

MEDAREX INC
Form 10-Q
February 09, 2007

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2006

OR

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

For the transition period from _____ to _____

Commission File No. 0-19312

MEDAREX, INC.

(Exact Name of Registrant as Specified in Its Charter)

New Jersey
(State or Other Jurisdiction
of Incorporation or Organization)

707 State Road, Princeton, New Jersey
(Address of Principal Executive Offices)

22-2822175
(I.R.S. Employer
Identification No.)

08540
(Zip Code)

Registrant's Telephone Number, Including Area Code: **(609) 430-2880**

Indicate by check x whether 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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes No

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

| Class | Outstanding at November 30, 2006 |
|-------------------------------|----------------------------------|
| Common Stock, \$.01 par value | 124,244,059 |

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MEDAREX, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

| | September 30, 2006 (Unaudited) | December 31, 2005 |
|--|--------------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 41,868 | \$ 90,602 |
| Marketable securities | 344,386 | 260,705 |
| Prepaid expenses and other current assets | 26,203 | 31,608 |
| Total current assets | 412,457 | 382,915 |
| Property, buildings and equipment: | | |
| Land | 6,780 | 6,795 |
| Buildings and leasehold improvements | 86,084 | 82,338 |
| Machinery and equipment | 60,053 | 54,130 |
| Furniture and fixtures | 5,048 | 4,553 |
| | 157,965 | 147,816 |
| Less accumulated depreciation and amortization | (72,735 |) (61,832 |
| | 85,230 | 85,984 |
| Marketable securities - Genmab | 306,860 | |
| Investment in Genmab | | 3,255 |
| Investments in, and advances to, other partners | 8,192 | 6,400 |
| Segregated cash | 2,059 | 2,033 |
| Other assets | 5,012 | 6,289 |
| Total assets | \$ 819,810 | \$ 486,876 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Trade accounts payable | \$ 5,665 | \$ 4,939 |
| Accrued liabilities | 47,197 | 29,371 |
| Deferred contract revenue - current | 19,918 | 20,872 |
| Total current liabilities | 72,780 | 55,182 |
| Deferred contract revenue - long-term | 97,643 | 106,827 |
| Other long-term liabilities | 3,687 | 4,032 |
| 2.25% Convertible senior notes due May 15, 2011 | 150,000 | 150,000 |
| Minority interest | 6,809 | 11,590 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock, \$1.00 par value, 2,000,000 shares authorized; none issued and outstanding | | |
| Common stock, \$.01 par value; 200,000,000 shares authorized; 124,288,191 shares issued and 124,233,767 outstanding | 1,243 | 1,118 |
| at September 30, 2006 and 111,773,230 shares issued and 111,687,930 outstanding | | |

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| | | |
|---|------------|------------|
| shares outstanding at December 31, 2005 | | |
| Capital in excess of par value | 1,090,822 | 943,245 |
| Treasury stock, at cost 54,424 shares in 2006 and 85,300 shares in 2005 | (137) | (215) |
| Deferred compensation | | (599) |
| Accumulated other comprehensive income (loss) | 302,911 | (2,351) |
| Accumulated deficit | (905,948) | (781,953) |
| Total shareholders' equity | 488,891 | 159,245 |
| Total liabilities and shareholders' equity | \$ 819,810 | \$ 486,876 |

See notes to these unaudited consolidated financial statements.

MEDAREX, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|--------------------|------------------------------------|--------------------|
| | 2006 | 2005 (restated) | 2006 | 2005 (restated) |
| Contract and license revenues | \$ 6,347 | \$ 6,479 | \$ 20,362 | \$ 22,619 |
| Contract and license revenues from Genmab | 375 | 1,142 | 1,158 | 3,250 |
| Reimbursement of development costs | 5,714 | 3,045 | 15,800 | 11,845 |
| Total revenues | 12,436 | 10,666 | 37,320 | 37,714 |
| Costs and expenses: | | | | |
| Research and development | 48,350 | 31,247 | 142,324 | 96,657 |
| General and administrative | 15,451 | 6,396 | 35,127 | 18,679 |
| Total costs and expenses | 63,801 | 37,643 | 177,451 | 115,336 |
| Operating loss | (51,365) | (26,977) | (140,131) | (77,622) |
| Equity in net loss of affiliate | | (1,816) | (1,037) | (3,473) |
| Interest and dividend income | 4,841 | 6,233 | 12,677 | 11,463 |
| Impairment loss on investments in partners | | | | (29,265) |
| Interest expense | (1,055) | (1,053) | (3,166) | (3,180) |
| Minority interest - Celldex | 1,675 | | 4,781 | |
| Non-cash gain on loss of significant influence in Genmab | | | 3,202 | |
| Loss before provision for income taxes | (45,904) | (23,613) | (123,674) | (102,077) |
| Provision for income taxes | 37 | 90 | 321 | 286 |
| Net loss | \$ (45,941) | \$ (23,703) | \$ (123,995) | \$ (102,363) |
| Basic and diluted net loss per share: | \$ (0.37) | \$ (0.21) | \$ (1.04) | \$ (0.93) |
| Weighted average number of common shares outstanding | | | | |
| - basic and diluted | 124,555 | 111,406 | 119,698 | 109,845 |

See notes to these unaudited consolidated financial statements.

MEDAREX, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

| | Nine Months Ended | |
|---|--------------------------|-------------------|
| | September 30, | 2005 |
| | 2006 | (restated) |
| Operating activities: | | |
| Net loss | \$ (123,995) | \$ (102,363) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 9,822 | 9,316 |
| Amortization | 2,478 | 4,742 |
| Net bond (discount)/premium amortization | (2,527) | |
| Stock options and awards to employees | 14,099 | 1,619 |
| Non cash revenue | (1,339) | |
| Non-cash gain on loss of significant influence in Genmab | (3,202) | |
| Equity in net loss of Genmab | 1,037 | 3,473 |
| Impairment losses on investments in partners and other assets | | 29,265 |
| Minority interest in net loss | (4,781) | |
| Gain on sale of equity securities | | (3,315) |
| Changes in operating assets and liabilities | | |
| Other current assets | 5,405 | (18,815) |
| Trade accounts payable | 726 | (2,377) |
| Accrued liabilities | 17,573 | (11,037) |
| Deferred contract revenue | (10,138) | 25,574 |
| Net cash used in operating activities | (94,842) | (63,918) |
| Investing activities: | | |
| Purchase of property and equipment | (9,527) | (5,869) |
| Investment in partner | (500) | |
| Proceeds from sale of land | 16 | |
| Increase in segregated cash | (26) | |
| Purchase of marketable securities | (192,005) | (56,108) |
| Sales and maturities of marketable securities | 113,095 | 107,287 |
| Net cash provided by (used in) investing activities | (88,947) | 45,310 |
| Financing activities: | | |
| Cash received from sales of securities and exercise of stock options, net | 133,451 | 28,775 |
| Deferred offering costs - Celldex | | (487) |
| Principal payments under capital lease obligations | (20) | (4) |
| Net cash provided by financing activities | 133,431 | 28,284 |
| Effect of exchange rate differences on cash and cash equivalents | 1,624 | |
| Net increase (decrease) in cash and cash equivalents | (48,734) | 9,676 |
| Cash and cash equivalents at beginning of period | 90,602 | 64,843 |
| Cash and cash equivalents at end of period | \$ 41,868 | \$ 74,519 |
| Non-cash investing and financing activities: | | |
| Unrealized gain on investment in Genmab | \$ 306,860 | \$ |
| Supplemental disclosures of cash flow information | | |
| Cash paid during period for: | | |
| Income taxes | \$ 313 | \$ 122 |
| Interest | \$ 1,697 | \$ 4,034 |

See notes to these consolidated financial statements.

MEDAREX, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Dollars in thousands, unless otherwise indicated, except per share data)

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements are unaudited and have been prepared from the books and records of Medarex, Inc. and its subsidiaries (collectively, the Company) in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. The consolidated interim financial statements, in the opinion of management, reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results for the interim periods ended September 30, 2006 and 2005.

The Company's financial statements consolidate all of its subsidiaries, including those that it controls and those in which it holds a majority voting interest. Medarex currently owns approximately 60% of the outstanding common stock of Celldex Therapeutics, Inc. (Celldex) (see Note 5).

Effective February 1, 2006, the Company ceased accounting for its investment in Genmab A/S (Genmab) under the equity method of accounting due to a reduction in ownership and a corresponding loss of significant influence (see Note 3). The Company currently accounts for its investment in Genmab in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

The consolidated results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year. The consolidated balance sheet at December 31, 2005 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required for complete financial statements. These consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto, which are contained in our annual report on Form 10-K/A for the year ended December 31, 2005 filed with the Securities and Exchange Commission, or SEC.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the following: (i) the reported amounts of assets and liabilities, (ii) the disclosure of contingent liabilities at the dates of the financial statements and (iii) the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

The Company has restated its consolidated financial statements for the three and nine month periods ended September 30, 2005 to correct errors related to stock-based compensation not previously recorded for certain equity awards (see Note 2).

Net Loss per Share

Basic and diluted net loss per share are calculated in accordance with the Financial Accounting Standards Board (FASB) SFAS No. 128, *Earnings per Share*. Basic net loss per share is based upon the number of weighted average shares of common stock outstanding. Diluted net loss per share is based upon the weighted

average number of shares of common stock and dilutive potential shares of common stock outstanding. Potential shares of common stock result from the assumed exercise of outstanding stock options, as well as the assumed conversion of convertible senior notes. Potentially dilutive securities have been excluded from the computation of diluted net loss per share for all periods presented, as their effect is antidilutive. A summary of such potentially dilutive securities is as follows:

| | Three And Nine Months Ended September 30 | |
|-------------------|---|-------------|
| | 2006 | 2005 |
| Convertible notes | 10,936,935 | 10,936,935 |
| Stock options | 17,786,823 | 17,066,861 |
| | 28,723,758 | 28,003,796 |

Marketable Securities and Long-Term Non-Marketable Investments

Marketable securities consist of fixed income investments with a maturity of greater than three months and other highly liquid investments that can be readily purchased or sold using established markets. Under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, these investments are classified as available-for-sale and are reported at fair value on the Company's consolidated balance sheet. Unrealized holding gains and losses are reported within accumulated other comprehensive income as a separate component of shareholders equity. Under the Company's accounting policy, a decline in the fair value of marketable securities is deemed to be other than temporary and such marketable securities are generally considered to be impaired if their fair value is less than the Company's cost basis for more than six months, or some other period in light of the particular facts and circumstances surrounding the investment. If a decline in the fair value of a marketable security below the Company's cost basis is determined to be other than temporary, such marketable security is written down to its estimated fair value as a new cost basis and the amount of the write-down is included in earnings as an impairment charge.

In addition, the Company has investments in several of its partners whose securities are not publicly traded. These investments are accounted for under the cost basis. Because these securities are not publicly traded, the Company values these investments by using information acquired from industry trends, management of these companies, such companies' financial statements, and other external sources. Specifically, the Company's determination of any potential impairment of the value of the privately held securities includes an analysis of the following for each company on a periodic basis: review of interim and year-end financial statements, cash position and overall rate of cash used to support operations, the progress and development of technology and product platform, the per share value of subsequent financings and potential strategic alternatives. Based on the information acquired through these sources, the Company records an impairment charge when it believes an investment has experienced a decline in value that is considered to be other than temporary.

The Company recorded no impairment charges related to investments in partners whose securities are publicly traded for the three and nine month periods ended September 30, 2006 and three and nine month periods ended September 30, 2005. The Company recorded no impairment charges in partners whose securities

are privately held for the three and nine month periods ended September 30, 2006. The Company recorded \$0 million and \$29.3 million of impairment charges in partners whose securities are privately held for the three and nine month periods ended September 30, 2005, respectively. The impairment charge for the nine month period ended September 30, 2005 related entirely to the Company's investment in Immuno-Design Molecules, S.A. (IDM). The amount of the impairment charge was calculated as the difference between (i) the estimated per share value expected to be received by IDM shareholders upon completion of its merger with Epimmune, Inc. (Epimmune), and (ii) the Company's carrying value. In August 2005, Epimmune and IDM announced the completion of their business combination in which the surviving company, IDM Pharma, Inc. (IDM Pharma) became a publicly traded company. If the Company deems any of its investments to be further impaired at the end of any future period, it may incur additional impairment charges on these investments.

Revenue Recognition

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The Company receives payments from customers and partners, for licenses to its proprietary technology for product development, for services and from the achievement of product development milestones and from the sale of antibodies. These payments are generally non-refundable and are reported as deferred revenue until they are recognizable as revenue. The Company follows the following principles in recognizing revenue:

- Fees received from the licensing of the Company's proprietary technologies for research and development performed by its partners are recognized generally over the term of the respective license period beginning after both the license period has begun and the technology has been delivered.
- Fees received for product development services are recognized ratably over the period during which the services are performed.
- Milestone payments are recognized as revenue upon the achievement of mutually agreed milestones, provided that (i) the milestone event is substantive and its achievement is not reasonably assured at the inception of the agreement, and (ii) there are no continuing performance obligations associated with the milestone payment.
- Revenue arrangements that include multiple deliverables are divided into separate units of accounting if the deliverables meet certain criteria, including whether the fair value of the delivered items can be determined and whether there is evidence of fair value of the undelivered items. In addition, the consideration is allocated among the separate units of accounting based on their fair values, and the applicable revenue recognition criteria are considered separately for each of the separate units of accounting.
- Revenues derived from reimbursements of costs associated with the development of product candidates are recorded in compliance with EITF Issue 99-19, Reporting Revenue Gross as a Principal Versus Net as an Agent (EITF 99-19). According to the criteria established by EITF 99-19, in transactions where the Company acts as a principal, with discretion to choose suppliers, bears credit risk and performs part of the services required in the transaction, the Company believes it has met the criteria to record revenue for the gross amount of the reimbursements.

- The Company sells antibodies primarily to partners in the United States and overseas. Revenue from these sales is recognized when the antibodies are shipped and the Company has no further obligations related to the development of the antibodies.
- Grant revenues are recognized as the Company provides the services stipulated in the underlying grant based on the time and materials incurred. Amounts received in advance of services provided are recorded as deferred revenue and amortized as revenue when the services are provided.

Recently Adopted Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*, which revises SFAS No. 123, *Accounting for Stock Issued to Employees*. Statement 123(R) requires a public company measure the cost of equity-based service awards based on the fair value of the award on its grant date. All share-based payments to employees, including grants of employee stock options, are required to be recognized in the statement of operations based on their fair value. The Company adopted Statement 123(R) on January 1, 2006 using the modified prospective transition method. (see Note 4).

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109* (FIN 48). This authoritative interpretation clarifies and standardizes the manner by which companies will be required to account for uncertain tax provisions. Adoption of FIN 48 is required for fiscal years beginning after December 15, 2006. Medarex will be required to adopt FIN no later than the quarter beginning January 1, 2007 and is currently evaluating the impact of adopting FIN 48.

2. Restatement of Consolidated Financial Statements

Subsequent to the filing of the Company's Annual Report on Form 10-K for the year ended December 31, 2005, the Company concluded that certain of its previously issued financial statements should be restated to correct errors related to stock-based compensation not previously recorded for certain equity grants. Accordingly, for the years 1996 through 2002, the Company has corrected these errors by restating its beginning accumulated deficit as of January 1, 2003 and has restated its consolidated financial statements as of December 31, 2005 and 2004, and for the years ended December 31, 2005, 2004 and 2003 (see the Company's amended Annual Report on Form 10-K/A for details of the restatement). In addition, the Company has also restated its consolidated balance sheet as of March 31, 2006 and its consolidated statements of operations and cash flows for the three month periods ended March 31, 2006 and 2005 (see the Company's amended Quarterly Report on Form 10-Q/A for details of the restatement). There was no impact on revenue or net cash used in operating activities for any period as a result of this compensation expense, nor was there any impact on income tax expense for any period given the Company's sustained history of losses.

Previously filed annual reports on Form 10-K and quarterly reports on Form 10-Q for all periods from 2000 up to and including September 30, 2005 affected by the restatements have not been amended and should not be relied upon.

In May 2006, the Company received a letter from the SEC informing the Company that the SEC was conducting an informal inquiry into the Company's stock option grant practices and requesting certain information and documentation related thereto. The Company also received a grand jury subpoena from the

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U.S. Attorney's Office, District of New Jersey, requesting substantially similar information and documentation as the SEC had requested.

In June 2006, the Company's Board of Directors initiated an investigation (the "Investigation") of the Company's stock option grant practices from 1996 through June 30, 2006 (the "relevant period") and designated one of its independent directors to oversee the Investigation. In September 2006, the Company's Board of Directors elected two new members, who were appointed, together with the previously designated director, to a Special Investigation Committee, to complete the Investigation. The Special Investigation Committee retained outside legal counsel that had not previously been involved with the Company's stock option plans and the outside legal counsel retained forensic accounting consultants to assist in the Investigation and the analysis of the measurement dates for equity awards during the relevant period.

As a result of the findings of the Special Investigation Committee, management has concluded that incorrect measurement dates were used for financial accounting purposes for certain equity awards made in prior periods. The Company recorded non-cash, stock-based compensation expense and related payroll tax liabilities with regard to past equity awards of approximately \$0.6 million and \$1.6 million for the three and nine month periods ended September 30, 2005. The effect of these adjustments was to increase previously reported basic and diluted net loss per share by \$0.01 and for the nine month period ended September 30, 2005. The adjustments did not impact basic and diluted net loss per share for the three month period ended September 30, 2005.

As a result of the grants described below, the Company is required to record non-cash compensation expense in accordance with APB No. 25, Accounting for Stock Issued to Employees, or APB No. 25. Stock based compensation expense was calculated as the excess of the fair market value of the Company's stock on the measurement dates less the exercise price of the option multiplied by the number of equity awards granted. Stock-based compensation is recognized ratably over the vesting period of the equity awards. Prior to September 2001, the Company's stock options had a vesting period of 1 year or less. Beginning in September 2001, the Company changed the vesting period for employee stock option grants to 4 years.

Based upon the information obtained in the Investigation, through July 2002, the Company had a practice, in many instances, of selecting dates for its stock option grants and restricted stock grants as of the date when the stock price was the lowest during the month of grant, without disclosing this practice in its public filings and without properly measuring the compensation expense on a date that the terms of the equity awards were finalized. The terms of these grants are discussed in further detail below. Subsequent to July 2002, while the practice of selecting dates as described above ceased by the Company in response to new legal and regulatory reporting requirements, there were two annual equity grants for rank and file employees for which the measurement dates differ from the grant dates recorded in the Company's books and records, which the Investigation revealed were primarily a result of administrative delays, with no apparent intent to achieve favorable exercise prices.

The Company analyzed the evidence gathered in the Investigation related to the equity awards including electronic and hard copy documents and interviews. Equity awards were organized into categories based upon recipient and the process by which the equity award was finalized. Based upon the specific facts and circumstances, the Company applied the controlling accounting standards to determine the proper accounting measurement date with respect to every grant during the period from 1996 through July 2002 within each of the following categories:

Equity Awards Issued From 1996 through July 2002

Officer Annual Equity Awards

Officers received equity awards on an annual basis (although the dates of such awards varied from year to year). The Company's Stock Option Committee would approve the number of equity awards to be granted to officers, however, the Stock Option Committee did not select or consider an exercise price when approving the number of annual equity awards during its Stock Option Committee meetings. The Company's procedure for establishing the exercise prices of such awards, at the time, would be for certain former officers to select the lowest price for the Company's common stock during the month of the grant of such annual awards. The former officers believed they had the discretionary authority to select such exercise prices and this procedure was followed by the Company during the period from 1996 through July 2002. Once the price was selected, the Form 4 filing process was started by the Company and unanimous written consents (UWCs) were prepared and circulated for execution by the members of the Stock Option Committee in situations where UWCs were used. UWCs for three grants could not be located in the Company's files. The UWCs, which included the exercise prices selected by the former officers, were subsequently approved, in all instances, by the Stock Option Committee when the UWCs were signed, without exception. Since the Company's practice was to select, at the conclusion of the month in which the grant was designated, the date corresponding to the lowest price for the Company's stock for the month, the Company has concluded that the most appropriate measurement date is the last business day of the month in which the designated grant date occurred since at that point both the exercise price and the number of equity awards was determinable.

For all officer annual stock option awards, of which there were seven, and one officer stock award, during the relevant period, a total of approximately 3.9 million stock options and/or stock awards were made to officers where the selected grant dates coincided with a date when the stock price was the lowest during the month in which the grant was dated. Accordingly, the Company determined the total stock based compensation expense, after accounting for forfeitures, associated with these seven officer annual stock option awards and one officer stock award was approximately \$8.9 million.

Director Equity Awards

There was no specific pattern regarding equity awards to directors except that each non-executive director received an equity award when he/she joined the Company's Board of Directors. In certain circumstances, certain directors received annual equity awards on the date of the Company's Annual Meeting of Shareholders in connection with previously agreed upon arrangements. There were four designated grant dates in which a total of approximately 0.8 million stock options were made to directors when the stock price was the lowest during the month in which the designated grant occurred. The Company determined the total stock based compensation expense associated with these four director awards was approximately \$5.9 million and is detailed as follows:

- Two of the four grants were issued at the same time as the officer annual awards described above and therefore, the Company has concluded that the most appropriate measurement date for these two grants is the last business day of the month in which the designated grant date occurred since at that point both the exercise price and the number of equity awards was determinable consistent with the determination

of measurement dates for officer annual awards described above. The Company determined the total stock based compensation expense associated with these two awards was approximately \$0.5 million.

- One grant was accounted for using variable accounting because the original grant price was modified when a Form 4 filing date was missed and the grant was cancelled and reissued subsequently at a lower price. In that situation, Form 4s for two stock option recipients were not filed on time and the Company cancelled and issued new stock options with an exercise price representing the lowest price of the Company's stock in the following month. Total variable stock based compensation expense associated with this grant was approximately \$0.3 million.
- The remaining grant was approved at a meeting of the Company's Board of Directors where the Board of Directors specified a designated grant date that preceded the date of the Board of Directors meeting. The Company's stock price on the designated grant date was lower than the Company's stock price on the date of approval. The Company used the date of approval by the Company's Board of Directors as the measurement date resulting in stock based compensation expense of approximately \$5.1 million.

Rank and File Employee Annual Equity Awards

Rank and file employees generally received equity awards on an annual basis (although the dates of such awards varied from year to year). The designated grant dates for such awards were the same as officer annual equity awards with the exception of one date where the grant of annual equity awards to rank and file employees occurred approximately one month after the date of the officers annual equity award. During the period from 1996 through July 2002, on an annual basis, management would allocate a pool of stock options previously discussed with and agreed to by the Chairman of the Stock Option Committee to individual employees. Once the allocation of the total awards was finalized by management, a UWC was prepared (which included the selected grant date and exercise price) and forwarded to the Stock Option Committee for execution. Attached to the UWC was a list of the optionees and the number of options allocated by management to the optionees. The Stock Option Committee rarely discussed individual rank and file employee equity awards, leaving it to management to make such allocations since it was generally understood that the allocation process was delegated to management and it was also generally understood that it was management's responsibility to perform this function. The Stock Option Committee did not dispute, challenge or question management's allocations of any of the annual equity awards to rank and file employees. The Company has concluded that the appropriate measurement date for rank and file annual equity awards is the UWC creation date, as both the exercise price and number of equity awards for each employee were known with finality at such date.

For all rank and file annual equity awards, of which there were six, during the relevant period, a total of approximately 3.1 million stock options and/or stock awards were made where the price of the Company's stock on the accounting measurement date was higher than the award's exercise price. Five grants had the same exercise price as the officers annual equity awards described above, however, the accounting measurement date was always later than the accounting measurement date for officer annual equity awards since the process of allocating the pool of options granted to rank and file employees was typically finalized a few weeks after the exercise price was determined. The remaining designated grant date had a different exercise price as this equity award occurred approximately one month after the date of the officers annual award. The Company determined

the total stock based compensation expense, after accounting for forfeitures, associated with all rank and file annual awards was approximately \$15.2 million during the relevant period.

New Hire Employee Equity Awards

Generally, all new employees received an equity award as of the respective employee's first day of employment. In one instance, the designated grant date used by the Company for a new officer's equity award of approximately 0.3 million stock options and/or stock awards was not the same as the accounting measurement date. In this instance, the designated grant date was the stated effective date of the officer's employment agreement which preceded the officer's first day of employment. Since the controlling accounting literature at the time required compensation cost to be measured as of the officer's first day of employment, the Company determined that approximately \$5.1 million of stock-based compensation should have been measured on the date employment began by the officer. Other than this one instance, there were no equity awards to new hires where the measurement date used by the Company was inappropriate.

Equity Awards Issued Subsequent to July 2002

For the period subsequent to July 2002 through 2005 there were two rank and file annual equity awards where option lists were finalized two days after the designated grant date resulting in stock based compensation expense of approximately \$0.6 million.

As part of this restatement, the Company recorded payroll tax liabilities relating to stock options that were incorrectly characterized as incentive stock options, or ISOs. The Company recorded a liability for payroll taxes in the event such grants would not be treated as ISOs under principles of the Internal Revenue Code, or IRC, and the regulations thereunder. These payroll tax liabilities, which have been classified within research and development expense and general and administrative expense are not material to the consolidated financial statements for any period.

The following set forth the effects of the restatement on the Company's consolidated statements of operations for the three and nine month periods ended September 30, 2005 and consolidated statement of cash flows for the nine month period ended September 30, 2005:

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| | Three Months Ended September 30, 2005 | | | Nine Months Ended September 30, 2005 | | |
|--|--|-------------|----------------|---|-------------|----------------|
| | As Reported | Adjustments | As Restated | As Reported | Adjustments | As Restated |
| Total revenues | \$ 10,666 | | \$ 10,666 | \$ 37,714 | | \$ 37,714 |
| Costs and expenses: | | | | | | |
| Research and development | 30,925 | \$ 322 | 31,247 | 95,802 | \$ 855 | 96,657 |
| General and administrative | 6,110 | 286 | 6,396 | 17,962 | 717 | 18,679 |
| Total costs and expenses | 37,035 | 608 | 37,643 | 113,764 | 1,572 | 115,336 |
| Operating loss | (26,369) | (608) | (26,977) | (76,050) | (1,572) | (77,622) |
| Equity in net loss of affiliate | (1,816) | | (1,816) | (3,473) | | (3,473) |
| Interest and dividend income | 6,233 | | 6,233 | 11,463 | | 11,463 |
| Impairment loss on investment in partners | | | | (29,265) | | (29,265) |
| Interest expense | (1,053) | | (1,053) | (3,180) | | (3,180) |
| Loss before provision for income taxes | (23,005) | (608) | (23,613) | (100,505) | (1,572) | (102,077) |
| Provision for income taxes | 90 | | 90 | 286 | | 286 |
| Net loss | \$ (23,095) | \$ (608) | \$ (23,703) | \$ (100,791) | \$ (1,572) | \$ (102,363) |
| Basic and diluted net loss per share: | \$ (0.21) | \$ (0.00) | \$ (0.21) | \$ (0.92) | \$ (0.01) | \$ (0.93) |
| Weighted average common shares outstanding basic and diluted | 111,406 | | 111,406 | 109,845 | | 109,845 |

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| | Nine Months Ended September 30, 2005 | | |
|--|--------------------------------------|-------------|----------------|
| | As Reported | Adjustments | As Restated |
| Operating activities: | | | |
| Net loss | \$ (100,791) | \$ (1,572) | \$ (102,363) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Depreciation | 9,316 | | 9,316 |
| Amortization | 4,742 | | 4,742 |
| Stock options and awards to employees | 242 | 1,377 | 1,619 |
| Equity in net loss of Genmab | 3,473 | | 3,473 |
| Impairment losses on investments in partners | 29,265 | | 29,265 |
| Gain on sale of equity securities | (3,315) | | (3,315) |
| Changes in operating assets and liabilities | | | |
| Other current assets | (18,815) | | (18,815) |
| Trade accounts payable | (2,377) | | (2,377) |
| Accrued liabilities | (11,232) | 195 | (11,037) |
| Deferred contract revenue | 25,574 | | 25,574 |
| Net cash used in operating activities | (63,918) | | (63,918) |
| Investing activities: | | | |
| Purchase of property and equipment | (5,869) | | (5,869) |
| Purchase of marketable securities | (56,108) | | (56,108) |
| Sales and maturities of marketable securities | 107,287 | | 107,287 |
| Net cash provided by investing activities | 45,310 | | 45,310 |
| Financing activities: | | | |
| Cash received from sales of securities and exercise of stock options, net | 28,775 | | 28,775 |
| Deferred offering costs - Celldex | (487) | | (487) |
| Principal payments under lease obligations | (4) | | (4) |
| Net cash provided by financing activities | 28,284 | | 28,284 |
| Net increase in cash and cash equivalents | 9,676 | | 9,676 |
| Cash and cash equivalents at beginning of period | 64,843 | | 64,843 |
| Cash and cash equivalents at end of period | \$ 74,519 | | \$ 74,519 |
| Supplemental disclosures of cash flow information | | | |
| Cash paid during the year for: | | | |
| Income taxes | \$ 122 | | \$ 122 |
| Interest | \$ 4,034 | | \$ 4,034 |

3. Investments in Genmab

As a result of a series of transactions, including an initial public offering by Genmab of its ordinary shares in October 2000, the Company owned an approximately 24.7% interest in Genmab as of December 31, 2004.

During the first quarter of 2005, the remaining basis of the Company's investment in Genmab (approximately \$1.7 million) was reduced to zero and accordingly, recognition of the Company's share of Genmab's net losses for the remainder of the first quarter of 2005, the second quarter of 2005 and a portion of the third quarter of 2005 was suspended.

In August 2005, Genmab sold approximately 2.5 million shares of its stock to a corporate partner in connection with a global development and commercialization agreement. As a result of this sale of stock, the

Company's ownership percentage in Genmab was reduced to approximately 22.2%. The difference between the Company's proportionate share of Genmab's equity and its carrying value after completion of Genmab's sale of stock to the corporate partner was approximately \$8.0 million and was accounted for in accordance with APB Opinion No.18, *The Equity Method of Accounting for Investment in Common Stock*, and Staff Accounting Bulletin No. 51, *Accounting for Sales of Stock by a Subsidiary*. This transaction was accounted for as an increase to capital in excess of par value at the time the transaction was completed.

As a result of the increase in carrying value of the Company's investment in Genmab of approximately \$8.0 million in August 2005 and in accordance with EITF 02-18, *Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition*, the Company was required to resume the recognition of its share of Genmab's net losses in the third quarter of 2005.

During the three month period ended March 31, 2006, the Company's investment in Genmab was adjusted to reflect its share (22.2%) of Genmab's net loss (\$1.0 million) prior to Genmab's February 1, 2006 private placement.

On February 1, 2006, Genmab completed the private placement of 5.75 million shares of its stock. As a result of this private placement, the Company's ownership percentage of Genmab was reduced to approximately 18.9%. As a result of a decrease in the Company's ownership below 20%, on February 1, 2006 the Company began accounting for its investment in Genmab as a marketable security in accordance with SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities*. The Company's investment in Genmab is classified as non-current marketable securities in the Company's September 30, 2006 consolidated balance sheet. Accounting for the Company's investment in Genmab as a marketable security in accordance with SFAS No. 115 resulted in an unrealized gain of approximately \$306.9 million as of September 30, 2006. Such unrealized gain is also included within accumulated other comprehensive income classified within shareholders' equity in the September 30, 2006 consolidated balance sheet.

In addition, the Company recorded a non-cash gain on loss of significant influence in Genmab for the nine month period ended September 30, 2006 of \$3.2 million in accordance with FASB Staff Position APB 18-1, *Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence (FSP APB 18-1)*. As a result of Genmab's private placement of 5.75 million shares of its stock in February 2006 and the corresponding reduction of the Company's ownership percentage below 20%, the Company's net foreign translation gains of approximately \$5.4 million associated with its investment in Genmab and reflected in accumulated other comprehensive income as of December 31, 2005 was first offset against the remaining carrying value of its investment in Genmab (\$2.2 million) reducing the Company's investment in Genmab to zero with the remaining balance (\$3.2 million) recorded as a non-cash gain in the consolidated statement of operations for the nine month period ended September 30, 2006.

4. Equity-Based Compensation

The Company's stock awards are governed by its 2005 Equity Incentive Plan, as amended (the "Plan"). The exercise price of stock options under the Plan is determined by the Compensation and Organization Committee of the Board of Directors of the Company (the "Committee") and may not be less than the fair market value of a share of the Company's common stock on the grant date. No incentive stock option is exercisable after 10 years from the grant date. As of September 30, 2006, a total of 7,729,841 shares were

available for future grants under the Plan.

Prior to January 1, 2006, the Company accounted for the Plan under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees* and related Interpretations, as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Other than the amounts discussed in Note 2, no compensation expense was recognized in the Statement of Operations for the years ended December 31, 2005 or 2004 related to stock option grants, as all options granted under the Plan had an exercise price equal to the fair market value of the underlying common stock on the grant date. Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), *Share-Based Payment*, using the modified-prospective-transition method. Under this transition method, compensation cost recognized for the three and nine month periods ended September 30, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of Statement 123(R). Results for prior periods have not been restated as a result of the adoption of Statement 123(R).

The following table illustrates the impact of equity-based compensation on reported amounts:

| | Three Months Ended September 30, 2006 | | Nine Months Ended September 30, 2006 | |
|--------------------------------------|--|---|---|---|
| | As reported | Impact of Equity-Based Compensation | As reported | Impact of Equity-Based Compensation |
| Net loss | \$ (45,941) | \$ (5,085) | \$ (123,995) | \$ (14,099) |
| Basic and diluted net loss per share | \$ (0.37) | \$ (0.04) | \$ (1.04) | \$ (0.12) |

The total stock based compensation cost relating to Statement 123(R) for the three month period ended September 30, 2006 has been included in the consolidated statement of operations within research and development expenses (\$2.9 million) and general and administrative expenses (\$2.1 million). The total stock-based compensation cost relating to Statement 123(R) for the nine month period ended September 30, 2006 has been included in the consolidated statement of operations within research and development expenses (\$7.7 million) and general and administrative expenses (\$6.4 million).

The following summarizes all stock option transactions for the Company under the Plan for the period from January 1, 2006 through September 30, 2006.

| | Common Stock Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value |
|--|-------------------------|---------------------------------------|---|---------------------------------|
| Outstanding at beginning of period | 16,803,728 | \$ 8.47 | | |
| Granted | 2,254,994 | \$ 10.03 | | |
| Exercised | (883,149) | \$ 5.10 | | |
| Canceled | (388,750) | \$ 7.27 | | |
| Outstanding at end of period | 17,786,823 | \$ 8.87 | 6.4 years | \$ 54,457 |
| Exercisable at end of period | 11,045,238 | \$ 8.93 | 5.2 years | \$ 40,537 |
| Vested and unvested expected to vest at September 30, 2006 | 17,250,253 | \$ 8.87 | 6.3 years | \$ 53,427 |

The weighted-average grant-date fair value of options granted during the nine month periods ended September 30, 2006 and 2005 were \$7.29 and \$7.95, respectively. The aggregate intrinsic value of options exercised during these same periods was \$6.5 million and \$2.9 million, respectively. The grant-date fair value of shares which vested during the nine month periods ended September 30, 2006 and 2005 was \$20.4 million and \$17.5 million, respectively. Cash proceeds from stock options exercised during the nine month periods ended September 30, 2006 and 2005 totaled \$4.5 million and \$3.1 million, respectively.

The fair value of each option grant is estimated using the Black-Scholes option pricing method. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period (4 years). Use of a valuation model requires management to make certain assumptions with respect to selected model inputs. Expected volatility was calculated based on the historical volatility of the Company's common stock. The average expected life was based on the contractual term of the option and expected employee exercise and post-vesting employment termination behavior. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term equal to the expected life assumed on the date of grant. Forfeitures are estimated based on voluntary termination behavior, as well as an analysis of actual option forfeitures. The Company is currently using an estimated forfeiture rate of 11.8%. The weighted average assumptions used in the Black-Scholes option pricing model are as follows:

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---------------------------------|---------------------------------------|--------|--------------------------------------|--------|
| | 2006 | 2005 | 2006 | 2005 |
| Expected stock price volatility | 82.7 % | 98.6 % | 82.8 % | 98.6 % |
| Risk-free interest rate | 4.59 % | 4.16 % | 4.62 % | 4.16 % |
| Expected life of options | 6.25 | 6.25 | 6.25 | 6.25 |
| Expected dividend yield | 0 % | 0 % | 0 % | 0 % |

As of September 30, 2006, the total unrecognized compensation cost related to non-vested stock options was approximately \$33.1 million. This cost is expected to be recognized over a weighted average period of 1.5 years.

Fair Value Disclosures Prior to Adopting SFAS 123(R)

Prior to January 1, 2006, the Company accounted for stock-based compensation plans in accordance with the provisions of APB Option No. 25, as permitted by SFAS No. 123, and, except for the options discussed in Note 2, accordingly did not recognize compensation expense for the issuance of options with an exercise price equal to or greater than the market price at the date of grant. Had the fair value based method as prescribed by SFAS No. 123 been applied by the Company, the effect on net loss and loss per share for the three and nine month periods ended September 30, 2005 would have been as follows:

| | Three Months Ended September 30, 2005 (restated) | Nine Months Ended September 30, 2005 (restated) |
|--|---|--|
| Net loss, as reported | \$ (23,703) | \$ (102,363) |
| Add: Non-cash employee compensation | 556 | 1,619 |
| Less: Total stock-based employee compensation expense determined under fair value method | (6,165) | (14,272) |
| Net loss, pro forma | \$ (29,312) | \$ (115,016) |
| Loss per share: | | |
| Basic and diluted, as reported | \$ (0.21) | \$ (0.93) |
| Basic and diluted, pro forma | \$ (0.26) | \$ (1.05) |

Deferred Compensation

The Company maintains deferred compensation programs, under which each of the Company's executive officers elected to have a portion of his 2005, 2004 and 2003 bonuses, which were otherwise payable in cash, converted to restricted stock units representing shares of the Company's common stock. Participants in the deferred compensation programs could elect to defer up to 50% of their respective bonuses. The number of restricted stock units awarded upon such conversion was determined by dividing (i) the amount of the bonus to be converted by (ii) the fair market value of the Company's common stock on the grant date. Participants in the deferred compensation programs elected to defer receipt of the common stock portion of their bonuses until the earlier of three years from the grant date or the participant's termination from the Company. The bonus portion deferred by each of the participants is matched on a 1:1 basis by the Company and 25% of the match vested as of the respective grant dates. So long as a participant remains employed by the Company, an additional 25% of the Company's matching contribution vests on each anniversary of the respective grant dates for the next three years. All benefits under each of the deferred compensation programs are distributed in separate payments and will be paid exclusively in the form of shares of the Company's common stock. The Company's matching contribution was approximately \$0.1 million and \$0.1 million for the three month periods ended September 30, 2006 and 2005, respectively and \$0.4 million and \$0.2 million for the nine month periods ended September 30, 2006 and 2005, respectively.

5. Celldex Therapeutics, Inc.

In March 2004, the Company assigned or licensed to Celldex certain intellectual property related to the Company's vaccine technology, including the rights to MDX-1307, one of the Company's product candidates for the treatment of cancer, as well as the Investigational New Drug Application (IND) associated with this product candidate which became effective in February 2004.

To complement its technology and its internal clinical pipeline, in October 2005, Celldex completed the acquisition of all of the issued and outstanding shares of capital stock of Lorantis Limited (Lorantis), a privately held biotechnology company based in Cambridge, U.K. and substantially all of the assets of Alteris Therapeutics, Inc. (Alteris), a privately held biotechnology company based in Philadelphia, Pennsylvania.

The purchase price of Lorantis consisted of 6.8 million shares of Celldex Class A common stock (valued at \$34.0 million).

The purchase price for substantially all of the Alteris assets consisted of 1.2 million shares of Celldex common stock (valued at \$6.0 million) and approximately \$1.6 million in cash. Celldex may be required to pay Alteris up to \$5.0 million upon obtaining the first approval for commercial sale of an EGFRvIII product. In addition, Celldex may be required to pay an amount equal to 20% of any upfront fees or milestone payments received from a certain unrelated third-party licensee, in the event that within 12 months of the closing, Celldex enters into a license agreement with such third party for any EGFRvIII-derived product developed using the technology acquired from Alteris. As a result of the Lorantis stock acquisition and the Alteris asset acquisition, the Company's ownership percentage of Celldex was reduced from 100% to approximately 60%.

6. Bristol-Myers Squibb Collaboration

In January 2005, the Company announced the closing of a collaboration and co-promotion agreement and a related securities purchase agreement with Bristol-Myers Squibb Company (BMS), pursuant to which the Company and BMS each granted the other certain intellectual property licenses and product rights on a worldwide basis in order to enable the parties to collaborate in research and development of certain antibody-based product candidates for the treatment of cancer and other diseases, and, in the event that further development work is successful, to commercialize any resulting products. In particular, the collaboration includes a grant by the Company to BMS of a license to commercialize ipilimumab, a fully human antibody product developed using the Company's UltiMab Human Antibody Development System®, that is antagonistic to cytotoxic T-lymphocyte antigen 4 (CTLA-4). Ipilimumab is currently under investigation for the treatment of a broad range of cancers. The collaboration also includes the grant by the Company to BMS of a sub-license to MDX-1379, a gp100 peptide vaccine, for use with ipilimumab for the treatment of metastatic melanoma.

As part of the collaboration, the two companies committed to an initial multi-year budget of approximately \$192.0 million to fund the development of ipilimumab as a potential treatment for a broad range of cancers. BMS is responsible for 65% of all development costs related to clinical trials intended to support regulatory approval in both the United States and Europe, with the remaining 35% to be paid by the Company. The parties will share equally the costs of any clinical trials of product candidates intended solely for regulatory approval in the United States, and BMS will be fully responsible for all development efforts that relate solely to regulatory approval in Europe and other parts of the world. Approximately \$3.9 million and \$2.9 million of the Company's revenue for the three month periods ended September 30, 2006 and 2005 and approximately \$11.7 million and

\$11.2 million of the Company's revenue for the nine month periods ended September 30, 2006 and 2005 represented the reimbursement of the Company's costs associated with the development of ipilimumab recorded in compliance with EITF 99-19. The Company's share of the BMS development costs for the three month periods ended September 30, 2006 and 2005 was approximately \$5.7 million and \$1.8 million, respectively and the Company's share of the BMS development costs for the nine month periods ended September 30, 2006 and 2005 was approximately \$17.4 million and \$2.3 million, respectively.

Under the terms of the collaboration, the Company could receive up to \$205.0 million from BMS if all regulatory milestones are met, plus up to an additional \$275.0 million in sales-related milestones. The Company will also have the option to co-promote any products in the United States, and, if the Company elects to exercise this option and has participated in the funding of the applicable Phase III clinical trial(s), the Company will receive 45% of any profits from commercial sales in the U.S. In the event the Company chooses not to exercise its co-promotion rights, BMS will have exclusive commercial rights in the United States and will pay the Company royalties on any commercial sales. Outside the United States, BMS will have exclusive commercial rights and will pay the Company royalties on any commercial sales.

Pursuant to these agreements, BMS made an initial cash payment to the Company of \$25.0 million, which has been recorded as deferred revenue. In addition, BMS purchased a total of 2,879,223 unregistered shares of the Company's common stock at a purchase price equal to \$8.6829 per share for an aggregate purchase price of \$25.0 million. The purchase price represented a small premium to the market price on the date the Company signed the collaboration agreement.

The Company determined that all elements under the collaboration and co-promotion agreement should be accounted for as a single unit of accounting under EITF 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*. In accordance with SAB No. 104 (Topic 13, *Revenue Recognition*), deferral of revenue is appropriate regarding nonrefundable, upfront fees received in single unit of accounting arrangements. As the Company has continuing obligations under the collaboration and co-promotion agreement, and as significant development risk remains, the Company recorded the \$25.0 million upfront fee as deferred revenue and the Company is recognizing this amount over the enforceable term of the technology sublicensed to BMS under the collaboration and co-promotion agreement of approximately 11 years, as well as the technology and know-how to be delivered in connection therewith.

The BMS collaboration became effective in January 2005, and unless terminated earlier, will continue for as long as development and/or commercialization of any collaboration product continues. BMS, however, may terminate the collaboration on a country-by-country basis at any time and, under certain conditions, on a product-by-product basis, resulting in the return of all rights to the Company with respect to such country and/or product. In addition, BMS may terminate the Company's co-promotion rights in the U.S. in the event that the Company fails to satisfy certain performance criteria. The Company may terminate the BMS collaboration in the event of certain specified material breaches by BMS (in which case product rights would revert to the Company), and the Company may terminate BMS's co-promotion rights in the event that BMS fails to satisfy certain performance criteria.

7. Public Offering of Common Stock

In April 2006, the Company completed a public offering of 10 million shares of common stock at a public offering price of \$11.75 per share. In May 2006, the underwriters exercised in full their option to purchase an

additional 1.5 million shares of common stock at the public offering price of \$11.75 per share. The exercise of the option to purchase the additional 1.5 million shares increased the size of the public offering to a total of 11.5 million shares of common stock resulting in net proceeds to the Company of approximately \$128.0 million.

8. Legal Proceedings

Derivative Shareholder Lawsuits

In June 2006, two derivative actions were filed in New Jersey state court by shareholders purporting to act on behalf of Medarex, naming Medarex as a nominal defendant and certain current and former directors as defendants. In November 2006 and January 2007, three additional derivative complaints were filed in the United States District Court for the District of New Jersey, containing nearly identical factual allegations concerning Medarex's historical stock option granting practices. The complaints allege, among other things, that certain of Medarex's officers and directors breached their fiduciary duties to the Company and violated federal securities laws in connection with public statements made in SEC filings relating to the Company's historical stock option granting practices and related accounting. The complaints seek unspecified damages and equitable relief. These actions are in their preliminary stages. We could be required to pay significant damages in connection with this litigation.

The Company is unable to reasonably estimate any possible range of loss or liability associated with the stock option inquiry and/or derivative suits due to their uncertain resolution.

9. Contingencies

Ability Biomedical Corporation

In August 2004, the Company completed the acquisition of all of the outstanding capital stock not already owned by the Company of Ability Biomedical Corporation (Ability Biomedical). Pursuant to this transaction, the Company acquired Ability Biomedical's intellectual property related to IP-10, a protein believed to be associated with a variety of immune disorders, including multiple sclerosis, rheumatoid arthritis, inflammatory bowel disease, chronic obstructive pulmonary disease and type I diabetes.

Upon achievement of certain development milestones with respect to the Company's anti-IP-10 antibody program, but no later than September 4, 2007, the Company may be required to pay the former shareholders of Ability Biomedical approximately \$3.68 million in cash and/or common stock, subject to fluctuations in currency exchange rates. In lieu of such additional payment, the Company also has the option to revert to the original joint collaboration agreement with the former shareholders of Ability Biomedical whereby each party would be responsible for 50% of the costs associated with the anti-IP-10 antibody program.

Kirin Brewery Co., Ltd.

Effective September 4, 2002, the Company entered into a Collaboration and License Agreement with Kirin which provides for the exchange by Kirin Brewery Co., Ltd. (Kirin) and the Company of certain cross-licenses for each other's technology for the development and commercialization of human antibody products. The Collaboration and License Agreement supersedes a previous binding letter of intent. Pursuant to the letter of intent, the Company and Kirin developed the KM-Mouse®, a unique crossbred mouse which combines the

traits of the Company's HuMAb-Mouse® with Kirin's TC Mouse. Under the Collaboration and License Agreement, the Company and Kirin are exchanging cross-licenses with respect to the KM-Mouse and other antibody-generating mice. In addition, each of the cross-licenses granted under the Collaboration and License Agreement are subject to certain license, milestone and royalty payments by each party to the other.

Through September 30, 2006, the Company has not made any milestone payments to Kirin. However, approximately \$2.8 million has been paid to Kirin as of September 30, 2006 representing a payment due Kirin as a result of the Company's collaboration with Pfizer. Based on a total of three products the Company is developing, which use or the Company believes may use Kirin technology and that (i) are currently in clinical trials, or (ii) the Company anticipates may enter clinical trials through the end of 2007, the Company may be required to make milestone payments to Kirin aggregating up to approximately \$12.75 million with respect to such products, or a maximum of approximately \$4.25 million per product. The Company's future milestone payment obligations to Kirin may or may not be triggered, and may vary in size, depending on a number of variables, almost all of which are currently unknown, including the following:

- whether or not a decision is made to request a license from Kirin;
- the type of license requested (research or commercial);
- the success and timing of development efforts and clinical trials of product candidates covered by any such licenses;
- the type of product developed, (payment obligations differ depending on whether a product is an *ex vivo* therapeutic, *in vivo* therapeutic, research reagent or diagnostic); and
- other financial provisions of the Kirin agreement that provide for variations in fee levels and netting of certain payments over specified periods of time that may impact the total amount potentially payable to Kirin for any particular license fee or milestone payment.

Whether the Company may be obligated to make milestone payments to Kirin in the future is subject to the success of its efforts with respect to products the Company is developing that utilize the Kirin technology and, accordingly, is inherently uncertain.

Unless terminated earlier, the Collaboration and License Agreement expires on December 31, 2014. The Collaboration and License Agreement can be terminated by either party in the event of a material breach by the other party if the breach is not cured during a specified cure period. In addition, either party may terminate any commercial license with respect to a specific biologic target granted to it by the other party under the agreement at any time.

Other Agreements

The Company has entered into a number of other agreements that contain in-licenses of third-party technology (in addition to Kirin) which may be used together with the Company's own platform technologies for the generation, development and/or manufacture of its antibody products. In addition, the Company has entered into other third-party agreements that contain in-licenses associated with antibody products that target specific antigens. Many of these agreements contain milestone payments that are due with respect to products using/targeting the licensed technology/antigen only if and when certain specified pre-commercialization events occur. Not all of the Company's products currently under development trigger such milestone payments. Through September 30, 2006, the Company had made milestone payments under these agreements of

approximately \$0.3 million. In addition, under the agreements the Company currently has in place (other than with Kirin), based on a total of nine products the Company is developing for which milestones are potentially due and that (i) are now in clinical trials, or (ii) which the Company anticipates may enter clinical trials before the end of 2007, the Company may be obligated to make future milestone payments aggregating up to approximately \$59.9 million with respect to such products. In general, potential milestone payments for antibody products may or may not be triggered under these licenses, and may vary in size, depending on a number of variables, almost all of which are currently uncertain. Typically, the events that trigger these milestone payments per product include:

- submission of IND(s) or foreign equivalents;
- commencement of Phase I, Phase II and/or Phase III clinical trials or foreign equivalents;
- submission of BLA(s) or foreign equivalents; and
- receipt of marketing approval(s) to sell products in a particular country or region.

In addition, the licenses above may trigger royalty payments in connection with the commercialization of certain of the Company's products. Whether the Company will be obligated to make milestone or royalty payments in the future is subject to the success of its product development efforts and, accordingly, is inherently uncertain.

Stock Option Grant Practices

In conjunction with the review of the Company's stock option grant practices, the Company has also evaluated the related tax issues to determine if the Company may be subject to additional tax liability as a result of the matters under review. As a result of the additional stock-based compensation charges, the Company may be entitled to additional tax deductions. The Company has net operating loss carryforwards, which may be affected, however, the Company has a full valuation allowance against its deferred tax assets and, as a result, do not expect any material impact on its financial position and results of operations. In addition, due to revision of measurement dates as described in Note 2, certain stock options that were previously treated as incentive stock options do not actually qualify for such treatment and must be treated as non-statutory stock options. Accordingly, the Company may be subject to fines and/or penalties relating to the tax treatment of such stock options. The Company believes that any additional tax liability as a result of the matters under review, if any, is not expected to have a material impact on the Company's financial position or results of operations.

The SEC is conducting an informal inquiry into our historical stock option grants and practices and related accounting and disclosures. In addition, the United States Attorney's Office for the District of New Jersey is conducting a grand jury investigation relating to the same matters. At the conclusion of the SEC's informal inquiry and the U.S. Attorney's Office investigation, the Company could be subject to regulatory or other fines or penalties or other contingent liabilities, however, no outcome is determinable at this time.

10. Comprehensive Income (Loss)

Comprehensive income (loss) is comprised of net loss and other comprehensive income (loss). Other comprehensive income (loss) includes changes in the fair value of the Company's marketable securities and the foreign exchange translation primarily relates to the Company's loss of significant influence in Genmab and the related impact on changes in unrealized gain in the statement of changes in shareholders' equity. The following

table sets forth the components of comprehensive income (loss):

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|--|------------------------------------|--------------------|-----------------------------------|--------------------|
| | 2006 | 2005 (restated) | 2006 | 2005 (restated) |
| Net loss | \$ (45,941) | \$ (23,703) | \$ (123,995) | \$ (102,363) |
| Unrealized gain (loss) on securities | 74,456 | 1,502 | 309,104 | (1,109) |
| Unrealized (loss) gain on foreign exchange | 502 | (105) | (3,842) | (100) |
| Total comprehensive income (loss) | \$ 29,017 | \$ (22,306) | \$ 181,267 | \$ (103,572) |

Accounting for the Company's investment in Genmab as a marketable security in accordance with SFAS No. 115 has resulted in an unrealized gain of approximately \$306.9 million as of September 30, 2006. Such unrealized gain is also included within accumulated other comprehensive income classified within shareholders' equity in the September 30, 2006 consolidated balance sheet.

11. Segment Information

The Company is a biopharmaceutical company focused on the discovery, development and potential commercialization of fully human antibody-based therapeutic products. The operations of the Company and its subsidiaries constitute one business segment.

Revenue from customers representing 10% or more of total revenues is as follows:

| Customer | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|------------------------------|------------------------------------|------|-----------------------------------|------|
| | 2006 | 2005 | 2006 | 2005 |
| Bristol-Myers Squibb | 37 % | 34 % | 38 % | 35 % |
| Genmab | 3 % | 11 % | 3 % | 9 % |
| Pfizer | 20 % | 22 % | 20 % | 18 % |
| Centocor, Inc. | | | | 11 % |
| Ono Pharmaceuticals Co. | 11 % | | 9 % | |
| National Institute of Health | 4 % | 10 % | 4 % | 8 % |

12. Subsequent Events

Notice of Default Relating to 2.25% Convertible Senior Notes

On August 25, 2006, the Company received a notice of default relating to the Company's 2.25% Convertible Senior Notes (the "Notes") in the aggregate principal amount of \$150 million due May 15, 2011.

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The notice of default under the Indenture governing the Notes cited the Company's failure to file its Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 as the basis for the notice of default. The notice of default further provided that if the Company did not file its June 30, 2006 Form 10-Q by October 24, 2006, an event of default under the Indenture would exist.

On October 4, 2006, the Company announced that it received the requisite consent to adopt the proposed amendments to the Indenture governing its Notes, pursuant to a previously announced consent solicitation statement dated September 22, 2006 as supplemented by a supplement dated October 2, 2006. The Company and the trustee of the Notes entered into a supplemental indenture effecting amendments to the Indenture. As consideration for the amendments to the Indenture and waiver of related defaults and events of defaults, the Company will no longer have the right to redeem the Notes prior to May 15, 2010. At any time on or after May 15, 2010 and until May 14, 2011, the Company will have the right to redeem the Notes in cash, in whole or in part, but only if the closing sale price of the Company's common stock for at least 20 of the 30 consecutive trading days immediately prior to the day the Company gives notice of redemption is greater than 150% of the applicable conversion price on that date of the notice. The cash redemption price for the period from May 15, 2010 to May 14, 2011 will equal 100.3% of the principal amount of the Notes to be redeemed plus accrued and unpaid interest, if any, to, but not including, the date of redemption. The Company is in the process of evaluating the accounting for the amendment to the optional redemption rights under the Indenture. The Notes are appropriately classified as a long term liability in the Company's consolidated balance sheets as no events of default (as defined in the Indenture) exist.

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which represent our projections, estimates, expectations or beliefs concerning among other things, financial items that relate to management's future plans or objectives or to our future economic and financial performance. Statements that are not historical facts, including statements preceded by, followed by, or that include the words potential; believe; anticipate; intend; plan; expect; estimate; could; may; or similar statements are forward-looking statements. Risks and uncertainties include risks associated with product discovery and development, uncertainties related to the outcome of clinical trials, unforeseen safety issues resulting from the administration of product candidates in patients, uncertainties associated with the collaborative process and uncertainties related to product manufacturing, as well as risks detailed from time to time in our periodic reports and registration statements filed with the SEC. There can be no assurance that our product development efforts will succeed, that developed products will receive the required regulatory clearance or that, even if such regulatory clearance were received, such products would ultimately achieve commercial success. All forward-looking statements included in this Quarterly Report are based on information available to us as of the date hereof, and we do not assume any obligation to update any such forward-looking statements. Our actual results may differ materially from the results discussed in the forward-looking statements. Among the factors that could cause actual results to differ materially are the factors detailed in Item 1A of Part II below. References to our product candidates, business, financial results or financial condition should be considered to refer to us and our subsidiaries unless the context otherwise requires.

The discussion and analysis set forth in this Item 2 has been amended to reflect the restatement of the Company's financial results, which is more fully described in Note 2, Restatement of Consolidated Financial Statements in the notes to the consolidated financial statements of this Form 10-Q. The impact of the adjustments for the three and nine month periods ended September 30, 2005 was to increase net loss by approximately \$0.6 million and \$1.6 million, respectively. The impact of these adjustments was not significant to the Company's operating results, trends, or liquidity for the three or nine month periods ended September 30, 2005.

Overview

We are a biopharmaceutical company focused on the discovery, development and potential commercialization of fully human antibody-based therapeutic products. We believe that our UltiMAB Human Antibody Development System® enables us to rapidly create and develop such products for a wide range of diseases, including cancer, inflammation, autoimmune disorders and other life-threatening and debilitating diseases.

Currently, 36 antibody product candidates generated from our UltiMAB Human Antibody Development System are in human clinical trials, or have had regulatory applications submitted for such trials⁽¹⁾. Phase III clinical trials are currently underway relating to seven of the most advanced product candidates in which Medarex has an economic interest through co-promotion/profit sharing rights, royalties and/or equity ownership. Six of the seven product candidates currently in Phase III trials were generated through the use of our UltiMAB® technology and include:

- ipilimumab (also known as MDX-010), which we are developing jointly with Bristol-Myers Squibb Company, or BMS, for the treatment of metastatic melanoma and other cancers;

(1) Information regarding the clinical status of third-party antibody products is based on publicly available information.

- golimumab (also known as CNTO 148) under development by Centocor, Inc., or Centocor (a subsidiary of Johnson & Johnson), for the treatment of rheumatoid arthritis, psoriatic arthritis and ankylosing spondylitis;
- CNTO 1275 for the treatment of psoriasis, also under development by Centocor;
- zanolimumab (also known as HuMax-CD4), being developed by Genmab A/S, or Genmab, and Merck Serono S.A. for the treatment of T-cell lymphomas;
- ofatumumab (also known as HuMax-CD20), being developed by Genmab and GlaxoSmithKline for the treatment of follicular non-Hodgkin's lymphoma and chronic lymphocyte leukemia; and
- zalutumumab (also known as HuMax-EGFr), being development by Genmab for the treatment of head and neck cancer.

The seventh product candidate currently in Phase III trials in which we have an economic interest is CP-675,206, which is being developed by Pfizer, Inc., or Pfizer, for the treatment of metastatic melanoma. We expect to receive double-digit royalties on sales of this product, should commercialization occur.

Medarex is committed to building value by developing a diverse pipeline of antibody products to address the world's unmet healthcare needs. In addition to the antibody candidates currently in Phase III trials, multiple product candidates in Phase II, Phase I and preclinical testing are being developed by Medarex either alone, jointly with, or separately by our partners, including Amgen, Inc., BMS, Centocor, Eli Lilly and Company, Genmab, ImClone Systems Incorporated, MedImmune, Inc., Novartis Pharma AG, Novo Nordisk A/S, Pfizer and Schering-Plough Corporation. We believe that through the broad use of our UltiMab technology, we are leveraging our efforts and our partners' efforts to create, develop and potentially commercialize innovative treatments for a wide range of diseases.

In addition to our UltiMab Human Antibody Development System, we have considerable experience in preclinical and clinical development as well as in manufacturing antibodies for clinical trials. Our existing manufacturing facility in Annandale, New Jersey currently has the capacity to undertake multiple antibody projects concurrently for clinical development purposes, meeting our near-term production demands. We have assembled a team of experienced scientific, product, clinical and regulatory personnel to facilitate the discovery and development of antibody-based products for us and for our partners. We intend to add sales and marketing and additional manufacturing capabilities as needed.

A portion of our revenue is derived from licensing our fully human antibody technology to pharmaceutical and biotechnology companies. The terms of these license agreements typically include potential license fees and a series of potential milestone payments commencing upon the initiation of clinical trials and continuing through commercialization. These payments may total \$7 million to \$10 million per product candidate if the product receives approval from the U.S. Food and Drug Administration, or FDA, and equivalent foreign agencies. In general, we are also entitled to receive royalties on product sales. Additional revenue may be earned from the sales of antibodies to, and, in some cases, the manufacturing of antibodies for, our partners, as well as from government grants.

Our most significant costs on an annual basis are research and development expenses and general and administrative expenses. Research and development expenses represent those costs that support the advancement of our product pipeline and primarily consist of personnel costs, facilities (including depreciation), research and laboratory supplies, funding of outside research, license and technology access fees, expenses related to antibody manufacturing and clinical trial expenses. We believe that continued investment in research

and development is critical to attaining our strategic objectives. General and administrative expenses consist primarily of personnel expenses for executive, finance, legal and administrative personnel, professional fees and other general corporate expenses. We may be required to add personnel in the future and incur additional costs as we expand our business activities.

We have a history of operating losses and may not achieve profitability. As of September 30, 2006, we had an accumulated deficit of approximately \$906.0 million. Over the next several years, we expect to incur substantial expenses as we continue to identify, develop and manufacture our product(s), invest in research, move forward with the development and prepare to commercialize our product(s). Our commitment of resources to research and the continued development and potential commercialization of our product candidates will require substantial additional funds. Our operating expenses may also increase as we invest in research or acquire additional technologies, as additional product candidates are selected for clinical development and as some of our earlier stage product candidates move into later stage clinical development. In addition, we may incur significant milestone payment obligations as our product candidates progress towards commercialization. In the absence of substantial revenues from new corporate collaborations or other sources, we will incur substantial operating losses and may be required to raise additional funds through debt or equity financings or delay, reduce or eliminate certain of our research and development programs.

Critical Accounting Policies

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our consolidated financial statements. We evaluate our estimates and judgments on an on-going basis. We base our estimates on historical experience and on assumptions that we believe to be reasonable under the circumstances. Our experience and assumptions form the basis for our judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may vary from what we anticipate and different assumptions or estimates about the future could materially change our reported results. We believe the following accounting policies are the most critical to us, in that they are important to the portrayal of our financial statements and they require our most difficult, subjective or complex judgments in the preparation of our consolidated financial statements:

Revenue Recognition

We receive payments from our customers and partners for licenses to our proprietary technology, for product development services, from the achievement of product development milestones and for the sale of antibodies. These payments are generally non-refundable and are reported as deferred revenue until they are recognizable as revenue. We follow the following principles in recognizing revenue:

- We receive research fees from the licensing of our proprietary technologies for research and development performed by our partners. Revenue from these research fees is recognized generally over the term of the respective license period beginning only after both the license period has begun and the technology has been delivered.
- We receive fees for product development services (including manufacturing) we perform for our partners. These fees are recognized ratably over the entire period during which the services are performed.
- Revenue from milestone payments is recognized when each milestone is achieved, when collectibility of such milestone payment is assured and we have no future performance obligations relating to that event. Milestone payments are triggered either by the results of our research efforts or by the efforts of our partners and include such events as submission of an Investigational New Drug Application, or

IND, commencement of Phase I, II or III clinical trials, submission of a Biologic License Application, or BLA, and regulatory approval of a product. Milestone payments are substantially at risk at the inception of an agreement.

- Revenue arrangements that include multiple deliverables, are divided into separate units of accounting if the deliverables meet certain criteria, including whether the fair value of the delivered items can be determined and whether there is evidence of fair value of the undelivered items. In addition, the consideration is allocated among the separate units of accounting based on their relative fair values, and the applicable revenue recognition criteria are considered separately for each of the separate units of accounting.
- Revenues derived from reimbursements of costs associated with the development of product candidates are recorded in compliance with EITF Issue 99-19, Reporting Revenue Gross as a Principal Versus Net as an Agent (EITF 99-19). According to the criteria established by EITF 99-19, in transactions where we act as a principal, with discretion to choose suppliers, bear the credit risk and perform part of the services required in the transaction, we believe we have met the criteria to record revenue for the gross amount of the reimbursements.
- We sell antibodies primarily to partners in the United States and overseas. Revenue from these sales is recognized when the antibodies are shipped and we have no further obligations related to the development of the antibodies.
- Grant revenues are recognized as we provide the services stipulated in the underlying grant based on the time and materials incurred. Amounts received in advance of services provided are recorded as deferred revenue and amortized as revenue when the services are provided.

Investments

Our investment policy calls for investments in fixed income high grade securities such as U.S. corporate debt securities, U.S. treasury obligations and money market funds for which we believe there is not a significant risk of loss. Our primary objectives for our investment portfolio are liquidity and safety of principal. Investments are made to achieve the highest rate of return consistent with these two objectives. However, in the course of our business, we have made and may continue to make investments in companies (both public and private) as part of our strategic collaborations. Investments in companies whose securities are publicly traded (other than Genmab) are classified as marketable securities in the current assets section of our consolidated balance sheets. The fair market value of investments in our partners whose securities are publicly traded (other than Genmab) was approximately 2.2% and 2.6% of total marketable securities as of September 30, 2006 and December 31, 2005, respectively.

Under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, our marketable securities are classified as available-for-sale securities and are carried at fair value. Marketable securities will include those securities of debt and publicly traded equity securities. These securities, including shares of Genmab, trade on listed exchanges; therefore, fair value is readily available. These securities are also subject to an impairment charge when we believe an investment has experienced a decline in value that is other than temporary. Under our accounting policy, a decline in the value of our investments is deemed to be other than temporary and such investments are generally considered to be impaired if their value is less than our cost basis for more than six (6) months, or some other applicable period in light of the facts and circumstances surrounding the investments.

In addition, in connection with our collaborative partnering business, we sometimes make strategic investments in the securities of companies that are privately held. Investments in our partners whose equity is not publicly traded are classified in a separate line item in our consolidated balance sheet entitled Investments in, and advances to, other partners and were approximately \$8.2 million as of September 30, 2006. These securities are carried at original investment cost and adjusted for other than temporary impairment charges, if any. Because these securities are not listed on a financial exchange, the value of these investments is inherently more difficult to estimate than investments in public companies. We value these investments by using information acquired from industry trends, management of these companies, such companies' financial statements, and other external sources. Specifically, our determination of any potential impairment of the value of the securities of privately held companies includes an analysis of the following for each such privately held company on a periodic basis: review of interim and year-end financial statements, cash position and overall rate of cash used to support operations, the progress and development of technology and product platform, the per share value of subsequent financings and potential strategic alternatives. Based on the information acquired through these sources, we record an investment impairment charge when we believe an investment has experienced a decline in value that is other than temporary.

Future adverse changes in market conditions or adverse changes in financial condition and/or operating results of the companies in which we invest that may not be reflected in an investment's current carrying value may also require an impairment charge in the future.

Stock-Based Compensation Expense

Prior to January 1, 2006, we accounted for our 2005 Equity Incentive Plan, as amended (the Plan), under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees* and related Interpretations, as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Other than the amounts discussed in Note 2 to the unaudited consolidated financial statements, no compensation expense was recorded in the financial statements for stock option grants, as all options granted under the Plan had an exercise price equal to the fair market value of the underlying common stock on the grant date. Effective January 1, 2006, we adopted the fair value recognition provisions of FASB Statement No. 123(R), *Share-Based Payment*, using the modified-prospective-transition method. Under this transition method, compensation cost recognized in 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of Statement No. 123(R). Results for prior periods have not been restated as a result of the adoption of Statement 123(R).

The fair value of each option grant is estimated using the Black-Scholes option pricing method. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period (4 years). Use of a valuation model requires management to make certain assumptions with respect to selected model inputs. Expected volatility was calculated based on the historical volatility of our common stock. The average expected life was based on the contractual term of the option, expected employee exercise and post-vesting employment termination behavior. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term equal to the expected life of the options assumed on the date of grant. Forfeitures are estimated based on voluntary termination behavior, as well as an analysis of actual option forfeitures.

Our results of operations for the nine month period ended September 30, 2006 include incremental share-based compensation expense of approximately \$14.1 million. We expect that non-cash share-based compensation expense for 2006 will be approximately \$17.0 million to \$18.0 million based upon current

outstanding awards and assumptions applied. However, any significant awards granted during the remainder of the year, required changes in the estimated forfeiture rates or significant changes in the market price of our stock could have an impact on this estimate.

As of September 30, 2006, the total unrecognized compensation cost related to non-vested stock options expected to vest was approximately \$33.1 million. This cost is expected to be recognized over a weighted average period of 1.5 years.

Valuation of Long-Lived and Intangible Assets

We assess the impairment of identifiable intangible assets and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important that could trigger an impairment review include the following:

- a significant underperformance relative to expected historical or projected future operating results;
- a significant change in the manner of our use of the acquired asset or the strategy for our overall business; and/or
- a significant negative industry or economic trend.

When we determine that the carrying value of intangible assets or long-lived assets are not recoverable based upon the existence of one or more of the above indicators of impairment, we may be required to record impairment charges for these assets that have not been previously recorded.

Results of Operations

Three months ended September 30, 2006 and 2005 (Restated)

Contract and License Revenues

Contract and license revenues totaled \$6.4 million and \$6.5 million for the three month periods ended September 30, 2006 and 2005, respectively, a decrease of \$0.1 million, or 2%. Because contract and license revenues depend to a large extent on the product development efforts of our partners and licensees, our period-to-period contract and license revenues can fluctuate significantly and are inherently difficult to predict.

Contract and License Revenues from Genmab

Contract and license revenues from Genmab were \$0.4 million and \$1.1 million for the three month periods ended September 30, 2006 and 2005, respectively, a decrease of \$0.7 million, or 67%. This decrease is primarily the result of a decrease in antibody exclusive licenses granted to Genmab in the third quarter of 2006 as compared to the third quarter of 2005.

Reimbursement of Development Costs

Revenues derived from the reimbursement of costs associated with the development of our product candidates are recorded in compliance with EITF Issue 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent* (EITF 99-19). Reimbursement of development costs totaled \$5.7 million and \$3.0 million for the three month periods ended September 30, 2006 and 2005, respectively, an increase of \$2.7 million, or

88%. This increase relates principally to the development of ipilimumab with Bristol-Myers Squibb Company, or BMS.

Research and Development Expenses

Research and development expenses for our product candidates in development were \$48.4 million and \$31.2 million for the three month periods ended September 30, 2006 and 2005, respectively, an increase of \$17.1 million, or 55%. Historically, we have not accounted for our research and development expenses on a project-by-project basis and, therefore, we do not provide a breakdown of such historical information in that format. We have, historically, tracked our costs in the categories discussed below, namely, research and product development and by the types of costs as outlined below.

Our research costs consist of costs associated with the breeding, care and continued development of our HuMAb-Mouse and KM-Mouse, as well as costs associated with research and testing of our product candidates prior to reaching the preclinical stage. Such research costs primarily include personnel costs, facilities (including depreciation), research supplies, funding of outside research and license and technology access fees.

Our product development costs consist of costs of preclinical development (including manufacturing) and conducting and administering clinical trials. Such product development costs also include personnel costs, facilities (including depreciation), supply expense related to antibody manufacturing and clinical trial expenses.

The following table sets forth a breakdown of our research and development expenses by those associated with research and those associated with product development for the periods indicated.

| | Three Months Ended September 30, | |
|---------------------|---|------------------|
| | 2006 | 2005 |
| Research | \$ 16,516 | \$ 11,063 |
| Product Development | 31,834 | 20,184 |
| Total | \$ 48,350 | \$ 31,247 |

Research Costs

Research costs for the three month period ended September 30, 2006 increased by \$5.5 million, or 49%, as compared to the three month period ended September 30, 2005. The increase in research costs primarily relates to the following:

- Personnel costs for the three month period ended September 30, 2006 were \$5.7 million, an increase of \$1.8 million, or 47%, as compared to the three month period ended September 30, 2005. Approximately \$1.1 million of the increase is the result of the adoption of SFAS No. 123(R), *Share-Based Payment* effective January 1, 2006 (see further discussion below). In addition, the increase reflects additional staff needed to support higher levels of new product development opportunities, the continued development of our UltiMAb system, and the performance of contract services for our collaborative partners. Personnel costs include salary, benefits, stock based compensation, payroll taxes and recruiting costs. We expect personnel costs to continue to increase as we continue to increase our research activities.
- License and technology access fees for the three month period ended September 30, 2006 were 2.8 million, an increase of \$2.4 million, or 546%, as compared to the three month period ended September 30, 2005. Increases and decreases in license and technology access fees are primarily the result of the timing

of the payments due under such agreements. These costs represent fees paid to certain partners and research organizations in connection with certain of our collaborations and license agreements. Included in the 2006 costs are payments to certain companies and research and academic institutions and other entities for licenses to certain technologies for which no comparable payments were made in 2005.

- Supply costs for the three month period ended September 30, 2006 were \$2.0 million, an increase of \$0.7 million, or 48%, as compared to the three month period ended September 30, 2005. The increased supply costs in 2006 are primarily attributable to the continued development of our UltiMab® system, and the performance of contract services for our collaborative partners. Included in these costs are materials, chemicals and disposables. We expect these costs to increase as we continue to expand our research efforts.

Product Development Costs

Product development costs for the three month period ended September 30, 2006 increased by \$11.7 million, or 58% as compared to the three month period ended September 30, 2005. The increase in product development costs primarily relates to the following:

- Our share of partners' product development costs for the three month period ended September 30, 2006 was \$7.4 million, an increase of \$5.6 million, or 320%, as compared to the three month period ended September 30, 2005. These costs primarily represent our share (35%) of the BMS costs for the development of ipilimumab. We expect our 35% share of BMS' s costs related to the development of ipilimumab to increase in the future as BMS continues to increase its development activities related to ipilimumab.
- Personnel costs for the three month period ended September 30, 2006 were \$9.6 million, an increase of \$2.7 million, or 39%, as compared to the three month period ended September 30, 2005. Approximately \$1.8 million of the increase is the result of the adoption of SFAS No. 123(R), *Share-Based Payment* effective January 1, 2006 (see further discussion below). In addition, this increase reflects increased staff needed to support more extensive clinical trial activities for ipilimumab. Personnel costs include salary, benefits, stock based compensation, payroll taxes and recruiting costs. We expect personnel costs to continue to increase as we continue to expand our product development activities to further progress our products through clinical trials.
- Contract manufacturing costs for the three month period ended September 30, 2006 were \$2.1 million, an increase of \$1.3 million, or 149%, as compared to the three month period ended September 30, 2005. This increase in third party contract manufacturing costs primarily represents production and packaging expenses related to clinical trials of MDX-060.

We expect product development costs to increase in the future as more of our products enter clinical trials. In addition, we may be obligated to make milestone payments on certain of our products as they progress through the clinical trial process. Completion of clinical trials may take several years or more. The length of time varies according to the type, complexity and intended use of the product candidate. We estimate that clinical trials of the type we generally conduct are typically completed over the following periods:

| <u>Clinical Phase</u> | <u>Estimated Completion Period</u> |
|-----------------------|------------------------------------|
| Phase I | 1-2 Years |
| Phase II | 1-2 Years |
| Phase III | 2-4 Years |

The duration and cost of clinical trials may vary significantly over the life of a particular project as a result of, among other things, the following factors:

- the length of time required to recruit qualified patients for clinical trials;
- the duration of patient dosing and follow-up in light of trial results;
- the number of clinical sites required for trials; and
- the number of patients that ultimately participate.

We continue to explore new collaborative arrangements that may affect future spending for research and development. As part of our partnering strategy, a significant portion of the research and development expenses incurred in connection with products using our technology is expected to be borne by our partners. We believe this allows us to participate in the research and development of substantially more potential product candidates than we could develop on our own if we bore the entire cost of development. Product candidates using our technology are currently in various stages of development from preclinical to Phase III. The successful development of these product candidates is dependent on many factors, including among other things, the efforts of our partners, unforeseen delays in, or expenditures relating to, preclinical development, clinical testing, manufacturing or regulatory approval, failure to receive market acceptance, the emergence of competitive products and the inability to produce or market our products due to third-party proprietary rights.

General and Administrative Expenses

General and administrative expenses include compensation, professional services, consulting, travel and facilities (including depreciation) and other expenses related to legal, business development, finance, information systems and investor relations. General and administrative expenses totaled \$15.5 million and \$6.4 million for the three month periods ended September 30, 2006 and 2005, respectively, an increase of \$9.1 million, or 142%. Approximately \$2.1 million of the increase is attributable to the operations of Celldex Therapeutics, Inc., or Celldex; approximately \$1.9 million of the increase is related the adoption of SFAS No. 123(R), *Share-Based Payment* effective January 1, 2006 (see further discussion below); and approximately \$5.2 million of the increase is related to fees associated with the Company's investigation of its prior stock option grant practices (see further discussion under Legal Proceedings in Part II). General and administrative expenses are expected to increase in the future as our products are developed and as we expand our business activities.

Interest and Dividend Income

Interest and dividend income consists primarily of interest earned from our cash, cash equivalents and marketable securities. Interest and dividend income was \$4.8 million and \$6.2 million for the three month periods ended September 30, 2006 and 2005, respectively, a decrease of \$1.4 million, or 22%. Included in interest and dividend income for the three month period ended September 30, 2005 is a gain on the sale of common stock of one of our partners of approximately \$3.2 million. Excluding the impact of this gain, interest and dividend income would have increased by 1.8 million, or 60%, as compared to the three month period ended September 30, 2006. The increase primarily reflects higher interest rates earned on our investment portfolio. In addition, we have higher interest and dividend income in 2006 as the result of higher average cash balances reflecting the proceeds received (approximately \$128.0 million) from our April 2006 public offering of 11.5 million shares of common stock. See further explanation under the section entitled *Liquidity and Capital Resources*.

Interest Expense

Interest expense for the three month periods ended September 30, 2006 and 2005 relates primarily to interest and amortization of issuance costs on our 2.25% Convertible Senior Notes issued in May 2004. Interest expense was \$1.1 million and \$1.1 million for the three month periods ended September 30, 2006 and 2005, respectively.

Minority Interest Celldex

Minority interest in loss of Celldex for the three month period ended September 30, 2006 of \$1.7 million represents 40% of Celldex's net loss for the third quarter of 2006. Prior to October 12, 2005, we owned 100% of the outstanding capital stock of Celldex. As a result of certain acquisitions in October of 2005 by Celldex, our ownership percentage was reduced from 100% to approximately 60%. Celldex's results of operations for 2006 have been consolidated for reporting purposes, and the \$1.7 million (the portion of Celldex's net loss for the three month period ended September 30, 2006 not attributable to us) is recorded as a reduction of our expenses.

Nine months ended September 30, 2006 and 2005 (Restated)

Contract and License Revenues

Contract and license revenues totaled \$20.4 million and \$22.6 million for the nine month periods ended September 30, 2006 and 2005, respectively, a decrease of \$2.2 million, or 10%. This decrease relates principally to \$4.0 million in milestone payments received in 2005 from our contract and licensing business which we did not receive in 2006. Because contract and license revenues depend to a large extent on the product development efforts of our partners and licensees, our period-to-period contract and license revenues can fluctuate significantly and are inherently difficult to predict.

Contract and License Revenues from Genmab

Contract and license revenues from Genmab were \$1.2 million and \$3.3 million for the nine month periods ended September 30, 2006 and 2005, respectively, a decrease of \$2.1million, or 64%. This decrease is primarily the result of a decrease in antibody exclusive licenses granted to Genmab in the first three quarters of 2006 as compared to the first three quarters of 2005.

Reimbursement of Development Costs

Revenues derived from the reimbursement of costs associated with the development of our product candidates are recorded in compliance with EITF Issue 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent* (EITF 99-19). Reimbursement of development costs totaled \$15.8 million and \$11.8 million for the nine month periods ended September 30, 2006 and 2005, respectively, an increase of \$4.0 million, or 33%. This increase relates principally to the development of MDX-1106 with Ono Pharmaceuticals Co. Ltd.

Research and Development Expenses

Research and development expenses for our product candidates in development were \$142.3 million and \$96.7 million for the nine month periods ended September 30, 2006 and 2005, respectively, an increase of \$45.6 million, or 47%. Historically, we have not accounted for our research and development expenses on a project-by-project basis and, therefore, we do not provide a breakdown of such historical information in that format. We

have, historically, tracked our costs in the categories discussed below, namely, research and product development and by the types of costs as outlined below.

Our research costs consist of costs associated with the breeding, care and continued development of our HuMAb-Mouse and KM-Mouse, as well as costs associated with research and testing of our product candidates prior to reaching the preclinical stage. Such research costs primarily include personnel costs, facilities (including depreciation), research supplies, funding of outside research and license and technology access fees.

Our product development costs consist of costs of preclinical development (including manufacturing) and conducting and administering clinical trials. Such product development costs also include personnel costs, facilities (including depreciation), supply expense related to antibody manufacturing and clinical trial expenses.

The following table sets forth a breakdown of our research and development expenses by those associated with research and those associated with product development for the periods indicated.

| | Nine Months Ended September 30, | |
|---------------------|------------------------------------|-----------|
| | 2006 | 2005 |
| Research | \$ 50,278 | \$ 34,830 |
| Product Development | 92,046 | 61,827 |
| Total | \$ 142,324 | \$ 96,657 |

Research Costs

Research costs for the nine month period ended September 30, 2006 increased by \$15.4 million, or 44%, as compared to the nine month period ended September 30, 2005. The increase in research costs primarily relates to the following:

- License and technology access fees for the nine month period ended September 30, 2006 were \$10.3 million, an increase of \$6.7 million, or 185%, as compared to the nine month period ended September 30, 2005. Increases and decreases in license and technology access fees are primarily the result of the timing of the payments due under such agreements. These costs represent fees paid to certain partners and research organizations in connection with certain of our collaboration and license agreements. Included in the 2006 costs are payments to certain companies and research and academic institutions and other entities for licenses to certain technologies for which no comparable payments were made in 2005.
- Personnel costs for the nine month period ended September 30, 2006 were \$16.3 million, an increase of \$4.8 million, or 42%, as compared to the nine month period ended September 30, 2005. Approximately \$2.7 million of the increase is the result of the adoption of SFAS No. 123(R), *Share-Based Payment* effective January 1, 2006 (see further discussion below). In addition, the increase reflects additional staff needed to support higher levels of new product development opportunities, the continued development of our UltiMAb system, and the performance of contract services for our collaborative partners. Personnel costs include salary, benefits, stock based compensation, payroll taxes and recruiting costs. We expect personnel costs to continue to increase as we continue to increase our research activities.
- Facility costs for the nine month period ended September 30, 2006 were \$8.3 million, an increase of \$2.0 million, or 32%, as compared to the nine month period ended September 30, 2005. The increases in facility costs primarily relates to property taxes and maintenance costs. Facility costs include

depreciation, utilities, maintenance, property taxes and other related expenses. We expect to incur increased facility costs as a result of increased energy costs and continued capital expansion.

Product Development Costs

Product development costs for the nine month period ended September 30, 2006 increased by \$30.2 million, or 49% as compared to the nine month period ended September 30, 2005. The increase in product development costs primarily relates to the following:

- Our share of partners' product development costs for the nine month period ended September 30, 2006 was \$19.9 million, an increase of \$17.4 million, or 699%, as compared to the nine month period ended September 30, 2005. These costs primarily represent our share (35%) of the BMS costs for the development of ipilimumab. We expect our 35% share of BMS's costs related to the development of ipilimumab to increase in the future as BMS continues to increase its development activities related to ipilimumab.
- Personnel costs for the nine month period ended September 30, 2006 were \$27.7 million, an increase of \$7.5 million, or 37%, as compared to the nine month period ended September 30, 2005. Approximately \$4.7 million of the increase is the result of the adoption of SFAS No. 123(R), *Share-Based Payment* effective January 1, 2006 (see further discussion below). In addition, this increase reflects increased staff needed to support more extensive clinical trial activities for ipilimumab. Personnel costs include salary, benefits, stock based compensation, payroll taxes and recruiting costs. We expect personnel costs to continue to increase as we continue to expand our product development activities to further progress our products through clinical trials.
- Clinical research fees for the nine month period ended September 30, 2006 were \$10.7 million, an increase of \$3.2 million, or 42%, as compared to the nine month period ended September 30, 2005. This increase resulted primarily from the continued enrollment of patients in the Phase III clinical trial for ipilimumab in combination with MDX-1379 and the initiation of additional sites for this trial. Sites participating in this trial are currently located in North America, Europe and Latin America. The continued enrollment of patients in the Phase III trial and the initiation of additional sites resulted in increased monitoring costs and increased investigator site fees. Clinical research fees include clinical investigator site fees, external trial monitoring costs and data accumulation costs. We expect expenses related to clinical trials to increase in the future as we continue to develop our therapeutic product pipeline.

We expect product development costs to increase in the future as more of our products enter clinical trials. In addition, we may be obligated to make milestone payments on certain of our products as they progress through the clinical trial process.

General and Administrative Expenses

General and administrative expenses include compensation, professional services, consulting, travel and facilities (including depreciation) and other expenses related to legal, business development, finance, information systems and investor relations. General and administrative expenses totaled \$35.1 million and \$18.7 million for the nine month period ended September 30, 2006 and 2005, respectively, an increase of \$16.4 million, or 88%. Approximately \$6.1 million of the increase is attributable to the operations of Celldex, approximately \$5.6 million of the increase is related to the adoption of SFAS No. 123(R), *Share-Based Payment* effective January 1, 2006 (see further discussion below) and approximately \$6.1 million of the increase is related to fees associated with the Company's Investigation of its prior stock option grant practices (see further

discussion under Legal Proceedings in Part II). General and administrative expenses are expected to increase in the future as our products are developed and we expand our business activities.

Equity in Net Loss of Affiliate

Equity in net loss of affiliate was \$1.0 million and \$3.5 million for the nine month period ended September 30, 2006 and 2005, respectively, a decrease of \$2.5 million, or 70%, and represents our share of Genmab's net loss for the nine month period ended September 30, 2006 and 2005. The decrease was primarily related to the suspension of our share of Genmab's net losses effective February 1, 2006. On February 1, 2006, Genmab completed the private placement of 5.75 million shares of its stock. As a result of this private placement, our ownership percentage of Genmab was reduced to approximately 18.9%. See Note 3 to the consolidated financial statements for further explanation. Beginning February 1, 2006 we began accounting for its investment in Genmab as a marketable security in accordance with SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities*.

Interest and Dividend Income

Interest and dividend income consists primarily of interest earned from our cash, cash equivalents and marketable securities. Interest and dividend income was \$12.7 million and \$11.4 million for the nine month period ended September 30, 2006 and 2005, respectively, an increase of \$1.3 million, or 11%. The increase primarily reflects higher interest rates earned on our investment portfolio. In addition, we have higher interest and dividend income in 2006 as the result of higher average cash balances reflecting the proceeds received (approximately \$128.0 million) from our April 2006 public offering of 11.5 million shares of common stock. See further explanation under the section entitled *Liquidity and Capital Resources*.

Impairment Loss on Investments in Partners

We have investments in several partners whose securities are not publicly traded. Because these securities are not publicly traded, the value of these investments is inherently more difficult to estimate than investments in publicly traded companies. We recorded impairment charges of \$0 and \$29.3 million for the nine month periods ended September 30, 2006 and 2005, respectively, related to investments in certain of our partners whose securities are not publicly traded. The impairment charge for the nine month periods ended September 30, 2005 related entirely to our investment in IDM. The amount of the impairment charge was calculated as the difference between (i) the estimated per share value expected to be received by IDM shareholders upon completion of its merger with Epimmune, Inc., a publicly traded company, which was announced on March 16, 2005 and completed in August 2005, and (ii) our carrying value. Our investment in IDM was reclassified to marketable securities in the third quarter of 2005. If we deem any of our investments to be further impaired at the end of any future period, we may incur additional impairment charges on these investments.

Interest Expense

Interest expense for the nine month periods ended September 30, 2006 and 2005 relates to interest and amortization of issuance costs on our 2.25% Convertible Senior Notes issued in May 2004. Interest expense was \$3.2 million and \$3.2 million for the nine month periods ended September 30, 2006 and 2005, respectively.

Minority Interest Celldex

Minority interest in loss of Celldex for the nine month periods ended September 30, 2006 of \$4.8 million represents 40% of Celldex's net loss for the first three quarters of 2006. Prior to October 12, 2005, we owned 100% of the outstanding capital stock of Celldex. As a result of certain acquisitions in October of 2005 by

Celldex, our ownership percentage was reduced from 100% to approximately 60%. Celldex's results of operations for 2006 have been consolidated for reporting purposes, and the \$4.8 million (the portion of Celldex's net loss for the nine month period ended September 30, 2006 not attributable to us) is recorded as a reduction of our expenses.

Non-Cash Gain on Investment in Genmab

Non-cash gain on investment in Genmab for the nine month period ended September 30, 2006 of \$3.2 million was recorded in accordance with FASB Staff Position APB 18-1, *Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence (FSP APB 18-1)*. As a result of Genmab's private placement of 5.75 million shares of its common stock in February 2006 and the corresponding reduction of our ownership percentage below 20%, our accumulated other comprehensive income associated with our investment in Genmab was first offset against the remaining carrying value of our investment in Genmab (\$2.2 million), reducing our investment in Genmab to zero, with the remaining balance (\$3.2 million) recorded as a non-cash gain in the consolidated statement of operations for the nine month period ended September 30, 2006.

Liquidity and Capital Resources

We require cash to fund our operations, to make capital expenditures and strategic investments, and to pay debt service on our convertible notes. Since inception, we have financed our operations through the sale of our securities in public and private placements, sales of our products for research purposes, development and manufacturing services, technology transfer and license fees and milestone payments. We expect to continue to fund our cash requirements from these sources in the future.

At September 30, 2006, we had \$386.3 million in cash, cash equivalents and marketable securities. Approximately \$16.4 million of cash and cash equivalents included in the September 30, 2006 balance relates to Celldex and is consolidated for accounting purposes. We primarily invest our cash equivalents and marketable securities in highly liquid, interest-bearing, investment grade and government securities in order to preserve principal.

Cash Used in Operating Activities

Cash used in operating activities was \$94.8 million and \$63.9 million for the nine month periods ended September 30, 2006 and 2005, respectively. This reflects an increase of \$30.9 million in 2006 as compared to the same period in 2005. The increase in net cash used in operating activities for the nine month period ended September 30, 2006 was primarily due to a decrease in cash received in connection with deferred contract revenue. Deferred contract revenue for the nine month period ended September 30, 2005 includes \$25.0 million received from our collaboration with BMS. There was no comparable addition to deferred revenue during the nine month period ended September 30, 2006. In addition, approximately \$6.1 million of the increase relates to fees associated with the Company's investigation of its prior stock option grant practices for which there were no comparable expenses in 2005.

We have incurred and will continue to incur significant costs in the area of research and development, including preclinical and clinical trials, as our product candidates are developed. We plan to spend significant amounts to progress our current product candidates through the clinical trial and commercialization process as well as to develop additional product candidates on our own or with our partners. As our product candidates progress through the clinical trial process, we may be obligated to make significant milestone payments. We also expect to incur future facility costs as a result of our continued capital expansion, renovations and

replacements. We expect our general and administrative costs to increase as we expand our administrative and business development activities. Furthermore, we expect our investment income to decrease as we fund our future operations and capital expenditures from our cash reserves. We anticipate that our operating expenditures may be partially offset by revenues from partners for license fees, milestone payments, and development and manufacturing services.

Cash Provided by (Used in) Investing Activities

Net cash used in investing activities was \$88.9 million for the nine month period ended September 30, 2006 compared to net cash provided by investing activities of \$45.3 million for the nine month period ended September 30, 2005. The overall increase in cash used in investing activities was \$34.6 million and was primarily the result of the following factors:

- Purchases of marketable securities totaled \$192.0 and \$56.1 million for the nine month periods ended September 30, 2006 and 2005, respectively. The 2006 purchases were made with the net proceeds of approximately \$128.0 million received from the sale of 11.5 million shares of our common stock at a public offering price of \$11.75 per share. The 2005 purchases were made with the proceeds received from the BMS collaboration.
- Sales and maturities of marketable securities were \$113.1 million and \$107.3 million for the nine month periods ended September 30, 2006 and 2005, respectively. Proceeds from sales of marketable securities in 2006 and 2005 were primarily used to fund operations and capital expenditures.

Cash Provided by Financing Activities

Cash provided by financing activities was \$133.4 million and \$28.3 million for the nine month periods ended September 30, 2006 and 2005, respectively. Cash provided by financing activities for the nine month period ended September 30, 2006 was primarily due to proceeds received from a public offering of 11.5 million shares of our common stock at a public offering price of \$11.75 per share, resulting in net proceeds of approximately \$128.0 million. Cash provided by financing activities for the nine month period ended September 30, 2005 was primarily due to the proceeds received (\$25.0 million) from the sale of common stock to BMS in connection with our collaboration.

Other Liquidity Matters

Effective February 1, 2006, we ceased accounting for our investment in Genmab A/S (Genmab) under the equity method of accounting due to a reduction in ownership and a corresponding loss of significant influence (see Note 2). We currently account for our investment in Genmab in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Our investment in Genmab has been classified as a non-current marketable security in our September 30, 2006 consolidated balance sheet.

Accounting for our investment in Genmab as a marketable security in accordance with SFAS No. 115 has resulted in an unrealized gain of approximately \$306.9 million as of September 30, 2006. Such unrealized gain is also included within accumulated other comprehensive income classified within shareholders' equity in the September 30, 2006 consolidated balance sheet.

In July 2004, we entered into an amendment to a collaboration and license agreement with Gilead Sciences, Inc., or Gilead, referred to herein as the Gilead Amendment. Under the terms of the Gilead Amendment, we agreed to pay Gilead a total of \$8.5 million in eight equal quarterly installments of \$1.063 million, payable at our election, in cash, registered shares of our common stock or a combination thereof, in exchange for (i) a

reduction of certain future royalty payment obligations payable by us to Gilead, and (ii) an expansion of the scope of certain licenses from Gilead to us relating to certain intellectual property rights regarding anti-CTLA-4 products. The first of these payments was paid on August 2, 2004 through the issuance of 185,622 shares of our common stock to Gilead. The second payment was made on October 1, 2004 in cash. The third, fourth, fifth and sixth payments (all made in 2005) were also made in cash. The seventh payment was made on January 3, 2006 and the eighth and final payment was made on April 3, 2006. Both of the 2006 payments were made in cash.

In August 2004, we completed the acquisition of all of the outstanding capital stock not already owned by us of Ability Biomedical. Pursuant to this transaction, we acquired Ability Biomedical's intellectual property related to IP-10, a protein believed to be associated with a variety of immune disorders, including multiple sclerosis, rheumatoid arthritis, inflammatory bowel disease, chronic obstructive pulmonary disease and type I diabetes.

Under the terms of the share purchase agreement with Ability Biomedical, we made cash payments totaling approximately \$606 thousand and issued a total of 731,823 shares of our common stock valued at approximately \$4.3 million in exchange for all of Ability Biomedical's issued and outstanding stock not already owned by us.

Upon achievement of certain development milestones with respect to our anti-IP-10 antibody program, but no later than September 4, 2007, we may be required to pay the former shareholders of Ability Biomedical an additional amount of approximately \$3.65 million in cash and/or common stock subject to fluctuations in currency exchange rates. In lieu of such additional payment, we also have the option to revert to the original joint collaboration agreement with the former shareholders of Ability Biomedical whereby each party would be responsible for 50% of the costs associated with the anti-IP-10 antibody.

In January 2005, we announced the closing of a collaboration and co-promotion agreement and a related securities purchase agreement with BMS. Under the terms of the collaboration, we and BMS each granted the other certain intellectual property licenses and product rights on a worldwide basis in order to enable us to collaborate in research and development of certain therapeutic antibody-based products for the treatment of cancer and other diseases, and, in the event that further development work is successful, to commercialize any resulting products. In particular, the collaboration includes a grant by us to BMS of a license to commercialize ipilimumab, a fully human antibody product developed using our UltiMab Human Antibody Development System. Ipilimumab is currently under investigation for the treatment of a broad range of cancers. The collaboration also includes the grant by us to BMS of a sub-license to MDX-1379, a gp100 peptide vaccine licensed by us from the U.S. Public Health Service, for use with ipilimumab for the treatment of metastatic melanoma. We and BMS are currently conducting a Phase III clinical trial with ipilimumab and MDX-1379 combination therapy in Stage III and Stage IV metastatic melanoma patients at multiple sites worldwide. In addition, we and BMS have initiated two registrational studies of ipilimumab for metastatic melanoma under two separate Special Protocol Assessment agreements with the FDA. One is a monotherapy registrational study of ipilimumab in second-line (previously treated with melanoma therapy other than ipilimumab) metastatic melanoma that is completed enrollment in 2006, and the other is a Phase III clinical trial of ipilimumab used in combination with chemotherapy in first-line (previously untreated) patients with metastatic melanoma.

As part of the collaboration, we and BMS committed to an initial multi-year budget of approximately \$192.0 million to fund the development of ipilimumab as a potential treatment for a broad range of cancers. BMS is responsible for 65% of all development costs related to clinical trials intended to support regulatory approval in both the United States and Europe, with the remaining 35% to be paid by us. We and BMS will share equally the costs of any clinical trials of products intended solely for regulatory approval in the United

States, and BMS will be fully responsible for all development costs that relate solely to regulatory approval in Europe and other parts of the world.

Under the terms of the collaboration, we could receive up to \$205.0 million from BMS if all regulatory milestones are met, plus up to an additional \$275.0 million in sales-related milestones. We will also have the option to co-promote any products in the United States, and, if we elect to exercise this option and have participated in the funding of the applicable Phase III clinical trial(s), we will receive 45% of any profits from commercial sales in the United States. In the event we choose not to exercise our co-promotion rights, BMS will have exclusive commercial rights in the United States and will pay us royalties on commercial sales. Outside the United States, BMS will have exclusive commercial rights and will pay us royalties on commercial sales.

Pursuant to these agreements, BMS made an initial cash payment to us on January 21, 2005 of \$25.0 million. In addition, BMS purchased a total of 2,879,223 unregistered shares of our common stock at a purchase price equal to \$8.6829 per share for an aggregate purchase price of \$25.0 million. These shares were issued in a private placement pursuant to the exemption from registration provided by Section 4(2) of the Securities Act of 1933. The purchase price represented a small premium to the market price on the date we entered into the collaboration. BMS agreed to a two-year lock-up period with respect to any sales of such stock. We have no future obligation to register such stock.

In October 2005, Celldex completed the acquisition of all of the issued and outstanding shares of capital stock of Lorantis Limited, or Lorantis, a privately held biotechnology company based in Cambridge, U.K. and substantially all of the assets of Alteris Therapeutics, Inc., or Alteris, a privately held biotechnology company based in Philadelphia, Pennsylvania.

The purchase price of Lorantis consisted of 6.8 million shares of Celldex Class A common stock (valued at \$34.0 million).

The purchase price for substantially all of the Alteris assets consisted of 1.2 million shares of Celldex common stock (valued at \$6.0 million) and approximately \$1.6 million in cash. Celldex may be required to pay Alteris up to \$5.0 million upon obtaining the first approval for commercial sale of an EGFRvIII product. In addition, Celldex may be required to pay an amount equal to 20% of any upfront fees or milestone payments received from a certain unrelated third-party licensee, in the event that within 12 months of the closing, Celldex enters into a license agreement with such third party for any EGFRvIII-derived product developed using the technology acquired from Alteris.

In April 2006, we completed a public offering of 10 million shares of common stock at a public offering price of \$11.75 per share. In May 2006, the underwriters exercised in full their option to purchase an additional 1.5 million shares of common stock at the public offering price of \$11.75 per share. The exercise of the option to purchase the additional 1.5 million shares increased the size of the public offering to a total of 11.5 million shares of common stock resulting in net proceeds to us of approximately \$128.0 million.

Financial Uncertainties Related to Potential Future Milestone Payments

Effective September 4, 2002, we entered into a collaboration and license agreement with Kirin Brewery Co., Ltd., or Kirin, which provides for us to exchange with Kirin certain cross-licenses for each other's technology for the development and commercialization of human antibody products. Pursuant to a letter of intent that was superseded by the collaboration and license agreement, we and Kirin developed the KM-Mouse®, a unique crossbred mouse that combines the traits of our HuMAb-Mouse® with Kirin's TC Mouse. Under the collaboration and license agreement, we are exchanging cross-licenses with Kirin with respect to the KM-Mouse and other antibody-generating mice. In addition, certain of the cross-licenses granted under the

Collaboration and License Agreement are subject to license, milestone and royalty payments by one party to the other.

Through September 30, 2006, we have not made any milestone payments to Kirin although approximately \$2.8 million has been paid to Kirin as of September 30, 2006 representing a payment due Kirin as a result of our collaboration with Pfizer, Inc., or Pfizer. In addition, based on a total of three products we are developing which use or, we believe may use, Kirin technology that (i) are currently in clinical trials, or (ii) we anticipate may enter clinical trials through the end of 2007, we may be required to make milestone payments to Kirin aggregating up to approximately \$12.75 million with respect to such products, or a maximum of approximately \$4.25 million per product. Our future milestone payment obligations to Kirin may or may not be triggered, and may vary in size, depending on a number of variables, almost all of which are currently unknown, including the following:

- whether or not a decision is made to request a license from Kirin;
- the type of license requested (research or commercial);
- the success and timing of development efforts and clinical trials of product candidates covered by any such licenses;
- the type of product developed, (payment obligations differ depending on whether a product is an ex vivo therapeutic, in vivo therapeutic, research reagent or diagnostic); and
- other financial provisions of the Kirin agreement that provide for variations in fee levels and netting of certain payments over specified periods of time that may impact the total amount potentially payable to Kirin for any particular license fee or milestone payment.

We have also entered into a number of other agreements that contain licenses of third-party technology which may be used together with our own platform technologies for the generation, development and/or manufacture of our antibody products. In addition, we have entered into other third-party agreements that contain licenses associated with antibody products that target specific antigens. Many of these agreements contain milestone payments that are due with respect to products using/targeting the licensed technology/antigen only if and when certain specified pre-commercialization events occur. Not all of our products currently under development trigger such milestone payments. Through September 30, 2006, we had made milestone payments of approximately \$0.3 million under these agreements. In addition, under the agreements we currently have in place (other than with Kirin), based on a total of nine products we are developing for which milestones are potentially due and that (i) are now in clinical trials, or (ii) which we anticipate may enter clinical trials before the end of 2007, we may be obligated to make future milestone payments aggregating up to approximately \$59.9 million with respect to such products. In general, potential milestone payments for our antibody products may or may not be triggered under these licenses, and may vary in size, depending on a number of variables, almost all of which are currently uncertain. Typically, the events that trigger these payments per product include:

- submission of IND(s) or foreign equivalents;
- commencement of Phase I, Phase II and/or Phase III clinical trials or foreign equivalents;
- submission of BLA(s) or foreign equivalents; and
- receipt of marketing approval(s) to sell products in a particular country or region.

In addition, the licenses above may trigger royalty payments in connection with the commercialization of certain of our products. To date, we have not made any royalty payments on sales of our products and believe we are at least a few years away from selling any products that would require us to make any such royalty payments. Whether we will be obligated to make milestone or royalty payments in the future is subject to the success of our product development efforts and, accordingly, is inherently uncertain.

Future Liquidity Resources

Our current sources of liquidity are our cash, cash equivalents and marketable securities, interest and dividends earned on such cash, cash equivalents and marketable securities, contract and licensing revenue and sales of our products for research. We believe that such sources of liquidity will be sufficient to meet our operating, debt service, and capital requirements for at least the next 24 months. To the extent our 2.25% Notes are converted into shares of our common stock on or before their maturity date, we will have use of that portion of the principal amount of the notes to fund our on-going operations. In any event, we may require additional financing within this time frame and may raise funds through public or private financings, line of credit arrangements, collaborative relationships and/or other methods. The use of cash on hand or other financial alternatives will depend on several factors including, but not limited to, the future success of our products in clinical development, the prevailing interest rate environment, and access to the capital markets. We cannot assure you that we will be able to raise such additional funds. We may be unable to raise sufficient funds to complete development of any of our product candidates or to continue operations. As a result, we may face delay, reduction or elimination of research and development programs or preclinical or clinical trials, in which case our business, financial condition or results of operations may be materially harmed.

Item 3. Quantitative and Qualitative Disclosures about Market Risks.

We do not use derivative financial instruments in our operations or investment portfolio. We regularly invest excess operating cash in deposits with major financial institutions, money market funds, notes issued by the U.S. Government, as well as fixed income investments and U.S. bond funds both of which can be readily purchased or sold using established markets. We believe that the market risk arising from our holdings of these financial instruments is minimal. We do not believe we have material exposure to market risks associated with changes in interest rates, as we have no variable interest rate debt outstanding. While we do not believe we have any material exposure to market risks associated with interest rates, we may experience reinvestment risk as fixed income securities mature and are reinvested in securities bearing lower interest rates.

Item 4. Controls and Procedures

Special Investigation Committee Review into Stock Option Grant Practices and Restatement

As discussed in Note 2 to the consolidated financial statements of this Quarterly Report on Form 10-Q, in June 2006, the Company's Board of Directors initiated an Investigation of the Company's stock option grant practices from 1996 through June 30, 2006, which was conducted by the Special Investigation Committee.

Based upon information obtained in the Investigation, through July 2002, the Company had a practice, in many instances, of selecting dates for its stock option grants and restricted stock grants as of the date when the stock price was the lowest during the month of grant, without disclosing this practice in its public filings and without properly measuring the compensation expense on a date that the terms of the equity awards were finalized. Subsequent to July 2002, while the Company had made changes in its equity award granting practices in response to legal and regulatory requirements, there were two annual rank and file equity grants for which the measurement dates differ from the grant dates recorded in the Company's books and records by a couple of days, which the Investigation revealed were primarily a result of administrative delays, with no apparent intent to achieve favorable exercise prices.

From July 2002 through 2005, the Company implemented improvements to procedures and processes to provide greater internal control over the equity award granting and administration function in compliance with the Sarbanes-Oxley Act of 2002 ("SOX"). These improvements included:

- Documenting and assessing the design and operation of internal controls
- Segregating responsibilities, adding reviews and redefining roles and responsibilities
- Identifying key controls, developing test plans, and testing controls in the equity award granting and administration function
- Certifying stock administration and other controls for SOX Section 404 compliance in 2005 and 2004

Evaluation of Disclosure Controls and Procedures: Our principal executive officer and principal financial officer reviewed and evaluated our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures are effective in ensuring that all material information required to be included in this Quarterly Report on Form 10-Q has been made known to them in a timely fashion.

Changes in Internal Controls Over Financial Reporting: Such evaluation did not identify any significant changes in our internal controls over financial reporting that occurred during the quarter ended September 30, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

In January 2007, we adopted a new policy and procedure for the granting of stock options and other equity-based incentives. This new policy and procedure was designed to ensure consistency in the granting and administration of equity awards and includes:

- Specific procedures for:
 - Equity grants to new officers, employees and members of the Board of Directors;
 - Annual equity grants to current officers, employees and members of the Board of Directors; and
 - Off-cycle grants to current officers, employees and members of the Board of Directors;
 - A methodology for establishing accounting measurement dates for the foregoing grants;
 - Procedures for the communication, documentation and implementation of equity awards by the stock option administrator; and
- Training for individuals involved in the administration and implementation of equity award procedures.

Limitations on the effectiveness of controls: A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within an organization have been detected.

Part II Other Information

Item 1. Legal Proceedings

The SEC is conducting an informal inquiry into our stock option grants and practices and related accounting. In addition, we have received a subpoena from the U.S. Attorney's Office, District of New Jersey, relating to the same matters. We could be required to pay significant fines or penalties in connection with these regulatory inquiries.

In June 2006, two derivative actions were filed in New Jersey state court by shareholders purporting to act on behalf of Medarex, naming Medarex as a nominal defendant and certain current and former directors as defendants. In November 2006 and January 2007, three additional derivative complaints were filed in the United States District Court for the District of New Jersey, containing nearly identical factual allegations concerning Medarex's historical stock option granting practices. The complaints allege, among other things, that certain of Medarex's officers and directors breached their fiduciary duties to the Company and violated federal securities laws in connection with public statements made in SEC filings relating to the Company's historical stock option granting practices and related accounting. The complaints seek unspecified damages and equitable relief. These actions are in their preliminary stages.

In the ordinary course of our business, we are at times subject to various legal proceedings. Except as described above, we do not believe that any of our current legal proceedings, individually or in the aggregate, will have a material adverse effect on our operations or financial condition.

Item 1A. Risk Factors

Medarex has marked with an asterisk (*) those risk factors that reflect substantive changes from the risk factors included in the Company's Form 10-K/A filed on February 9, 2007 with the SEC for the fiscal year ended December 31, 2005.

Additional factors that might affect future results include the following:

Risks Related to Our Business and Industry

Successful development of our products is uncertain.

Based on public disclosures, as of February 1, 2007, regulatory applications, including INDs, have been submitted to the FDA or comparable foreign authorities, for 36 product candidates derived from our UltiMAb platform. Neither we nor our partners have any product candidates employing our human antibody technology that have been approved for sale by the FDA or comparable foreign authorities and/or commercialized. Product candidates employing our human antibody technology have not advanced and may not advance beyond clinical development or demonstrate clinical safety and effectiveness.

Our development of current and future product candidates is subject to the risks of failure and delay inherent in the development of new pharmaceutical products and products based on new technologies. These risks include:

- delays in product development, clinical testing or manufacturing;
- slower than expected patient enrollment;
- unplanned expenditures in product development, clinical testing or manufacturing;
- failure in clinical trials or failure to receive regulatory approvals;

- emergence of superior or equivalent products;
- inability to manufacture on our own, or through others, product candidates on a commercial scale;
- inability to market products due to third-party proprietary rights;
- election by our partners not to pursue product development;
- failure by our partners to develop products successfully; and
- failure to achieve market acceptance.

In certain instances, we have experienced delays in our product development and clinical testing as a result of slower than anticipated patient recruitment. In a number of instances, we have terminated the development of certain products in the early stages of human clinical testing due to a lack of effectiveness.

Because of these risks, our research and development efforts or those of our partners may not result in any commercially viable products. If a significant portion of these development efforts are not successfully completed, required regulatory approvals are not obtained or any approved products are not commercially successful, our business, financial condition and results of operations may be materially harmed.

Our revenue and profit potential are unproven. No revenues have been generated from the commercial sale of our products and our products may not generate commercial revenues in the future.

Because we and our partners have not begun commercial sales of our products, our revenue and profit potential are unproven, which makes it difficult for an investor to evaluate our business and prospects. Our technology may not result in any meaningful benefits to our current or potential partners. No revenues have been generated from the commercial sale of our products, and our products may not generate revenues in the future. Our business and prospects should be considered in light of the heightened risks and unexpected expenses and problems we may face as a company in a rapidly evolving biopharmaceutical industry.

***We have incurred large operating losses, and we anticipate that these losses will continue.**

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We have incurred large operating losses, and we anticipate that these losses will continue for the foreseeable future. In particular, as of September 30, 2006, we had an accumulated deficit of approximately \$905.9 million. Our net losses were \$148.0 million and \$124.0 million for the year ended December 31, 2005 and the nine-month period ended September 30, 2006, respectively. Our losses have resulted principally from:

- research and development costs relating to the development of our technology and antibody product candidates;
- costs associated with the establishment of our laboratory and manufacturing facilities and manufacturing of products; and
- general and administrative costs relating to our operations.

We intend to continue to make significant investments in:

- research and development;
- preclinical testing and clinical trials;
- manufacturing clinical supplies of our antibody products;
- establishing new collaborations; and
- new technologies.

In addition, we may be obligated to make milestone payments with respect to certain of our products as they progress through the clinical trial process.

We do not know when or if we or our partners will complete any pending or future product development efforts, receive regulatory approval or successfully commercialize any approved products.

We may continue to incur substantial operating losses even if our revenues increase. As a result, we cannot predict the extent of future losses or the time required for us to achieve profitability, if at all.

Our operating results may vary significantly from period-to-period, which may result in a decrease in the price of our securities.

Our future revenues and operating results are expected to vary significantly from period-to-period due to a number of factors. Many of these factors are outside of our control. These factors include:

- the timing of the commencement, completion or termination of partnership agreements;
- the introduction of new products and services by us, our partners or our competitors;
- delays in, or termination of, preclinical testing and clinical trials;
- changes in regulatory requirements for clinical trials;
- costs and expenses associated with preclinical testing and clinical trials;
- the timing of regulatory approvals, if any;
- sales and marketing expenses; and
- the amount and timing of operating costs and capital expenditures relating to the expansion of our business operations and facilities.

Period-to-period comparisons of our results of operations may not be relied upon as an indication of future performance.

It is possible that in some future periods, our operating results may be below expectations of analysts and investors. If this happens, the price of our securities may decrease.

We are subject to an informal inquiry by the SEC and a grand jury investigation by the United States Attorney's Office for the District of New Jersey, relating to our stock option granting practices, and such governmental inquiry and investigation may result in charges filed against us and in fines or penalties.

The SEC is conducting an informal inquiry into our historical stock option grants and practices and related accounting and disclosures. In addition, the United States Attorney's Office for the District of New Jersey is conducting a grand jury investigation relating to the same matters. A Special Investigation Committee of our outside directors oversaw a review of those practices. Based on the results of the Special Investigation Committee's review, we have restated our financial statements for the quarter ended March 31, 2006 and the years ended December 31, 2005, 2004 and 2003, respectively.

Criminal or civil charges could be filed against Medarex and we could be required to pay significant fines or penalties in connection with either or both of the inquiry and investigation. We have incurred, and continue to incur, substantial costs related to the inquiry and investigation and the inquiry and investigation will cause a diversion of our management's time and attention which could have a material adverse effect on our financial condition and results of operations. Any inquiry, investigation or legal action by the SEC or the U.S. Attorney's Office could materially harm our business, results of operations, financial position and cash flows.

We have civil litigation pending that relates to our stock option granting practices, and we cannot predict the ultimate outcome of this litigation.

In June 2006, two derivative actions were filed in New Jersey state court by shareholders purporting to act on behalf of Medarex, naming Medarex as a nominal defendant and certain current and former directors as defendants. In November 2006, and January 2007, three additional derivative complaints were filed in the United States District Court for the District of New Jersey, containing nearly identical factual allegations concerning Medarex's historical stock option granting practices. The complaints allege, among other things, that certain of Medarex's officers and directors breached their fiduciary duties to the Company and violated federal securities laws in connection with public statements made in SEC filings relating to the Company's historical stock option granting practices and related accounting. The complaints seek unspecified damages and equitable relief. These actions are in their preliminary stages. We could be required to pay significant damages in connection with this litigation.

We are at risk of securities class action litigation.

In the past, securities class action litigation has often been brought against a company following a decline in the market price of its securities. The risk is especially relevant for us because biotechnology companies have experienced greater than average price volatility in recent years. If we faced such litigation, it could result in substantial costs and a diversion of management's attention and resources, which could harm our business.

We may need substantial additional funding. We may not be able to obtain sufficient funds to grow our business or continue our operations.

We will continue to expend substantial resources for research and development, including costs associated with developing our antibody technology and conducting preclinical testing and clinical trials. Our future capital requirements will depend on a number of factors, including, for example:

- the size and complexity of research and development programs;
- the scope and results of preclinical testing and clinical trials;
- the retention of existing and establishment of further partnerships, if any;
- continued scientific progress in our research and development programs;
- the time and expense involved in seeking regulatory approvals;
- competing technological and market developments;
- the time and expense of filing and prosecuting patent applications and enforcing patent claims; and
- the cost of establishing commercial scale manufacturing capabilities, conducting commercialization activities and arrangements and in-licensing products.

We believe our current sources of liquidity will be sufficient to meet our operating, debt service and capital requirements for at least the next 24 months. To the extent our 2.25% convertible senior notes due in 2011 are converted into shares of our common stock on or before their maturity date, we will have use of that portion of the principal amount of the notes to fund our on-going operations. In any event, we may require additional financing within this time frame and may raise funds through public or private financings, line of credit arrangements, collaborative relationships and/or other methods. The use of cash on hand or other financial alternatives will depend on several factors including, but not limited to, the future success of our products in clinical development, the prevailing interest rate environment and access to the capital markets. We may be unable to raise sufficient funds to complete development of any of our product candidates, to continue operations or to repay our debt obligations at maturity. As a result, we may face delay, reduction or elimination

of research and development programs or preclinical or clinical trials, in which case our business, financial condition or results of operations may be materially harmed.

We have a significant amount of debt and may have insufficient cash to satisfy our debt service obligations. In addition, the amount of our debt could impede our operations and flexibility.

We have \$150.0 million in aggregate principal amount of our 2.25% convertible senior notes outstanding, which, unless converted to shares of our common stock or redeemed, will mature in 2011. Generally, during the last five years, our operating cash flows were negative and insufficient to cover our fixed charges. Our ability to generate sufficient operating cash flow to service our indebtedness, including the notes, and fund our operating requirements will depend on our ability, alone or with others, to successfully develop, manufacture, and obtain required regulatory approvals and market our product candidates, as well as other factors, including general economic, financial, competitive, legislative and regulatory conditions, some of which are beyond our control. If we are unable to generate sufficient operating cash flow to service our indebtedness and fund our operating requirements, we may need to obtain additional debt or equity financing to do so, which may not be available to us on satisfactory terms or at all. In addition, if new indebtedness is incurred, the risks relating to our ability to service our indebtedness that we face could intensify.

Even if we are able to meet our debt service obligations, the amount of debt we have could adversely affect us in a number of ways, including by:

- limiting our ability to obtain any necessary financing in the future for working capital, capital expenditures, debt service requirements or other purposes;
- limiting our flexibility in planning for, or reacting to, changes in our business;
- placing us at a competitive disadvantage relative to our competitors who have lower levels of debt;
- making us more vulnerable to a downturn in our business or the economy generally; and
- requiring us to use a substantial portion of our cash to pay principal and interest on our debt, instead of applying those funds to other purposes such as working capital and capital expenditures.

***Clinical trials required for our product candidates are expensive and time-consuming, and their outcome is uncertain.**

To obtain FDA approval to market a new drug product, we or our partners must demonstrate proof of safety and efficacy in humans. To meet these requirements, we or our partners will have to conduct extensive preclinical testing and adequate and well-controlled clinical trials. Conducting clinical trials is a lengthy, time-consuming and expensive process. The length of time may vary substantially according to the type, complexity, novelty and intended use of the product candidate, and often can be several years or more per trial. Delays associated with products for which we are directly conducting preclinical or clinical trials may cause us to incur additional operating expenses. Moreover, we will continue to be affected by delays associated with the preclinical testing and clinical trials of certain product candidates conducted by our partners over which we have no control. The commencement and rate of completion of clinical trials may be delayed by many factors, including, for example:

- the inability to manufacture sufficient quantities of qualified materials under cGMPs for use in clinical trials;
- the need or desire to modify our manufacturing processes;
- slower than expected rates of patient recruitment;
- modification of clinical trial protocols;
- the inability to adequately observe patients after treatment;

- changes in regulatory requirements for clinical trials;
- the lack of effectiveness during the clinical trials;
- unforeseen safety issues;
- delays, suspension or termination of the clinical trials due to the institutional review board responsible for overseeing the study at a particular study site; and
- government or regulatory delays or clinical holds requiring suspension or termination of the trials.

Even if we obtain positive results from preclinical or clinical trials, we may not achieve the same success in future trials. Clinical trials may not demonstrate statistically sufficient safety and effectiveness to obtain the requisite regulatory approvals for product candidates employing our human antibody technology. In a number of instances, we have terminated the development of certain products in the early stages of human clinical testing due to a lack of effectiveness.

Generally, our clinical trials, including our melanoma trials, are conducted in patients with serious or life-threatening diseases for whom conventional treatments have been unsuccessful or for whom no conventional treatment exists, and in some cases, our product is used in combination with approved therapies that themselves have significant adverse event profiles. During the course of treatment, these patients could suffer adverse medical events or die for reasons that may or may not be related to our products. The most common adverse events associated with our trials of ipilimumab have consisted of flu-like symptoms such as fever, chills and nausea. These events were expected and generally responded to standard medical therapy. In addition, some patients have experienced anticipated drug-related immune-mediated events, such as diarrhea, rash, reduced pituitary function, colitis and increased liver enzymes, ranging from mild in most cases to severe in a very small number of instances. Other than a very small number of fatalities not directly related to progression or complications of the disease being treated, representing approximately 1% of over 1,000 patients treated in all previous trials, which may or may not be attributable to our product candidate, most events resolved with treatment. We cannot assure you that additional safety issues will not arise with respect to our products in the future.

To date, we have experienced slower than expected rates of patient recruitment in certain of our clinical trials. As a result, in certain instances, we have experienced or may experience delays in our product development and clinical testing.

Data obtained from clinical trials of our product candidates to date have been insufficient to demonstrate safety and efficacy under applicable FDA criteria. As a result, such data will not support an application for regulatory approval without further clinical trials. Clinical trials that we conduct or that third parties conduct on our behalf may not demonstrate sufficient safety and efficacy to obtain the requisite regulatory approvals for any of our product candidates. We expect to commence new clinical trials from time to time in the course of our business as our product development work continues. The failure of clinical trials to demonstrate safety and effectiveness for our desired indications could harm the development of that product candidate as well as other product candidates. Any change in, or termination of, our clinical trials could materially harm our business, financial condition and results of operations.

Success in early clinical trials may not be indicative of results obtained in later trials.

Results of our early clinical trials and those of our partners using our human antibody technology are based on a limited number of patients and may, upon review, be revised or negated by authorities or by later stage clinical results. Historically, the results from preclinical testing and early clinical trials have often not been predictive of results obtained in later clinical trials. A number of new drugs and biologics have shown promising results in initial clinical trials, but subsequently failed to establish sufficient safety and effectiveness

data to obtain necessary regulatory approvals. Data obtained from preclinical and clinical activities are subject to varying interpretations, which may delay, limit or prevent regulatory approval.

In addition, regulatory delays or rejections may be encountered as a result of many factors, including changes in regulatory policy during the period of product development.

Product candidates employing our antibody technology may fail to gain market acceptance.

Even if clinical trials demonstrate the safety and effectiveness of products developed by us or our partners using our technology and all regulatory approvals have been obtained, product candidates employing our antibody technology may not gain market acceptance among physicians, patients, third-party payors and the medical community. For example, the current delivery systems for antibody-based therapeutic products are intravenous and subcutaneous injection, which are generally less well received by patients than tablet or capsule delivery. The degree of market acceptance of any product candidates employing our technology will depend on a number of factors, including, for example:

- establishment and demonstration of clinical efficacy and safety, especially as compared to conventional treatments;
- cost-effectiveness;
- alternative treatment methods;
- reimbursement policies of government and third-party payors; and
- marketing and distribution support for our product candidates.

In addition, many of our activities involve genetic engineering in animals and animal testing, controversial subjects which have generally received adverse publicity from animal rights activists and various other interest groups. Such adverse publicity could decrease market acceptance of products employing our technology.

If products employing our technology do not achieve significant market acceptance, our business, financial condition and results of operations may be materially harmed.

The successful commercialization of our antibody products will depend on obtaining coverage and reimbursement for use of these products from third-party payors.

Sales of pharmaceutical products largely depend on the reimbursement of patients' medical expenses by government health care programs and private health insurers. Without the financial support of the governments or third-party payors, the market for products employing our human antibody technology will be limited. These third-party payors are increasingly challenging the price and examining the cost effectiveness of medical products and services. In addition, significant uncertainty exists as to the reimbursement status of newly approved healthcare products. We may need to conduct post-marketing studies in order to demonstrate the cost-effectiveness of our products. Such studies may require us to dedicate a significant amount of resources. Our project candidates may not be considered cost-effective. Third-party payors may not reimburse sales of products employing our human antibody technology, or enable us or our partners to sell them at profitable prices.

Our manufacturing facilities may not continue to meet regulatory requirements and may have limited capacity.

Before approving a new drug or biologic product, the FDA requires that the facilities at which the product will be manufactured are in compliance with cGMP requirements. To be successful, our therapeutic products must be manufactured for development and, following approval, in commercial quantities, in compliance with regulatory requirements and at acceptable costs. While we believe our current facilities are adequate for the

limited production of product candidates for clinical trials, our facilities are not adequate to produce sufficient quantities of any products for commercial sale.

If we are unable to establish and maintain a manufacturing facility or secure third-party manufacturing capacity within our planned time and cost parameters, the development and sales of our products and our financial performance may be materially harmed.

We may also encounter problems with the following:

- production yields;
- quality control and assurance;
- shortages of qualified personnel;
- compliance with FDA regulations, including the demonstration of purity and potency;
- changes in FDA requirements;
- production costs; and/or
- development of advanced manufacturing techniques and process controls.

We are aware of only a limited number of companies on a worldwide basis that operate manufacturing facilities in which our product candidates can be manufactured under cGMP regulations, a requirement for all pharmaceutical products. We are currently pursuing late-stage clinical and commercial supply agreements with cGMP-compliant third-party manufacturers with available capacity to meet our internal production timetables. We have entered into clinical supply agreements with Lonza with respect to ipilimumab and MDX-060. As part of our collaboration with Bristol-Myers Squibb, we assigned to Bristol-Myers Squibb the clinical supply agreement with respect to ipilimumab. Our partner Bristol-Myers Squibb is responsible for securing commercial supply agreements for ipilimumab and is currently in negotiations with respect to such arrangements. Bristol-Myers Squibb may not be able to successfully consummate such arrangements. We do not currently have the capability to manufacture our product candidates under development in large commercial quantities and have no experience in commercial-scale manufacturing. It would take a substantial period of time for a contract facility that has not been producing antibodies to begin producing antibodies under cGMP regulations. We cannot make assurances that we will be able to contract with such companies for clinical and/or commercial supply on acceptable terms or in a timely manner, if at all. Moreover, even if we are able to enter into clinical and/or commercial supply manufacturing arrangements with cGMP-compliant third-party manufacturers, we cannot assure you that such manufacturers will be able to produce products that are substantially equivalent to the product candidates that we have produced in our own facilities and used in our clinical trials. If such companies are not able to produce products that are substantially equivalent to our product candidates, the progress of our clinical trials and/or commercialization of our products may be delayed and our business, financial condition and results of operations may be materially harmed.

In addition, we and any third-party manufacturer will be required to register manufacturing facilities with the FDA and other regulatory authorities. The facilities will be subject to inspections confirming compliance with cGMP or other regulations. If we or any of our third-party manufacturers fail to maintain regulatory compliance, the FDA or other regulatory authorities can impose regulatory sanctions including, among other things, refusal to approve a pending application for a new drug product or biologic product, or revocation of a pre-existing approval. As a result, our business, financial condition and results of operations may be materially harmed.

The development of commercialization of our lead product candidate, ipilimumab, is, in large part, dependent on the actions of Bristol-Myers Squibb, which are outside of our control.

We depend, in part, on our partners to support our business, including the development of products generated through the use of our antibody technology. In particular, under the terms of our collaboration and co-promotion agreement with Bristol-Myers Squibb, we have granted a license to commercialize our lead product candidate, ipilimumab, to Bristol-Myers Squibb for the treatment of all diseases. We have also granted to Bristol-Myers Squibb a sub-license to MDX-1379 for use in combination with ipilimumab for the treatment of metastatic melanoma. The successful development and commercialization of ipilimumab is dependent, in large part, on the actions of Bristol-Myers Squibb, which are outside of our control. The failure of Bristol-Myers Squibb to act in accordance with its obligations under the collaboration and co-promotion agreement may cause us to incur substantial additional costs in order to develop and commercialize ipilimumab, which could have a material adverse effect on our business.

We are, in part, dependent on our partners' willingness and/or ability to devote resources to the development of product candidates or otherwise support our business as contemplated in our partnership agreements.

We currently, or in the future may, rely on our partners to:

- access proprietary antigens for the development of product candidates;
- access skills and information that we do not possess;
- fund our research and development activities;
- manufacture products;
- fund and conduct preclinical testing and clinical trials;
- seek and obtain regulatory approvals for product candidates; and/or
- commercialize and market future products.

Our dependence on our partners subjects us to a number of risks, including:

- our partners have significant discretion whether to pursue planned activities;
- we cannot control the quantity and nature of the resources our partners may devote to product candidates;
- our partners may not develop products generated using our antibody technology as expected; and
- business combinations or significant changes in a partner's business strategy may adversely affect that partner's willingness or ability to continue to pursue these product candidates.

If we do not realize the contemplated benefits from our partners, our business, financial condition and results of operations may be materially harmed.

***Our existing partnerships may be terminated, and we may not be able to establish additional partnerships.**

Our licensing partners generally have the right to terminate our partnerships at any time. Our ability to continue our current partnerships and to enter into additional partnerships is dependent in large part on our ability to successfully demonstrate that our UltiMAB technology is an attractive method of developing fully human antibody therapeutic products. Existing or potential partners may pursue alternative technologies, including those of our competitors, or enter into other transactions that could make a collaboration with us less attractive to them. For example, if an existing partner purchases or is purchased by a company that is one of our competitors, that company could be less willing to continue its collaboration with us and may, instead, become

one of our competitors. In April 2006, Abgenix, Inc., or Abgenix, and Amgen, Inc., or Amgen, completed a merger, that resulted in Amgen's ownership of Abgenix's XenoMouse technology. As a result, Amgen may be less willing to continue its collaboration with us and may, through the use of its newly acquired XenoMouse technology, engage in direct competition with us in the area of generating fully human monoclonal antibodies for antibody-based therapeutics. In addition, a company that has a strategy of purchasing companies rather than entering into partnership arrangements might have less incentive to enter into a collaboration agreement with us. Moreover, disputes may arise with respect to the ownership of rights to any technology or products developed with any current or future partner. Lengthy negotiations with potential new partners or disagreements between us and our partners may lead to delays or termination in the research, development or commercialization of product candidates. If we are not able to establish additional partnerships on terms that are favorable to us or if a significant number of our existing partnerships are terminated and we cannot replace them, we may be required to increase our internal product development and commercialization efforts. This would likely:

- limit the number of product candidates that we will be able to develop and commercialize;
- significantly increase our need for capital; and/or
- place additional strain on management's time.

Any of the above may materially harm our business, financial condition and results of operations.

***Due to the size of our equity interest in Celldex Therapeutics, Inc., we must consolidate the results of its operations in our financial statements.**

We own approximately 60% of Celldex Therapeutics, Inc., a privately held biopharmaceutical company. Due to the size of our equity interest in Celldex, we are currently required to consolidate the operations of Celldex in our financial statements, which results in the inclusion of their losses in our financial statements. We are unable to predict what such losses will be. For the year ended December 31, 2005 and the nine-month period ended September 30, 2006, our share, net of minority interest, of Celldex's net loss included in our financial statements was approximately \$12.6 million and \$7.2 million, respectively.

Our strategic equity investments in our partners expose us to equity price risk and, in addition, investments in our partners may be deemed impaired, which would affect our results of operations.

We have a number of strategic investments which expose us to equity price risk. These investments may become impaired, which would adversely affect our results of operations.

We are exposed to equity price risk on our strategic investments in our publicly-traded partners, and as part of our business strategy, we may choose to make additional similar investments in public companies in the future. As these investments are the result of strategic alliances with our collaborative partners, we typically do not attempt to reduce or eliminate our market exposure of these types of strategic investments. Under SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, these investments are designated as available-for-sale and are reported at fair value on our consolidated balance sheet. Unrealized holding gains and losses on available-for-sale securities are generally excluded from earnings and reported within other comprehensive income which is a separate component of shareholders' equity. Under our accounting policy, marketable equity securities are generally considered to be impaired if their fair value is less than our cost basis in such securities for more than six months, or some other period in light of the particular facts and circumstances surrounding the investment. If a decline in the fair value of available-for-sale securities is considered to be other than temporary, the cost basis of the security is written down to fair value as a new cost basis and the amount of the write-down is included in earnings as an impairment charge. During each of the years ended December 31, 2005 and 2003, no impairment charges were recorded related to the value of our investments in publicly traded companies. For the year ended December 31, 2004, we recorded impairment

charges of \$0.2 million on investments in partners whose securities are publicly traded. If we deem these investments to be further impaired at the end of any future reporting period, we may incur additional impairment charges on these investments.

In addition, we have investments in several of our partners whose securities are not publicly traded. The value of our investments in these companies are inherently more difficult to estimate than our investments in publicly traded companies. We estimate the value of these investments by using information acquired from industry trends, management of these companies, financial statements and other external sources. Specifically, our determination of any potential impairment of the value of privately held securities includes an analysis of the following for each company on a periodic basis: review of interim and year-end financial statements, cash position and overall rate of cash used to support operations, the progress and development of technology and product platform, the per share value of subsequent financing and potential strategic alternatives. Based on the information acquired through these sources, we record an investment impairment charge when we believe an investment has experienced a decline in value that is considered to be other than temporary. For the years ended December 31, 2005, 2004 and 2003, we recorded impairment charges of approximately \$33.3 million, \$7.1 million and \$1.4 million, respectively, on our investments in privately-held companies. Approximately \$7.0 million of the 2004 impairment charge related to IDM Pharma, Inc., or IDM. Approximately \$29.3 million of the 2005 impairment charge related to IDM prior to their share exchange with Epimmune, Inc., at which time IDM became a publicly traded company. Future adverse changes in market conditions or adverse changes in operating results of these companies may also require an impairment charge in the future.

***Because competition for qualified personnel is intense, we may not be able to retain or recruit personnel, which could impact the development and sales of our products.**

For us to pursue product development, marketing and commercialization plans, we will need to hire additional qualified scientific personnel to perform research and development. We will also need to hire personnel with expertise in clinical testing, government regulation, manufacturing, sales and marketing, relevant law and finance. We may not be able to attract and retain personnel on acceptable terms, given the competition for such personnel among biotechnology, pharmaceutical and healthcare companies, universities and non-profit research institutions. If we are not able to attract and retain qualified personnel, our business, financial condition and results of operations may be materially harmed.

***We have had and may continue to face product liability claims related to the use or misuse of products developed by us or our partners.**

The administration of drugs to humans, in clinical trials or after approval and during commercialization, may expose us to product liability claims. Consumers, healthcare producers or persons selling products based on our technology may be able to bring claims against us based on the use of our products in clinical trials and the sale of products based on our technology. Product liability claims may be expensive to defend and may result in large judgments against us. We have obtained limited product liability coverage for our clinical trials, under which coverage limits are \$20.0 million per occurrence and \$20.0 million in the aggregate. Although we believe these coverage limits are adequate, we cannot be certain that the insurance policies will be sufficient to cover all claims that may be made against us. We intend to increase our coverage limits as we progress into additional late-stage clinical trials and to expand our insurance coverage to include the sale of commercial products if we obtain marketing approval for products in development. Product liability insurance is expensive, difficult to obtain and may not be available in the future on acceptable terms.

In November 1998, we voluntarily suspended clinical trials for one of our products after some patients experienced serious adverse events, or SAEs. This product did not employ our core fully human antibody technology and we have determined not to pursue further development of this product. As a result of these

SAEs, we received a small number of claims, of which five resulted in lawsuits being filed. All of these lawsuits have been settled for insubstantial amounts. We cannot make assurances that additional claims will not be filed against us relating to these SAEs or arising out of any other clinical trial we have conducted or will conduct in the future.

Generally, our clinical trials, including our melanoma trials, are conducted in patients with serious life-threatening diseases for whom conventional treatments have been unsuccessful or for whom no conventional treatment exists, and in some cases, our product is used in combination with approved therapies that themselves have significant adverse event profiles. During the course of treatment, these patients could suffer adverse medical events or die for reasons that may or may not be related to our products. The most common adverse events associated with our melanoma trials of ipilimumab have consisted of flu-like symptoms such as fever, chills and nausea. These events were expected and generally responded to standard medical therapy. In addition, some patients have experienced anticipated drug-related immune-mediated adverse events, such as diarrhea, rash, reduced pituitary function, colitis and increased liver enzymes, ranging from mild in most cases to severe in a very small number of instances. Almost all of these adverse events responded to medical therapy. In a very small number of instances (approximately 1% of over 1,000 patients treated), fatalities not directly related to disease progression or complications have occurred during the course of these trials such fatalities may or may not be attributable to our product. Any of these events or any other adverse events in any of our other clinical trials could result in a product liability claim. Any such claims against us, regardless of their merit, could result in significant awards against us, which could materially harm our business, financial condition and results of operations.

***We face intense competition and rapid technological change.**

The development of biotechnology and pharmaceutical products is a highly competitive business subject to significant and rapid technological change. We face competition in several different forms. First, our human antibody generation activities currently face competition from several competitors with similar technology to ours as well as distinctly different technologies. Second, the actual products being developed by us or by our partners also face actual and potential competition. Developments by our competitors may render our human antibody technology or our products obsolete or non-competitive.

We are aware of several pharmaceutical and biotechnology companies that are actively engaged in research and development in areas related to antibody therapeutics. Some of these companies have commenced clinical trials of antibody products or have successfully commercialized antibody products. Many of these companies are addressing the same disease indications as are we and our partners. Also, we compete with companies that offer antibody generation services to other companies that have disease related target antigens. These competitors have specific expertise or technology related to monoclonal antibody development. In the past, we competed directly with Abgenix, which merged with Amgen in April 2006, with respect to the generation of fully human antibodies from transgenic mice. As a result of the merger, Amgen owns Abgenix's XenoMouse technology and may engage in direct competition with us in the area of generating fully human monoclonal antibodies for antibody-based therapeutics. In February 2007, Regeneron Pharmaceuticals, Inc licensed its VelocImmune® monoclonal antibody generation technology to AstraZeneca, potentially enabling AstraZeneca to compete with us in the generation of therapeutic antibodies. In addition, we have entered into agreements with each of Kirin and Genmab, respectively, that grant these companies licenses to our proprietary transgenic mouse technology platform, enabling them to compete with us in offering antibody generation and development services in certain markets.

We have also entered into license agreements with Pfizer which enable it to compete with us in the development of antibodies to CTLA-4. Pfizer is developing CP-675,206, a fully human antibody generated by using transgenic mouse technology substantially similar to our HuMAb-Mouse technology that targets the T-cell receptor CTLA-4. According to publicly available information, a first-line Phase III clinical trial comparing CP-675,206 alone to chemotherapy alone for metastatic melanoma was initiated by Pfizer in March 2006. In

addition, CP-675,206 is being explored as a monotherapy treatment for metastatic melanoma. Pfizer has disclosed that it expects to file a Biologics License Application, or BLA, with respect to CP-675,206 in 2007.

Xenerex Biosciences, or Xenerex, and XTL Biopharmaceutical, Ltd., or XTL, have developed technology that, according to Xenerex and XTL, will allow them to generate fully human monoclonal antibodies in functionally modified mice. Numerous additional companies are developing therapeutic products comprising human antibody components. Furthermore, several companies are developing, or have developed, technologies that do not involve immunization of animals for creating antibodies comprising human antibody sequences. For example, phage display technology is being used by companies, such as Cambridge Antibody Technology Group plc (part of the AstraZeneca group of companies), Dyax and MorphoSys to generate potentially therapeutic products comprising human antibody sequences. Companies such as Johnson & Johnson, MedImmune, Amgen, Biogen Idec, Novartis, Genentech, PDL BioPharma, Wyeth, Abbott Laboratories and GlaxoSmithKline have generated therapeutic products that are currently in development or on the market and that are derived from recombinant DNA that comprise human antibody components.

Other technologies can also be applied to the treatment of the diseases that we or our partners are pursuing. For example, immunoconjugates monoclonal antibodies linked to toxins are being developed by others, as well as by us, and other companies are developing antibodies linked to radioactive isotopes. In addition, the application of recombinant DNA technology to develop potential products consisting of proteins (such as growth factors, hormones, enzymes, cytokines receptor fragments and fusion proteins) that do not occur normally in the body, or occur only in small amounts, has been underway for some time. Included in this group are interleukins such as IL-2 and IL-11, interferons, colony stimulating factors