited)	As of December 31, 2009
Current assets:		
Cash and cash equivalents	$ 247,698	$ 100,554
Short-term investments, including restricted investments of $430	24,083	56,542
Short-term investments held by Symphony Icon, Inc. (Note 4)	—	5,417
Accounts receivable, net of allowances of $35	2,083	815
Prepaid expenses and other current assets	8,589	6,356
Total current assets	282,453	169,684
Property and equipment, net of accumulated depreciation and amortization of $77,192 and $75,795, respectively	56,552	58,754
Goodwill	25,798	25,798
Other assets	352	3,525
Total assets	$ 365,155	$ 257,761
Liabilities and Equity		
Current liabilities:		
Accounts payable	$ 3,547	$ 5,919
Accrued liabilities	6,285	5,611
Current portion of deferred revenue	514	942
Current portion of long-term debt	17,100	38,482
Total current liabilities	27,446	50,954
Deferred revenue, net of current portion	14,212	14,212
Long-term debt	27,922	28,482
Other long-term liabilities	540	616
Total liabilities	70,120	94,264
Commitments and contingencies		
Equity:		
Lexicon Pharmaceuticals, Inc. stockholders' equity:		
Preferred stock, $.01 par value; 5,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $.001 par value; 900,000 shares authorized; 337,562 and 175,785 shares issued, respectively	338	176
Additional paid-in capital	917,828	733,874
Accumulated deficit	(622,894)	(570,175)
Treasury stock, at cost, 158 and 80 shares, respectively	(237)	(88)
Total Lexicon Pharmaceuticals, Inc. stockholders' equity	295,035	163,787

Noncontrolling interest in Symphony Icon, Inc. (Note 4)		—		(290)
Total equity		295,035		163,497
Total liabilities and equity	$	365,155	$	257,761

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

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Lexicon Pharmaceuticals, Inc.

Consolidated Statements of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Revenues:				
Collaborative research	$ 1,164	$ 2,787	$ 2,805	$ 6,392
Subscription and license fees	69	202	69	765
Total revenues	1,233	2,989	2,874	7,157
Operating expenses:				
Research and development, including stock-based compensation of $809, $766, $1,615 and $1,595, respectively	20,239	20,220	41,327	43,084
General and administrative, including stock-based compensation of $511, $590, $1,010 and $1,203, respectively	5,068	5,551	10,587	10,425
Total operating expenses	25,307	25,771	51,914	53,509
Loss from operations	(24,074)	(22,782)	(49,040)	(46,352)
Gain on investments, net	53	306	141	823
Interest income	200	239	417	566
Interest expense	(729)	(729)	(1,456)	(1,395)
Other expense, net	(643)	(576)	(1,325)	(1,521)
Consolidated net loss	(25,193)	(23,542)	(51,263)	(47,879)
Less: Net loss attributable to noncontrolling interest in Symphony Icon, Inc. (Note 4)	—	3,469	—	6,246
Net loss attributable to Lexicon Pharmaceuticals, Inc.	$ (25,193)	$ (20,073)	$ (51,263)	$ (41,633)
Net loss attributable to Lexicon Pharmaceuticals, Inc. per common share, basic and diluted	$ (0.07)	$ (0.15)	$ (0.19)	$ (0.30)
Shares used in computing net loss attributable to Lexicon Pharmaceuticals, Inc. per common share, basic and diluted	337,404	137,331	267,709	137,203

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

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Lexicon Pharmaceuticals, Inc.

Consolidated Statements of Stockholders' Equity
(In thousands)
(Unaudited)

	Lexicon Pharmaceuticals, Inc. Stockholders								
	Common Stock Shares	Par Value	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Total	Noncontrolling Interest (Note 4)	Total Equity
Balance at December 31, 2008	136,797	$ 137	$ 672,838	$ (487,395)	$ —	$ —	$ 185,580	$ 10,247	$ 195,827
Stock-based compensation	—	—	3,163	—	—	—	3,163	—	3,163
Grant of restricted stock	534	—	—	—	—	—	—	—	—
Net loss	—	—	—	(41,633)	—	—	(41,633)	(6,246)	(47,879)
Unrealized loss on investments	—	—	—	—	(1)	—	(1)	—	(1)
Comprehensive loss							(41,634)		(47,880)
Balance at June 30, 2009	137,331	$ 137	$ 676,001	$ (529,028)	$ (1)	$ —	$ 147,109	$ 4,001	$ 151,110
Balance at December 31, 2009	175,785	$ 176	$ 733,874	$ (570,175)	$ —	$ (88)	$ 163,787	$ (290)	$ 163,497
Deconsolidation of Symphony Icon	—	—	—	—	—	—	—	290	290
Cumulative-effect adjustment for adoption of new accounting principle (Note 4)	—	—	—	(1,456)	—	—	(1,456)	—	(1,456)
Stock-based compensation	—	—	2,625	—	—	—	2,625	—	2,625
Issuance of common stock, net of fees	161,770	162	181,312	—	—	—	181,474	—	181,474
Exercise of common stock options	7	—	17	—	—	—	17	—	17
Repurchase of common stock	—	—	—	—	—	(149)	(149)	—	(149)
Net loss	—	—	—	(51,263)	—	—	(51,263)	—	(51,263)
Balance at June 30, 2010	337,562	$ 338	$ 917,828	$ (622,894)	$ —	$ (237)	$ 295,035	$ —	$ 295,035

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

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Lexicon Pharmaceuticals, Inc.

Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six Months Ended June 30,	
	2010	2009
Cash flows from operating activities:		
Consolidated net loss	$ (51,263)	$ (47,879)
Adjustments to reconcile consolidated net loss to net cash used in operating activities:		
Depreciation	2,745	3,317
Impairment of fixed assets	—	445
Amortization of Symphony Icon, Inc. purchase option	1,357	1,071
Stock-based compensation	2,625	2,798
Gain on auction rate securities (“ARS”)	(9,866)	(725)
Loss (gain) on ARS Rights	9,725	(98)
(Gain) loss on disposal of property and equipment	(10)	4
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(851)	38
(Increase) decrease in prepaid expenses and other current assets	3,053	(2,530)
Decrease in other assets	49	51
Decrease in accounts payable and other liabilities	(1,459)	(4,177)
Decrease in deferred revenue	(428)	(4,398)
Net cash used in operating activities	(44,323)	(52,083)
Cash flows from investing activities:		
Purchases of property and equipment	(562)	(242)
Proceeds from disposal of property and equipment	29	37
Maturities of investments held by Symphony Icon, Inc. (Note 4)	—	8,875
Purchases of investments	—	(59,955)
Maturities of investments	32,600	30,179
Net cash provided by (used in) investing activities	32,067	(21,106)
Cash flows from financing activities:		
Proceeds from issuance of common stock	181,491	—
Repurchase of common stock	(149)	—
Proceeds from debt borrowings	11,377	37,392
Repayment of debt borrowings	(33,319)	(910)
Net cash provided by financing activities	159,400	36,482
Net increase (decrease) in cash and cash equivalents	147,144	(36,707)
Cash and cash equivalents at beginning of period	100,554	85,873
Cash and cash equivalents at end of period	$ 247,698	$ 49,166
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 1,220	$ 1,267
Supplemental disclosure of non-cash investing and financing activities:		
Unrealized loss on investments	$ —	$ (1)

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

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Lexicon Pharmaceuticals, Inc.

Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Lexicon Pharmaceuticals, Inc. ("Lexicon" or the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the six-month period ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ended December 31, 2010.

The accompanying consolidated financial statements include the accounts of Lexicon and its wholly-owned subsidiaries. Intercompany transactions and balances are eliminated in consolidation. In 2009, the consolidated financial statements also include the accounts of one variable interest entity, Symphony Icon, Inc. ("Symphony Icon"), for which the Company was the primary beneficiary and therefore had consolidated the financial condition and results of operations of Symphony Icon. Upon the adoption of a new accounting pronouncement regarding variable interest entities (formerly Statement of Financial Accounting Standards ("SFAS") No. 167, "Amendments to FASB Interpretation No. 46(R)") on January 1, 2010, Lexicon determined that it is no longer the primary beneficiary of Symphony Icon, and is therefore no longer consolidating the financial condition and results of operations of Symphony Icon.

For further information, refer to the financial statements and footnotes thereto included in Lexicon's annual report on Form 10-K for the year ended December 31, 2009, as filed with the SEC.

2. Net Loss Per Share

Net loss per share is computed using the weighted average number of shares of common stock outstanding during the applicable period. Shares associated with stock options and warrants are not included because they are antidilutive. There are no differences between basic and diluted net loss per share for all periods presented.

3. Stock-Based Compensation

The Company recorded \$1.3 million and \$1.4 million of stock-based compensation expense for the three months ended June 30, 2010 and 2009, respectively, and \$2.6 million and \$2.8 million of stock-based compensation expense for the six months ended June 30, 2010 and 2009, respectively. The Company utilized the Black-Scholes valuation model for estimating the fair value of the stock compensation granted, with the following weighted-average assumptions for options granted in the six months ended June 30, 2010 and 2009:

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	Expected Volatility	Risk-free Interest Rate	Expected Term	Dividend Rate
June 30, 2010:				
Employees	86%	2.4%	5	0%
Officers and non-employee directors	80%	3.3%	8	0%
June 30, 2009:				
Employees	78%	1.9%	5	0%
Officers and non-employee directors	77%	2.7%	8	0%

The following is a summary of option activity under Lexicon's stock option plans for the six months ended June 30, 2010:

	Options (in thousands)	Weighted Average Exercise Price
Outstanding at December 31, 2009	17,346	$4.16
Granted	4,806	1.88
Exercised	(7)	2.50
Expired	(1,673)	5.77
Forfeited	(333)	1.71
Outstanding at June 30, 2010	20,139	3.52
Exercisable at June 30, 2010	10,908	$4.94

During 2009, Lexicon granted its officers restricted stock bonus awards in lieu of cash bonus awards. The shares subject to the awards vested in two installments over the one-year period following the date of grant. The following is a summary of restricted stock bonus activity under Lexicon's stock option plans for the six months ended June 30, 2010:

	Shares (in thousands)	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2009	255	$1.45
Vested	(255)	1.45
Nonvested at June 30, 2010	—	$—

During the six months ended June 30, 2010, Lexicon granted certain employees restricted stock units with a performance condition. The shares subject to the restricted stock units vest upon the dosing of the first patient in a pivotal human clinical trial in any country, the results of which could be used to establish safety and efficacy of a pharmaceutical product discovered or developed by Lexicon as a basis for a New Drug Application. Stock-based compensation expense for awards with performance conditions is recognized over the period from the date the performance condition is determined to be probable of occurring through the time the applicable condition is met. The following is a summary of restricted stock units activity under Lexicon's stock option plans for the six months ended June 30, 2010:

	Shares (in thousands)	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2009	—	$—
Granted	387	1.90
Nonvested at June 30, 2010	387	$1.90

4. Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board ("FASB") issued a new accounting pronouncement regarding variable interest entities (formerly SFAS No. 167) which changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities that most significantly impacts the entity's economic performance. The impact of the adoption of this pronouncement may be applied retrospectively with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated, or through a cumulative-effect adjustment on the date of adoption. This pronouncement, found under FASB ASC Topic 810, is effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2009. The Company has determined that upon adoption of this pronouncement on January 1, 2010, Lexicon is no longer the primary beneficiary of Symphony Icon, and therefore has not included the financial condition and results of operations of Symphony Icon in its consolidated financial statements as of and for the three and six months ended June 30, 2010. As of December 31, 2009, Symphony Icon had $6.2 million in current assets, $5.4 million of which was short-term investments, and $4.2 million in current liabilities. On January 1, 2010, Lexicon recorded a cumulative-effect adjustment to retained earnings (accumulated deficit) as a result of adopting this pronouncement, which increased the accumulated deficit balance by $1.5 million.

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In October 2009, the FASB issued Accounting Standards Update (“ASU”) No. 2009-13, “Multiple-Deliverable Revenue Arrangements”, which amends FASB ASC Topic 605. ASU No. 2009-13 addresses how to determine whether an arrangement involving multiple deliverables contain more than one unit of accounting and how to allocate consideration to each unit of accounting in the arrangement. This pronouncement replaces all references to fair value as the measurement criteria with the term selling price and establishes a hierarchy for determining the selling price of a deliverable. The pronouncement also eliminates the use of the residual value method for determining the allocation of arrangement consideration, and requires additional disclosures. This pronouncement should be applied prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. This pronouncement’s impact on accounting for revenue arrangements is dependent upon arrangements entered into on or after that time.

In April 2010, the FASB issued ASU No. 2010-17, “Milestone Method of Revenue Recognition”, which amends FASB ASC Topic 605. ASU No. 2010-17 provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Research or development arrangements frequently include payment provisions whereby a portion or all of the consideration is contingent upon milestone events such as successful completion of phases in a study or achieving a specific result from the research or development efforts. The amendments in this ASU provide guidance on the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate. ASU 2010-17 is effective for fiscal years and interim periods within those years beginning on or after June 15, 2010, with early adoption permitted. This pronouncement’s impact on accounting for revenue arrangements with milestones is dependent upon milestones achieved on or after that time.

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5. Cash and Cash Equivalents and Investments

The fair value of cash and cash equivalents and investments held at June 30, 2010 and December 31, 2009 are as follows:

	As of June 30, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash and cash equivalents	$ 247,698	$ —	$ —	$ 247,698
Securities maturing within one year:				
Certificates of deposit	508	—	—	508
ARS Rights	—	—	—	—
Securities maturing after ten years:				
Auction rate securities	23,575	—	—	23,575
Total short-term investments	$ 24,083	$ —	$ —	$ 24,083
Total cash and cash equivalents and investments	$ 271,781	$ —	$ —	$ 271,781

	As of December 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash and cash equivalents	$ 100,554	$ —	$ —	$ 100,554
Securities maturing within one year:				
Certificates of deposit	508	—	—	508
ARS rights	—	9,725	—	9,725
Securities maturing after ten years:				
Auction rate securities	56,175	—	(9,866)	46,309
Total short-term investments	$ 56,683	$ 9,725	$ (9,866)	$ 56,542
Short-term investments held by Symphony Icon, Inc.:				
Cash and cash equivalents	5,417	—	—	5,417
Total short-term investments held by Symphony Icon, Inc.	$ 5,417	$ —	$ —	$ 5,417
Total cash and cash equivalents and investments	$ 162,654	$ 9,725	$ (9,866)	$ 162,513

There were no realized gains or losses for the three and six months ended June 30, 2010 and 2009. The cost of securities sold is based on the specific identification method.

At June 30, 2010, Lexicon held $23.6 million (par value), with an estimated fair value of $23.6 million, of investments with an auction interest rate reset feature, known as auction rate securities. At December 31, 2009, Lexicon held $56.2 million (par value), with an estimated fair value of $46.3 million, of auction rate securities. These notes were issued by various state agencies for the purpose of financing student loans. The securities have historically traded at par and were redeemable at par plus accrued interest at the option of the issuer. Interest was typically paid at the end of each auction period or semiannually. Until February 2008, the market for Lexicon's auction rate securities was highly liquid. However, starting in February 2008, a substantial number of auctions "failed," meaning that there was not enough demand to sell all of the securities that holders desired to sell at auction. The immediate effect of a failed auction was that such holders could not sell the securities at auction and the interest rate on the security generally reset to a maximum interest rate. In the case of funds invested by Lexicon in auction rate securities which were the subject of a failed auction, Lexicon was not able to access the funds without a loss of principal unless a future auction on these investments was successful or the issuer redeemed the security. Lexicon has modified its current investment strategy to reallocate its investments more into U.S. treasury securities and U.S. treasury-backed money market investments.

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At June 30, 2010 and December 31, 2009, observable auction rate securities market information was not available to determine the fair value of Lexicon's investments. Lexicon has estimated the fair value of these securities at $23.6 million and $46.3 million as of June 30, 2010 and December 31, 2009, respectively. At December 31, 2009, Lexicon estimated the fair value of these securities using models of the expected future cash flows related to the securities and taking into account assumptions about the cash flows of the underlying student loans, as well as secondary market trading data. The assumptions used in preparing the discounted cash flow model include estimates of interest rates, timing and amount of cash flows, liquidity premiums and expected holding periods of the auction rate securities, based on data available as of December 31, 2009. The underlying assumptions are volatile and are subject to change as market conditions change. As of June 30, 2010, Lexicon estimated the fair value of these securities at par value, as Lexicon received the entire par value amount in cash on July 1, 2010, as discussed below.

In November 2008, Lexicon accepted an offer from UBS AG, the investment bank that sold Lexicon the auction rate securities, providing Lexicon with rights related to its auction rate securities ("ARS Rights"). The ARS Rights permitted Lexicon to require UBS to purchase its $23.6 million (par value) of auction rate securities at par value during the period from June 30, 2010 through July 2, 2012. Conversely, UBS had the right, in its discretion, to purchase or sell the securities at any time by paying Lexicon the par value of such securities. On June 30, 2010, Lexicon exercised the ARS Rights and UBS purchased Lexicon's $23.6 million of auction rate securities at par value on July 1, 2010. Lexicon was also eligible to borrow from UBS Bank USA, an affiliate of UBS, at no net cost up to 75% of the market value of the securities, as determined by UBS Bank USA, which loans became payable upon the purchase or sale of the securities by UBS (see note 7). On July 1, 2010, Lexicon paid the remaining $16.0 million outstanding under this credit line.

The enforceability of the ARS Rights resulted in a separate asset that was measured at its fair value. Lexicon elected to measure the ARS Rights under a fair value option, which permits entities to choose, at certain election dates, to measure eligible items at fair value. As a result of accepting the ARS Rights, Lexicon elected to classify the ARS Rights and reclassify its investments in auction rate securities as trading securities from available-for-sale securities. As a result, Lexicon was required to assess the fair value of these two individual assets and record changes each period until the ARS Rights were exercised and the auction rate securities were redeemed.

6. Fair Value Measurements

The Company uses various inputs in determining the fair value of its investments and measures these assets on a recurring basis. Financial assets recorded at fair value in the consolidated balance sheets are categorized by the level of objectivity associated with the inputs used to measure their fair value. The following levels are directly related to the amount of subjectivity associated with the inputs to fair valuation of these financial assets:

- Level 1 – quoted prices in active markets for identical investments
- Level 2 – other significant observable inputs (including quoted prices for similar investments, market corroborated inputs, etc.)
- Level 3 – significant unobservable inputs (including the Company's own assumptions in determining the fair value of investments)

The inputs or methodology used for valuing securities are not necessarily an indication of the credit risk associated with investing in those securities. The following table provides the fair value measurements of applicable Company financial assets that are measured at fair value on a recurring basis according to the fair value levels described above as of June 30, 2010 and December 31, 2009.

	Financial Assets at Fair Value as of June 30, 2010			
	Level 1	Level 2	Level 3	Total
		(in thousands)		
Cash and cash equivalents	$ 247,698	$ —$	—$	247,698
Short-term investments	508	—	23,575	24,083
Total cash and cash equivalents and investments	$ 248,206	$ —$	23,575	$ 271,781

	Financial Assets at Fair Value as of December 31, 2009			
	Level 1	Level 2	Level 3	Total
		(in thousands)		
Cash and cash equivalents	$ 100,554	$ —$	—$	100,554
Short-term investments	508	—	56,034	56,542
Short-term investments held by Symphony Icon, Inc.	5,417	—	—	5,417
Total cash and cash equivalents and investments	$ 106,479	$ —$	56,034	$ 162,513

The table presented below summarizes the change in consolidated balance sheet carrying value associated with Level 3 financial assets for the six months ended June 30, 2010 and 2009.

	Short-term Investments	Long-term Investments	Total
		(in thousands)	
Balance at December 31, 2009	$ 56,034	$ —$	56,034
Unrealized gains included in earnings as gain on investments, net	141	—	141
Net sales and settlements	(32,600)	—	(32,600)
Balance at June 30, 2010	$ 23,575	$ —$	23,575
Balance at December 31, 2008	$ —$	55,686	$ 55,686
Unrealized gains included in earnings as gain on investments, net	—	823	823
Net sales and settlements	—	(100)	(100)
Balance at June 30, 2009	$ —$	56,409	56,409

The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include goodwill associated with the acquisition of Coelacanth Corporation in 2001. For these assets, measurement at fair value in periods subsequent to their initial recognition is applicable if one or more is determined to be impaired.

7. Debt Obligations

Mortgage Loan. In April 2004, Lexicon obtained a $34.0 million mortgage on its facilities in The Woodlands, Texas. The mortgage loan has a ten-year term with a 20-year amortization and bears interest at a fixed rate of 8.23%. The mortgage had a principal balance outstanding of $29.0 million as of June 30, 2010. The fair value of Lexicon's mortgage loan approximates its carrying value. The fair value of Lexicon's mortgage loan is estimated using discounted cash flow analysis, based on the Company's current incremental borrowing rate.

UBS Credit Line. In January 2009, Lexicon entered into a credit line agreement with UBS Bank USA that provided an uncommitted, demand, revolving line of credit. Lexicon entered into the credit line in connection with its acceptance of an offer from UBS AG, the investment bank that sold Lexicon its auction rate securities, providing Lexicon with rights to require UBS to purchase its $23.6 million (par value) of auction rate securities at par value during the period from June 30, 2010 through July 2, 2012. On June 30, 2010, Lexicon exercised its rights and UBS purchased Lexicon's $23.6 million of auction rate securities at par value on July 1, 2010. The credit line was secured only by these auction rate securities and advances under the credit line were made on a "no net cost" basis, meaning that the interest paid by Lexicon on advances did not exceed the interest or dividends paid to Lexicon by the issuer of the auction rate securities. The interest rate paid on the line of credit was less than the Company's estimated current incremental borrowing rate. As of June 30, 2010, Lexicon had $16.0 million outstanding under this credit line, which was repaid on July 1, 2010 with the proceeds from the UBS purchase of Lexicon's auction rate securities.

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8. Arrangements with Symphony Icon, Inc.

On June 15, 2007, Lexicon entered into a series of related agreements providing for the financing of the clinical development of certain of its drug candidates, including LX1031 and LX1032, along with any other pharmaceutical compositions modulating the same targets as those drug candidates (the “Programs”). The agreements included a Novated and Restated Technology License Agreement pursuant to which the Company licensed to Symphony Icon, a wholly-owned subsidiary of Symphony Icon Holdings LLC (“Holdings”), the Company’s intellectual property rights related to the Programs. Holdings contributed $45 million to Symphony Icon in order to fund the clinical development of the Programs.

Under a Share Purchase Agreement, dated June 15, 2007, between the Company and Holdings, the Company issued and sold to Holdings 7,650,622 shares of its common stock on June 15, 2007 in exchange for $15 million and the Purchase Option (as defined below).

Under a Purchase Option Agreement, dated June 15, 2007, among the Company, Symphony Icon and Holdings, the Company received from Holdings an exclusive purchase option (the “Purchase Option”) that gave the Company the right to acquire all of the equity of Symphony Icon, thereby allowing the Company to reacquire all of the Programs. Lexicon originally calculated the value of the Purchase Option as the difference between the fair value of the common stock issued to Holdings of $23.6 million (calculated at the time of issuance) and the $15.0 million in cash received from Holdings for the issuance of the common stock. Lexicon recorded the value of the Purchase Option as an asset, and was amortizing this asset over the four-year option period. Upon the adoption of a new accounting pronouncement regarding variable interest entities (formerly SFAS No. 167) on January 1, 2010, $2.3 million of structuring and legal fees originally allocated to noncontrolling interest was allocated to the value of the Purchase Option. This resulted in a cumulative-effect adjustment to retained earnings of $1.5 million, representing the additional amortization expense that would have been recorded through December 31, 2009. The unamortized balance of $2.6 million and $3.1 million is recorded in prepaid expenses and other current assets and other assets in the accompanying consolidated balance sheets as of June 30, 2010 and December 31, 2009, respectively. The amortization expense of $678,000 and $535,000 is recorded in other expense, net in the accompanying consolidated statements of operations for the three months ended June 30, 2010 and 2009, respectively, and $1,357,000 and $1,070,000 for the six months ended June 30, 2010 and 2009, respectively.

Under an Amended and Restated Research and Development Agreement, dated June 15, 2007, among the Company, Symphony Icon and Holdings (the “R&D Agreement”), Symphony Icon and the Company were developing the Programs in accordance with a specified development plan and related development budget. The R&D Agreement provided that the Company would continue to be primarily responsible for the development of the Programs. The Company’s development activities were supervised by Symphony Icon’s development committee, which was comprised of an equal number of representatives from the Company and Symphony Icon. The development committee reported to Symphony Icon’s board of directors, which was comprised of five members, including one member designated by the Company and two independent directors.

Under a Research Cost Sharing, Payment and Extension Agreement, dated June 15, 2007, among the Company, Symphony Icon and Holdings, upon the recommendation of the development committee, Symphony Icon’s board of directors had the right to require the Company to pay Symphony Icon up to $15 million for Symphony Icon’s use in the development of the Programs in accordance with the specified development plan and related development budget. Through June 2010, Symphony Icon’s board of directors requested the Company to pay Symphony Icon $9.3 million under this agreement, all of which was paid through June 30, 2010.

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Prior to January 1, 2010, Lexicon had determined that Symphony Icon was a variable interest entity for which it was the primary beneficiary. This determination was based on Holdings' lack of controlling rights with respect to Symphony Icon's activities and the limitation on the amount of expected residual returns Holdings could expect from Symphony Icon if Lexicon exercised its Purchase Option. Lexicon had determined it was a variable interest holder of Symphony Icon due to its contribution of the intellectual property relating to the Programs and its issuance of shares of its common stock in exchange for the Purchase Option. Lexicon had determined that it was a primary beneficiary as a result of certain factors, including its primary responsibility for the development of the Programs and its contribution of the intellectual property relating to the Programs. As a result, Lexicon included the financial condition and results of operations of Symphony Icon in its consolidated financial statements through December 31, 2009. Symphony Icon's cash and cash equivalents have been recorded on Lexicon's consolidated financial statements as short-term investments held by Symphony Icon as of December 31, 2009. The noncontrolling interest in Symphony Icon on Lexicon's consolidated balance sheet initially reflected the $45 million proceeds contributed into Symphony Icon less $2.3 million of structuring and legal fees. As the collaboration progressed, this line item was reduced by Symphony Icon's losses, which were $6.2 million in the six months ended June 30, 2009. The reductions to the noncontrolling interest in Symphony Icon were reflected in Lexicon's consolidated statements of operations using a similar caption and reduced the amount of Lexicon's reported net loss.

Upon the adoption of a new accounting pronouncement regarding variable interest entities (formerly SFAS No. 167) on January 1, 2010, Lexicon determined that it was no longer the primary beneficiary of Symphony Icon. Under the new accounting guidance, neither Lexicon nor Holdings has the power to direct the activities that most significantly impact the economic performance of Symphony Icon; therefore, there was no primary beneficiary. As a result, Lexicon deconsolidated Symphony Icon as of January 1, 2010, and has not included the financial condition and results of operations of Symphony Icon in its consolidated financial statements as of and for the three and six months ended June 30, 2010. Symphony Icon had $5.9 million of total assets and $3.9 million of total liabilities as of June 30, 2010 based on information provided by Symphony Icon. Lexicon's maximum exposure to loss as a result of its involvement with Symphony Icon is limited to additional funding of $5.7 million under the Research Cost Sharing, Payment and Extension Agreement as discussed above. Through June 30, 2010, Lexicon has not charged any license fees and has not recorded any revenue from Symphony Icon, and does not expect to do so based on the current agreements with Symphony Icon and Holdings.

On July 30, 2010, Lexicon entered into an Amended and Restated Purchase Option Agreement with Symphony Icon and Holdings and simultaneously exercised the Purchase Option, thereby reacquiring the Programs. Pursuant to the amended terms of the Purchase Option, Lexicon paid Holdings $10 million and agreed to make up to $80 million in additional deferred and contingent payments.

The deferred payments will be in an amount equal to $50 million less a 50% share of the expenses Lexicon incurs after its exercise of the Purchase Option for the development of LX1031, LX1032, LX1033 and other pharmaceutical compositions modulating the same target as those drug candidates (the "LG103 Programs"), subject to certain exceptions for studies currently in progress and up to an aggregate reduction of $15 million. The deferred payments are payable in Lexicon's discretion at any time before July 30, 2013.

The contingent payments will consist of a 50% share of any consideration Lexicon receives pursuant to any licensing transaction under which Lexicon grants a third party rights to commercialize a drug candidate from the LG103 Programs (a "Licensing Transaction"), subject to certain exceptions, up to a maximum of $30 million plus the amount of any reduction in the deferred payments for Lexicon's development expenses for the LG103 Programs (the "Recapture Eligible Amount"). The contingent payments will be due if and when Lexicon receives such consideration from a Licensing Transaction. In the event Lexicon receives regulatory approval in the United States for the marketing and sale of any product resulting from the LG103 Programs prior to entering into a Licensing Transaction for the commercialization of such product in the United States, in lieu of any contingent payment from a Licensing

Transaction in the United States with respect to such product, Lexicon will pay Holdings the sum of $15 million and any Recapture Eligible Amount attributable to the development of such product, reduced by up to 50% of such sum for the amount of any contingent payments paid prior to such United States regulatory approval attributable to any such Licensing Transaction outside of the United States with respect to such product. In the event Lexicon makes any such payment upon United States regulatory approval, Lexicon will have no obligation to make subsequent contingent payments attributable to any such Licensing Transactions for the commercialization of such product outside the United States until the proceeds of such Licensing Transactions exceed 50% of the payment made as a result of such United States regulatory approval.

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The deferred payments and the contingent payments may be paid in cash, common stock, or a combination of cash and common stock, in Lexicon's discretion, provided that at least 50% of any payment made on or prior to July 30, 2012 will be paid in common stock and no more than 50% of any payment made after such date will be paid in common stock. Lexicon is currently evaluating the effect of exercising the Purchase Option on its financial condition and results of operations.

9. Commitments and Contingencies

Operating Lease Obligations: A Lexicon subsidiary leases laboratory and office space in Hopewell, New Jersey under an agreement which expires in June 2013. The lease provides for two five-year renewal options at 95% of the fair market rent and includes escalating lease payments. Rent expense is recognized on a straight-line basis over the original lease term. Lexicon is the guarantor of the obligations of its subsidiary under this lease. The maximum potential amount of future payments the Company could be required to make under this agreement is $7.7 million. The Company is required to maintain restricted investments to collateralize a standby letter of credit for this lease. The Company had $0.4 million in restricted investments as collateral as of June 30, 2010 and December 31, 2009. Additionally, Lexicon leases certain equipment under operating leases.

Legal Proceedings. Lexicon is from time to time party to claims and legal proceedings that arise in the normal course of its business and that it believes will not have, individually or in the aggregate, a material adverse effect on its results of operations, financial condition or liquidity.

10. Other Capital Stock Agreements

Common Stock: In March 2010, Lexicon completed the public offering and sale and concurrent private placement of an aggregate of 161,770,206 shares of its common stock at a price of $1.15 per share, resulting in net proceeds of $181.5 million, after deducting underwriting discounts and commissions of $4.3 million and offering expenses of $0.3 million. Invus purchased 94,270,206 of these shares. All of the net proceeds of this offering are reflected as issuance of common stock in the accompanying financial statements.

11. Collaboration and License Agreements

Lexicon has derived substantially all of its revenues from drug discovery and development collaborations, target validation collaborations for the development and, in some cases, analysis of the physiological effects of genes altered in knockout mice, government grants and contracts, technology licenses, subscriptions to its databases and compound library sales. Revenues generated from third parties under collaborative arrangements are recorded on a gross basis on the consolidated statements of operations as Lexicon is the principal participant for these transactions for the purpose of accounting for these arrangements.

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Lexicon established an alliance with Bristol-Myers Squibb in December 2003 to discover, develop and commercialize small molecule drugs in the neuroscience field. Revenue recognized under this agreement was none and $0.8 million for the three months ended June 30, 2010 and 2009, respectively, and none and $1.7 million for the six months ended June 30, 2010 and 2009 respectively.

Lexicon established an alliance with Organon in May 2005 to jointly discover, develop and commercialize novel biotherapeutic drugs. Revenue recognized under this agreement was none and $0.8 million for the three months ended June 30, 2010 and 2009, respectively, and $0.2 million and $2.3 million for the six months ended June 30, 2010 and 2009, respectively.

Lexicon established an alliance with Taconic Farms in November 2005 for the marketing, distribution and licensing of certain lines of knockout mice and entered into an expanded collaboration with Taconic in July 2009. Revenue recognized under these agreements was $0.8 million and $0.4 million for the three months ended June 30, 2010 and 2009, respectively, and $1.5 million and $0.8 million for the six months ended June 30, 2010 and 2009, respectively.

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

Overview

We are a biopharmaceutical company focused on the discovery and development of breakthrough treatments for human disease. We have used our proprietary gene knockout technologies and an integrated platform of advanced medical technologies to identify and validate, in vivo, more than 100 targets with promising profiles for drug discovery. For targets that we believe have high pharmaceutical value, we engage in programs for the discovery and development of potential new drugs, focusing in the core therapeutic areas of immunology, metabolism, cardiology and ophthalmology. Human clinical trials are currently underway for four of our drug candidates, with three additional drug candidates in preclinical development and compounds from a number of additional programs in various stages of preclinical research.

We are working both independently and through strategic collaborations and alliances to capitalize on our technology, drug target discoveries and drug discovery and development programs. Consistent with this approach, we seek to retain exclusive rights to the benefits of certain of our small molecule drug programs by developing drug candidates from such programs internally and to collaborate with third parties with respect to the discovery, development and commercialization of small molecule and biotherapeutic drug candidates for other targets, particularly when the collaboration provides us with access to expertise and resources that we do not possess internally or are complementary to our own. We have established drug discovery and development collaborations with a number of leading pharmaceutical and biotechnology companies which have enabled us to generate near-term cash while offering us the potential to retain economic participation in products our collaborators develop through the collaboration. In addition, we have established collaborations and license agreements with other leading pharmaceutical and biotechnology companies, research institutes and academic institutions under which we received fees and, in some cases, are eligible to receive milestone and royalty payments, in return for granting access to some of our technologies and discoveries.

We derive substantially all of our revenues from drug discovery and development collaborations and other collaborations and technology licenses. To date, we have generated a substantial portion of our revenues from a limited number of sources.

Our operating results and, in particular, our ability to generate additional revenues are dependent on many factors, including our success in establishing new collaborations and technology licenses, expirations of our existing collaborations and alliances, the success rate of our discovery and development efforts leading to opportunities for new collaborations and licenses, as well as milestone payments and royalties, the timing and willingness of collaborators to commercialize products that would result in milestone payments and royalties, and general and industry-specific economic conditions which may affect research and development expenditures. Our future revenues from collaborations and technology licenses are uncertain because our existing agreements have fixed terms or relate to specific projects of limited duration and we depend, in part, on securing new agreements. Our ability to secure future revenue-generating agreements will depend upon our ability to address the needs of our potential future collaborators and licensees, and to negotiate agreements that we believe are in our long-term best interests. We may determine, as we have with our four clinical drug candidates, that our interests are better served by retaining rights to our discoveries and advancing our therapeutic programs to a later stage, which could limit our near-term revenues. Because of these and other factors, our operating results have fluctuated in the past and are likely to do so in the future, and we do not believe that period-to-period comparisons of our operating results are a good indication of our future performance.

Since our inception, we have incurred significant losses and, as of June 30, 2010, we had an accumulated deficit of $622.9 million. Our losses have resulted principally from costs incurred in research and development, general and administrative costs associated with our operations, and non-cash stock-based compensation expenses associated with stock options and restricted stock granted to employees and consultants. Research and development expenses consist primarily of salaries and related personnel costs, external research costs related to our preclinical and clinical efforts, material costs, facility costs, depreciation on property and equipment and other expenses related to our drug discovery and development programs. General and administrative expenses consist primarily of salaries and related expenses for executive and administrative personnel, professional fees and other corporate expenses including information technology, facilities costs and general legal activities. In connection with the continued expansion of our drug discovery and development programs, we expect to continue to incur significant research and development costs. As a result, we will need to generate significantly higher revenues to achieve profitability.

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Critical Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make judgments, estimates and assumptions in the preparation of our consolidated financial statements and accompanying notes. Actual results could differ from those estimates. We believe there have been no significant changes in our critical accounting policies as discussed in our Annual Report on Form 10-K for the year ended December 31, 2009.

Recent Accounting Pronouncements

See Note 4, Recent Accounting Pronouncements, of the Notes to Consolidated Financial Statements, for a discussion of the impact of the new accounting standards on our consolidated financial statements.

Results of Operations

Revenues

Total revenues and dollar and percentage changes as compared to the corresponding periods in the prior year are as follows (dollar amounts are presented in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Total revenues	$1.2	$3.0	$2.9	$7.2
Dollar decrease	$(1.8)		$(4.3)	
Percentage decrease	(59)%		(60)%	

- Collaborative research – Revenue from collaborative research for the three months ended June 30, 2010 decreased 58% to $1.2 million, and for the six months ended June 30, 2010 decreased 56% to $2.8 million, as compared to the corresponding periods in 2009, primarily due to reduced revenues in the three and six months ended June 30, 2010 under our alliances with N.V. Organon and Bristol-Myers Squibb due to the completion in 2009 of the target discovery portion of these alliances.

- Subscription and license fees – Revenue from subscriptions and license fees for the three months ended June 30, 2010 decreased 66% to $0.1 million, and for the six months ended June 30, 2010 decreased 91% to $0.1 million, as compared to the corresponding periods in 2009, primarily due to a decrease in technology license fees.

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Research and Development Expenses

Research and development expenses and dollar and percentage changes as compared to the corresponding periods in the prior year are as follows (dollar amounts are presented in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Total research and development expense	$20.2	$20.2	$41.3	$43.1
Dollar decrease	$(0.0)		$(1.8)	
Percentage decrease	(0)%		(4)%	

Research and development expenses consist primarily of salaries and other personnel-related expenses, third-party and other services, facility and equipment costs, laboratory supplies, and stock-based compensation expenses.

- Personnel – Personnel costs for the three months ended June 30, 2010 decreased 1% to $7.9 million, and for the six months ended June 30, 2010 decreased 13% to $16.1 million, as compared to the corresponding periods in 2009, primarily due to reductions in our personnel in January 2009 and associated severance costs. Salaries, bonuses, employee benefits, payroll taxes, recruiting and relocation costs are included in personnel costs.

- Third-party and other services – Third-party and other services for the three months ended June 30, 2010 increased 5% to $5.5 million, and for the six months ended June 30, 2010 increased 14% to $11.5 million, as compared to the corresponding periods in 2009, primarily due to an increase in external preclinical and clinical research and development costs.

- Facilities and equipment – Facilities and equipment costs for the three months ended June 30, 2010 decreased 9% to $3.4 million, and for the six months ended June 30, 2010 decreased 11% to $7.0 million, as compared to the corresponding periods in 2009, primarily due to a decrease in depreciation expense.

- Laboratory supplies – Laboratory supplies expense for the three months ended June 30, 2010 was $1.6 million, consistent with the corresponding period in 2009. Laboratory supplies expense for the six months ended June 30, 2010 decreased 6% to $3.0 million, as compared to the corresponding period in 2009, primarily due to reductions in compound acquisitions.

- Stock-based compensation – Stock-based compensation expense for the three months ended June 30, 2010 was $0.8 million, and for the six months ended June 30, 2010 was $1.6 million, consistent with the corresponding periods in 2009.

- Other – Other costs for the three months ended June 30, 2010 increased 12% to $1.0 million, and for the six months ended June 30, 2010 increased 16% to $2.0 million, as compared to the corresponding periods in 2009.

General and Administrative Expenses

General and administrative expenses and dollar and percentage changes as compared to the corresponding periods in the prior year are as follows (dollar amounts are presented in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Total general and administrative expense	$5.1	$5.6	$10.6	$10.4

Dollar increase (decrease)	$(0.5)	$0.2
Percentage increase (decrease)	(9)%	2%

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General and administrative expenses consist primarily of salaries and other personnel-related expenses, professional fees such as legal fees, facility and equipment costs, and stock-based compensation expenses.

- Personnel – Personnel costs for the three months ended June 30, 2010 decreased 4% to $2.3 million, and for the six months ended June 30, 2010 increased 2% to $5.0 million, as compared to the corresponding periods in 2009. Salaries, bonuses, employee benefits, payroll taxes, recruiting and relocation costs are included in personnel costs.

- Professional fees – Professional fees for the three months ended June 30, 2010 decreased 25% to $1.1 million, and for the six months ended June 30, 2010 increased 7% to $2.3 million, as compared to the corresponding periods in 2009, primarily due to changes in patent-related legal costs.

- Facilities and equipment – Facilities and equipment costs for the three months ended June 30, 2010 decreased 15% to $0.6 million, and for the six months ended June 30, 2010 decreased 12% to $1.2 million, as compared to the corresponding periods in 2009, primarily due to a decrease in electricity costs.

- Stock-based compensation – Stock-based compensation expense for the three months ended June 30, 2010 decreased 13% to $0.5 million, and for the six months ended June 30, 2010 decreased 16% to $1.0 million as compared to the corresponding periods in 2009.

- Other – Other costs for the three months ended June 30, 2010 increased 36% to $0.6 million, and for the six months ended June 30, 2010 increased 33% to $1.0 million, as compared to the corresponding periods in 2009.

Gain on Investments, Net, Interest Income, Interest Expense and Other Expense, Net

Gain on Investments, Net. Gain on investments was $7.6 million and $9.9 million for the three and six months ended June 30, 2010, representing the increase in fair value of our student loan auction rate securities. These gains were offset by a loss on investments of $7.6 million and $9.7 million for the three and six months ended June 30, 2010, representing the decline in fair value of the rights obtained from UBS AG, the investment bank that sold us our auction rate securities. Gain on investments was $0.8 million and $0.7 million for the three and six months ended June 30, 2009, representing the increase in fair value of our student loan auction rate securities. These gains are offset by a loss on investments of $0.5 million for the three months ended June 30, 2009, and are in addition to a gain on investments of $0.1 million for the six months ended June 30, 2009, representing the change in fair value of the rights obtained from UBS AG.

Interest Income. Interest income for the three months ended June 30, 2010 was $0.2 million, consistent with the corresponding period in 2009. Interest income for the six months ended June 30, 2010 decreased 26% to $0.4 million, as compared to the corresponding period in 2009, due to lower yields on our investments.

Interest Expense. Interest expense for the three months ended June 30, 2010 was $0.7 million, consistent with the corresponding period in 2009. Interest expense for the six months ended June 30, 2010 increased 4% to $1.5 million as compared to the corresponding period in 2009.

Other Expense, Net. Other expense, net for the three months ended June 30, 2010 was $0.6 million, consistent with the corresponding period in 2009. Other expense, net for the six months ended June 30, 2010 decreased 13% to $1.3 million as compared to the corresponding period in 2009.

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Noncontrolling Interest in Symphony Icon, Inc.

For the three and six months ended June 30, 2009, the losses attributable to the noncontrolling interest holders of Symphony Icon were $3.5 million and $6.2 million, respectively. As discussed in Note 4, Recent Accounting Pronouncements of the Notes to Consolidated Financial Statements, we have determined that upon the adoption of a new accounting pronouncement regarding variable interest entities on January 1, 2010, we are not the primary beneficiary of Symphony Icon, and therefore, we are no longer including the financial condition and results of operations of Symphony Icon in our consolidated financial statements.

Net Loss Attributable to Lexicon Pharmaceuticals, Inc. and Net Loss Attributable to Lexicon Pharmaceuticals, Inc. per Common Share

Net loss attributable to Lexicon Pharmaceuticals, Inc. increased to $25.2 million in the three months ended June 30, 2010 from $20.1 million in the corresponding period in 2009. Net loss attributable to Lexicon Pharmaceuticals, Inc. per common share decreased to $0.07 in the three months ended June 30, 2010 from $0.15 in the corresponding period in 2009. Net loss attributable to Lexicon Pharmaceuticals, Inc. increased to $51.3 million in the six months ended June 30, 2010 from $41.6 million in the corresponding period in 2009. Net loss attributable to Lexicon Pharmaceuticals, Inc. per common share decreased to $0.19 in the six months ended June 30, 2010 from $0.30 in the corresponding period in 2009.

Our quarterly operating results have fluctuated in the past and are likely to do so in the future, and we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance.

Liquidity and Capital Resources

We have financed our operations from inception primarily through sales of common and preferred stock, contract and milestone payments we have received under our drug discovery and development collaborations, target validation, database subscription and technology license agreements, government grants and contracts, and financing obtained under debt and lease arrangements. We have also financed certain of our research and development activities under our agreements with Symphony Icon, Inc. From our inception through June 30, 2010, we had received net proceeds of $786.9 million from issuances of common and preferred stock. In addition, from our inception through June 30, 2010, we received $449.9 million in cash payments from drug discovery and development collaborations, target validation, database subscription and technology license agreements, sales of compound libraries and reagents, and government grants and contracts, of which $437.6 million had been recognized as revenues through June 30, 2010.

As of June 30, 2010, we had $271.8 million in cash, cash equivalents and investments. As of December 31, 2009, we had $157.1 million in cash, cash equivalents and investments and $5.4 million in investments held by Symphony Icon. We used cash of $44.3 million in operations in the six months ended June 30, 2010. This consisted primarily of the consolidated net loss for the period of $51.3 million and a net gain on investments and auction rate security rights of $0.1 million, partially offset by non-cash charges of $2.7 million related to depreciation expense, $2.6 million related to stock-based compensation expense, $1.4 million related to the amortization of the Symphony Icon purchase option, and a net decrease in other operating assets net of liabilities of $0.4 million. Investing activities provided cash of $32.1 million in the six months ended June 30, 2010, primarily due to maturities of investments of $32.6 million, partially offset by purchases of property and equipment of $0.6 million. Financing activities provided cash of $159.4 million due to net proceeds from issuance of common stock of $181.5 million, partially offset by net repayment of debt borrowings of $21.9 million.

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UBS Credit Line. In January 2009, we entered into a credit line agreement with UBS Bank USA that provided an uncommitted, demand, revolving line of credit. We entered into the credit line in connection with our acceptance of an offer from UBS AG, the investment bank that sold us our auction rate securities, providing us with rights to require UBS to purchase our $23.6 million (par value) of auction rate securities at par value during the period from June 30, 2010 through July 2, 2012. On June 30, 2010, we exercised our rights and UBS purchased our remaining $23.6 million of auction rate securities at par value on July 1, 2010. The credit line was secured only by these auction rate securities and advances under the credit line were made on a “no net cost” basis, meaning that the interest paid by us on advances would not exceed the interest or dividends paid to us by the issuer of the auction rate securities. As of June 30, 2010, we had $16.0 million outstanding under this credit line, which was repaid on July 1, 2010 with the proceeds from the UBS purchase of our auction rate securities.

Invus Securities Purchase Agreement. In June 2007, we entered into a securities purchase agreement with Invus, L.P, pursuant to which Invus purchased 50,824,986 shares of our common stock for approximately $205.4 million in August 2007. Pursuant to the securities purchase agreement, as amended and supplemented, and after accounting for the $181.5 million net proceeds of our public offering and concurrent private placement of common stock in March 2010, Invus has the right to require us to initiate one pro rata rights offering to our stockholders, which would provide all stockholders with non-transferable rights to acquire shares of our common stock, in an aggregate amount of up to approximately $163.0 million, less the proceeds of any “qualified offerings” that we may complete in the interim involving the sale of our common stock at prices above $4.50 per share. We have not completed any such qualified offering. Invus may exercise its right to require us to conduct such a rights offering by giving us notice within a period of one year beginning on February 28, 2011, which will be extended by the number of days during such period that Invus is not permitted under the securities purchase agreement to initiate the rights offering as a result of any “blackout period” in connection with certain public offerings of our common stock. If Invus elects to exercise its right to require us to initiate a rights offering, Invus would be required to purchase its pro rata portion of the offering.

In connection with the securities purchase agreement, we entered into a stockholders’ agreement with Invus under which Invus (a) has specified rights with respect to designation of directors and participation in future equity issuances by us, (b) is subject to certain standstill restrictions, as well as restrictions on transfer and the voting of the shares of common stock held by it and its affiliates, and (c), as long as Invus holds at least 15% of the total number of outstanding shares of our common stock, is entitled to certain minority protections.

Symphony Drug Development Financing Agreement. In June 2007, we entered into a series of related agreements providing for the financing of the clinical development of certain of our drug candidates, including LX1031, LX1032 and LX1033, along with any other pharmaceutical compositions modulating the same targets as those drug candidates. Under the financing arrangement, we licensed to Symphony Icon, a wholly-owned subsidiary of Symphony Icon Holdings LLC, our intellectual property rights related to the programs and Holdings contributed $45 million to Symphony Icon in order to fund the clinical development of the programs. We also entered into a share purchase agreement with Holdings under which we issued and sold to Holdings 7,650,622 shares of our common stock in exchange for $15 million and an exclusive option to acquire all of the equity of Symphony Icon, thereby allowing us to reacquire the programs.

Upon the recommendation of Symphony Icon’s development committee, which was comprised of an equal number of representatives from us and Symphony Icon, Symphony Icon’s board of directors had the right to require us to pay Symphony Icon up to $15 million for Symphony Icon’s use in the development of the programs in accordance with the specified development plan and related development budget. Through June 2010, Symphony Icon’s board of directors requested us to pay Symphony Icon $9.3 million under this agreement, all which has been paid through June 30, 2010.

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In July 2010, we entered into an amended and restated purchase option agreement with Symphony Icon and Holdings and simultaneously exercised our purchase option, thereby reacquiring the programs. Pursuant to the amended terms of the purchase option, we paid Holdings $10 million and agreed to make up to $80 million in additional deferred and contingent payments.

The deferred payments will be in an amount equal to $50 million less a 50% share of the expenses we incur after our exercise of the purchase option for the development of LX1031, LX1032, LX1033 and other pharmaceutical compositions modulating the same target as those drug candidates, which we refer to as the "LG103 programs," subject to certain exceptions for studies currently in progress and up to an aggregate reduction of $15 million. The deferred payments are payable in our discretion at any time before July 30, 2013.

The contingent payments will consist of a 50% share of any consideration we receive pursuant to any licensing transaction under which we grant a third party rights to commercialize a drug candidate from the LG103 programs, subject to certain exceptions, up to a maximum of $30 million plus the amount of any reduction in the deferred payments for our development expenses for the LG103 programs, which we refer to as the "recapture eligible amount." The contingent payments will be due if and when we receive such consideration from such a licensing transaction. In the event we receive regulatory approval in the United States for the marketing and sale of any product resulting from the LG103 programs prior to entering into such a licensing transaction for the commercialization of such product in the United States, in lieu of any contingent payment from such a licensing transaction in the United States with respect to such product, we will pay Holdings the sum of $15 million and any recapture eligible amount attributable to the development of such product, reduced by up to 50% of such sum for the amount of any contingent payments paid prior to such United States regulatory approval attributable to any such licensing transaction outside of the United States with respect to such product. In the event we make any such payment upon United States regulatory approval, we will have no obligation to make subsequent contingent payments attributable to any such licensing transactions for the commercialization of such product outside the United States until the proceeds of such licensing transactions exceed 50% of the payment made as a result of such United States regulatory approval.

The deferred payments and the contingent payments may be paid in cash, common stock, or a combination of cash and common stock, in our discretion, provided that at least 50% of any payment made on or prior to July 30, 2012 will be paid in common stock and no more than 50% of any payment made after such date will be paid in common stock.

Facilities. In April 2004, we obtained a $34.0 million mortgage on our facilities in The Woodlands, Texas. The mortgage loan has a ten-year term with a 20 year amortization and bears interest at a fixed rate of 8.23%. The mortgage had a principal balance outstanding of $29.0 million as of June 30, 2010. In May 2002, our subsidiary Lexicon Pharmaceuticals (New Jersey), Inc. leased a 76,000 square-foot laboratory and office space in Hopewell, New Jersey. The term of the lease extends until June 30, 2013. The lease provides for an escalating yearly base rent payment of $1.3 million in the first year, $2.1 million in years two and three, $2.2 million in years four to six, $2.3 million in years seven to nine and $2.4 million in years ten and eleven. We are the guarantor of the obligations of our subsidiary under the lease.

Our future capital requirements will be substantial and will depend on many factors, including our ability to obtain drug discovery and development collaborations and other collaborations and technology license agreements, the amount and timing of payments under such agreements, the level and timing of our research and development expenditures, market acceptance of our products, the resources we devote to developing and supporting our products and other factors. Our capital requirements will also be affected by any expenditures we make in connection with license agreements and acquisitions of and investments in complementary technologies and businesses. We expect to devote substantial capital resources to continue our research and development efforts, to expand our support and product development activities, and for other general corporate activities. We believe that our current unrestricted cash and investment balances and cash and revenues we expect to derive from drug discovery and development collaborations and other collaborations and technology licenses will be sufficient to fund our operations for at least the next 12 months. During or after this period, if cash generated by operations is insufficient to satisfy our liquidity requirements, we will need to sell additional equity or debt securities or obtain additional credit arrangements. Additional financing may not be available on terms acceptable to us or at all. The sale of additional equity or convertible debt securities may result in additional dilution to our stockholders.

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Disclosure about Market Risk

We are exposed to limited market and credit risk on our cash equivalents which have maturities of three months or less at the time of purchase. We maintain a short-term investment portfolio which consists of U.S. Treasury bills, money market accounts and certificates of deposit that mature three to 12 months from the time of purchase and auction rate securities that mature greater than 12 months from the time of purchase, which we believe are subject to limited market and credit risk, other than as discussed below. We currently do not hedge interest rate exposure or hold any derivative financial instruments in our investment portfolio.

At June 30, 2010, we held $23.6 million (par value), with an estimated fair value of $23.6 million, of investments with an auction interest rate reset feature, known as auction rate securities. These notes were issued by various state agencies for the purpose of financing student loans. The securities have historically traded at par and were redeemable at par plus accrued interest at the option of the issuer. Interest was typically paid at the end of each auction period or semiannually. Until February 2008, the market for our auction rate securities was highly liquid. Starting in February 2008, a substantial number of auctions "failed," meaning that there was not enough demand to sell all of the securities that holders desired to sell at auction. The immediate effect of a failed auction was that such holders could not sell the securities at auction and the interest rate on the security generally reset to a maximum interest rate. In the case of funds invested by us in auction rate securities which were the subject of a failed auction, we were not able to access the funds without a loss of principal, unless a future auction on these investments was successful or the issuer redeemed the security. We have modified our current investment strategy to reallocate our investments more into U.S. treasury securities and U.S. treasury-backed money market investments.

At June 30, 2010, observable auction rate securities market information was not available to determine the fair value of our investments. We have estimated the fair value of these securities at $23.6 million as of June 30, 2010 as we received the entire par value on July 1, 2010 as discussed below.

In November 2008, we accepted an offer from UBS AG, the investment bank that sold us our auction rate securities, providing us with rights related to our auction rate securities. The rights permitted us to require UBS to purchase our $23.6 million (par value) of auction rate securities at par value during the period from June 30, 2010 through July 2, 2012. Conversely, UBS had the right, in its discretion, to purchase or sell the securities at any time by paying us the par value of such securities. On June 30, 2010, we exercised the rights and UBS purchased our $23.6 million of auction rate securities at par value on July 1, 2010.

The enforceability of the rights resulted in a separate asset that was measured at its fair value. We elected to measure the rights under a fair value option, which permits entities to choose, at certain election dates, to measure eligible items at fair value. As a result of accepting the rights, we have elected to classify the rights and reclassify our investments in auction rate securities as trading securities from available-for-sale securities. As a result, we assessed the fair value of these two individual assets and recorded changes each period until the rights were exercised and the auction rate securities were redeemed.

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Including the auction rate securities at June 30, 2010, net of the credit line from UBS repaid on July 1, 2010, we had approximately $255.8 million in cash and cash equivalents and short-term investments. We believe that the working capital available to us will be sufficient to meet our cash requirements for at least the next 12 months.

We have operated primarily in the United States and substantially all sales to date have been made in U.S. dollars. Accordingly, we have not had any material exposure to foreign currency rate fluctuations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See "Disclosure about Market Risk" under "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" for quantitative and qualitative disclosures about market risk.

Item 4. Controls and Procedures

Our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by us in the reports we file under the Securities Exchange Act is gathered, analyzed and disclosed with adequate timeliness, accuracy and completeness, based on an evaluation of such controls and procedures as of the end of the period covered by this report.

Subsequent to our evaluation, there were no significant changes in internal controls or other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

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Part II Other Information

Item 1. Legal Proceedings

We are from time to time party to claims and legal proceedings that arise in the normal course of our business and that we believe will not have, individually or in the aggregate, a material adverse effect on our results of operations, financial condition or liquidity.

Item 1A. Risk Factors

The following risks and uncertainties are important factors that could cause actual results or events to differ materially from those indicated by forward-looking statements. The factors described below are not the only ones we face and additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations.

Risks Related to Our Need for Additional Financing and Our Financial Results

- We will need additional capital in the future and, if it is unavailable, we will be forced to significantly curtail or cease our operations. If it is not available on reasonable terms, we will be forced to obtain funds by entering into financing agreements on unattractive terms.

- We have a history of net losses, and we expect to continue to incur net losses and may not achieve or maintain profitability.

- Our operating results have been and likely will continue to fluctuate, and we believe that period-to-period comparisons of our operating results are not a good indication of our future performance.

Risks Related to Discovery and Development of Our Drug Candidates

- We are an early-stage company, and have not proven our ability to successfully develop and commercialize drug candidates based on our drug target discoveries.

- Clinical testing of our drug candidates in humans is an inherently risky and time-consuming process that may fail to demonstrate safety and efficacy, which could result in the delay, limitation or prevention of regulatory approval.

Risks Related to Regulatory Approval of Our Drug Candidates

- Our drug candidates are subject to a lengthy and uncertain regulatory process that may not result in the necessary regulatory approvals, which could adversely affect our ability to commercialize products.

- If our potential products receive regulatory approval, we or our collaborators will remain subject to extensive and rigorous ongoing regulation.

Risks Related to Commercialization of Products

- The commercial success of any products that we may develop will depend upon the degree of market acceptance of our products among physicians, patients, health care payors, private health insurers and the medical community.

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If we are unable to establish sales and marketing capabilities or enter into agreements with third parties to market and sell our drug candidates, we may be unable to generate product revenues.

- If we are unable to obtain adequate coverage and reimbursement from third-party payors for any products that we may develop, our revenues and prospects for profitability will suffer.

- Our competitors may develop products that make our products obsolete.

- We may not be able to manufacture our drug candidates in commercial quantities, which would prevent us from commercializing our drug candidates.

Risks Related to Our Relationships with Third Parties

- We are dependent in many ways upon our collaborations with major pharmaceutical companies. The revenues we receive under our existing collaborations have been decreasing in recent periods and are likely to continue to decrease in the future. If we are unable to achieve milestones under our collaborations or if our collaborators' efforts fail to yield pharmaceutical products on a timely basis, our opportunities to generate revenues and earn royalties will be reduced.

- Conflicts with our collaborators could jeopardize the success of our collaborative agreements and harm our product development efforts.

- We rely on third parties to carry out drug development activities.

- We lack the capability to manufacture materials for preclinical studies, clinical trials or commercial sales and rely on third parties to manufacture our drug candidates, which may harm or delay our product development and commercialization efforts.

Risks Related to Our Intellectual Property

- If we are unable to adequately protect our intellectual property, third parties may be able to use our technology, which could adversely affect our ability to compete in the market.

- We may be involved in patent litigation and other disputes regarding intellectual property rights and may require licenses from third parties for our discovery and development and planned commercialization activities. We may not prevail in any such litigation or other dispute or be able to obtain required licenses.

- We use intellectual property that we license from third parties. If we do not comply with these licenses, we could lose our rights under them.

- We have not sought patent protection outside of the United States for some of our inventions, and some of our licensed patents only provide coverage in the United States. As a result, our international competitors could be granted foreign patent protection with respect to our discoveries.

- We may be subject to damages resulting from claims that we, our employees or independent contractors have wrongfully used or disclosed alleged trade secrets of their former employers.

Risks Related to Employees, Growth and Facilities Operations

- The loss of key personnel or the inability to attract and retain additional personnel could impair our ability to expand our operations.

- Our collaborations with outside scientists may be subject to restriction and change.
- Security breaches may disrupt our operations and harm our operating results.

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- Because most of our operations are located at a single facility, the occurrence of a disaster could significantly disrupt our business.

Risks Related to Environmental and Product Liability

- We use hazardous chemicals and radioactive and biological materials in our business. Any claims relating to improper handling, storage or disposal of these materials could be time consuming and costly.
- We may be sued for product liability.

Risks Related to Our Common Stock

- Our stock price may be extremely volatile.
- Invus' ownership of our common stock and its other rights under our stockholders' agreement we entered into in connection with Invus' $205.4 million initial investment in our common stock provide Invus with substantial influence over matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, as well as other corporate matters.
- We may engage in future acquisitions, which may be expensive and time consuming and from which we may not realize anticipated benefits.
- Future sales of our common stock may depress our stock price.
- If we are unable to meet Nasdaq continued listing requirements, Nasdaq may take action to delist our common stock.

For additional discussion of the risks and uncertainties that affect our business, see "Item 1A. Risk Factors" included in our annual report on Form 10-K for the year ended December 31, 2009, as filed with the Securities and Exchange Commission.

Item 6. Exhibits

Exhibit No.		Description
31.1	—	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	—	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	—	Certification of Principal Executive and Principal Financial Officers Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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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.

Lexicon Pharmaceuticals, Inc.

Date: August 6, 2010	By:	/s/ Arthur T. Sands Arthur T. Sands, M.D., Ph.D. President and Chief Executive Officer
Date: August 6, 2010	By:	/s/ Jeffrey L. Wade Jeffrey L. Wade Executive Vice President, Corporate Development and Chief Financial Officer

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Index to Exhibits

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