LEXICON PHARMACEUTICALS, INC./DE
Form 10-Q
May 05, 2011
Table of Contents

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

FORM 10-Q
(Mark One)

R QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended March 31, 2011

or

q TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from _____ to _____

Commission File Number: 000-30111

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No

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

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

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

Yes No þ

As of May 3, 2011, 337,659,869 shares of the registrant's common stock, par value $0.001 per share, were outstanding.

Table of Contents

Lexicon Pharmaceuticals, Inc.

Table of Contents

		Page
Factors Affecting Forward-Looking Statements		2
Part I – Financial Information		3
Item 1.	Financial Statements	3
	Consolidated Balance Sheets – March 31, 2011 (unaudited) and December 31, 2010	3
	Consolidated Statements of Operations (unaudited) – Three Months Ended March 31, 2011 and 2010	4
	Consolidated Statements of Stockholders' Equity (unaudited) – Three Months Ended March 31, 2011 and 2010	5
	Consolidated Statements of Cash Flows (unaudited) – Three Months Ended March 31, 2011 and 2010	6
	Notes to Consolidated Financial Statements (unaudited)	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	19
Item 4.	Controls and Procedures	19
Part II – Other Information		19
Item 1.	Legal Proceedings	20
Item 1A.	Risk Factors	20
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	22
Item 6.	Exhibits	22
Signatures		23

Factors Affecting Forward Looking Statements

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

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

Table of Contents

Part I – Financial Information

Item 1. Financial Statements

Lexicon Pharmaceuticals, Inc.

Consolidated Balance Sheets
(In thousands, except par value)

	As of March 31, 2011	As of December 31, 2010
Assets	(unaudited)	
Current assets:		
Cash and cash equivalents	$20,118	$47,208
Short-term investments, including restricted investments of $430	168,792	163,903
Accounts receivable, net of allowances of $35	831	744
Prepaid expenses and other current assets	3,448	2,883
Total current assets	193,189	214,738
Property and equipment, net of accumulated depreciation and amortization of $82,253 and $80,323, respectively	51,815	53,427
Goodwill	44,543	44,543
Other intangible assets	53,557	53,557
Other assets	304	619
Total assets	$343,408	$366,884
Liabilities and Equity		
Current liabilities:		
Accounts payable	$5,452	$3,159
Accrued liabilities	7,688	6,264
Current portion of deferred revenue	185	214
Current portion of long-term debt	1,155	1,138
Total current liabilities	14,480	10,775
Deferred revenue, net of current portion	14,212	14,212
Long-term debt	27,044	27,345
Deferred tax liabilities	18,745	18,745
Other long-term liabilities	49,610	48,783
Total liabilities	124,091	119,860
Commitments and contingencies		
Equity:		
Preferred stock, $.01 par value; 5,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $.001 par value; 900,000 shares authorized; 337,875 and 337,566 shares issued, respectively	338	338
Additional paid-in capital	922,319	920,324
Accumulated deficit	(703,035)	(673,406)
Accumulated other comprehensive gain	40	5
Treasury stock, at cost, 218 and 158 shares, respectively	(345)	(237)
Total equity	219,317	247,024
Total liabilities and equity	$343,408	$366,884

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

Table of Contents

Lexicon Pharmaceuticals, Inc.

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

	Three Months Ended March 31,	
	2011	2010
Revenues:		
Collaborative research	$516	$1,641
Subscription and license fees	80	—
Total revenues	596	1,641
Operating expenses:		
Research and development, including stock-based compensation of $839 and $806, respectively	23,921	21,088
Increase in fair value of Symphony Icon, Inc. purchase liability	1,058	—
General and administrative, including stock-based compensation of $633 and $499, respectively	4,753	5,519
Total operating expenses	29,732	26,607
Loss from operations	(29,136)	(24,966)
Gain on investments, net	—	88
Interest income	87	217
Interest expense	(607)	(727)
Other income (expense), net	27	(682)
Consolidated net loss	$(29,629)	$(26,070)
Consolidated net loss per common share, basic and diluted	$(0.09)	$(0.13)
Shares used in computing consolidated net loss per common share, basic and diluted	337,527	197,239

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

Table of Contents

Lexicon Pharmaceuticals, Inc.

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

	Lexicon Pharmaceuticals, Inc. Stockholders								
	Common Stock		Additional		Accumulated Other Comprehensive				
	Shares	Par Value	Paid-In Capital	Accumulated Deficit	Gain (Loss)	Treasury Stock	Total	Noncontrolling Interest	Total Equity
Balance at December 31, 2009	175,785	$176	$733,874	$(570,175)	$—	$(88)	$163,787	$(290)	$163,497
Deconsolidation of Symphony Icon	—	—	—	—	—	—	—	290	290
Cumulative-effect adjustment for adoption of new accounting principle	—	—	—	(1,456)	—	—	(1,456)	—	(1,456)
Stock-based compensation	—	—	1,305	—	—	—	1,305	—	1,305
Issuance of common stock, net of fees	161,770	162	181,309	—	—	—	181,471	—	181,471
Exercise of common stock options	7	—	17	—	—	—	17	—	17
Repurchase of common stock	—	—	—	—	—	(149)	(149)	—	(149)
Net loss	—	—	—	(26,070)	—	—	(26,070)	—	(26,070)
Balance at March 31, 2010	337,562	$338	$916,505	$(597,701)	$—	$(237)	$318,905	$—	$318,905
Balance at December 31, 2010	337,566	$338	$920,324	$(673,406)	$5	$(237)	$247,024	$—	$247,024
Stock-based compensation	—	—	1,472	—	—	—	1,472	—	1,472
Grant of stock in lieu of bonus	201	—	363	—	—	—	363	—	363
Exercise of common stock options	108	—	160	—	—	—	160	—	160
Repurchase of common stock	—	—	—	—	—	(108)	(108)	—	(108)
Net loss	—	—	—	(29,629)	—	—	(29,629)	—	(29,629)
	—	—	—	—	35	—	35	—	35

Unrealized gain on investments									
Comprehensive loss							(29,594)		(29,594)
Balance at March 31, 2011	337,875	$338	$922,319	$(703,035)	$40	$(345)	$219,317	$—	$219,317

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

Table of Contents

Lexicon Pharmaceuticals, Inc.

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

	Three Months Ended March 31,	
	2011	2010
Cash flows from operating activities:		
Consolidated net loss	$(29,629)	$(26,070)
Adjustments to reconcile consolidated net loss to net cash used in operating activities:		
Depreciation	1,307	1,380
Impairment of fixed assets	800	—
Amortization of Symphony Icon, Inc. purchase option	—	678
Change in fair value of Symphony Icon, Inc. purchase liability	1,058	—
Stock-based compensation	1,472	1,305
Net gain on auction rate securities (“ARS”) and ARS Rights	—	(88)
Gain on disposal of property and equipment	(31)	—
Changes in operating assets and liabilities:		
Increase in accounts receivable	(87)	(737)
(Increase) decrease in prepaid expenses and other current assets	(565)	3,285
Decrease in other assets	315	24
Increase (decrease) in accounts payable and other liabilities	3,849	(1,111)
Decrease in deferred revenue	(29)	(366)
Net cash used in operating activities	(21,540)	(21,700)
Cash flows from investing activities:		
Purchases of property and equipment	(507)	(485)
Proceeds from disposal of property and equipment	43	9
Purchases of investments	(33,895)	—
Maturities of investments	29,041	2,575
Net cash provided by (used in) investing activities	(5,318)	2,099
Cash flows from financing activities:		
Proceeds from issuance of common stock	160	181,488
Repurchase of common stock	(108)	(149)
Proceeds from debt borrowings	—	750
Repayment of debt borrowings	(284)	(2,916)
Net cash provided by (used in) financing activities	(232)	179,173
Net increase (decrease) in cash and cash equivalents	(27,090)	159,572
Cash and cash equivalents at beginning of period	47,208	100,554
Cash and cash equivalents at end of period	$20,118	$260,126
Supplemental disclosure of cash flow information:		
Cash paid for interest	$584	$606
Supplemental disclosure of non-cash investing and financing activities:		
Unrealized gain on investments	$35	$—

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

6

Table of Contents

Lexicon Pharmaceuticals, Inc.

Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

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

In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ended December 31, 2011.

The accompanying consolidated financial statements include the accounts of Lexicon and its wholly-owned subsidiaries. Intercompany transactions and balances are eliminated in consolidation.

For further information, refer to the financial statements and footnotes thereto included in Lexicon's annual report on Form 10-K for the year ended December 31, 2010, as filed with the SEC.

2. Net Loss Per Share

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

3. Stock-Based Compensation

The Company recorded $1.5 million and $1.3 million of stock-based compensation expense for the three months ended March 31, 2011 and 2010, respectively. The Company utilized the Black-Scholes valuation model for estimating the fair value of the stock compensation granted, with the following weighted-average assumptions for options granted in the three months ended March 31, 2011 and 2010:

	Expected Volatility	Risk-free Interest Rate	Expected Term	Dividend Rate
March 31, 2011:				
Employees	88 %	2.2 %	5	0%
Officers and non-employee directors	78 %	3.2 %	8	0%
March 31, 2010:				
Employees	86 %	2.4 %	5	0%
Officers and non-employee directors	80 %	3.3 %	8	0%

Table of Contents

The following is a summary of option activity under Lexicon's stock option plans for the three months ended March 31, 2011:

	Options	Weighted Average Exercise Price
	(in thousands)	
Outstanding at December 31, 2010	19,598	$3.46
Granted	2,879	1.80
Exercised	(108)	1.47
Expired	(720)	10.07
Forfeited	(186)	1.77
Outstanding at March 31, 2011	21,463	3.04
Exercisable at March 31, 2011	12,690	$3.91

During the three months ended March 31, 2011, Lexicon granted its officers 200,277 shares of stock bonus awards in lieu of cash bonus awards. The stock bonus awards had a weighted average grant date fair value of $1.81 per share and vested immediately.

During the three months ended March 31, 2011, Lexicon granted its employees restricted stock units in lieu of or in addition to the annual stock option awards. These restricted stock units vest in four annual installments. The following is a summary of restricted stock units activity under Lexicon's stock option plans for the three months ended March 31, 2011:

	Shares	Weighted Average Grant Date Fair Value
	(in thousands)	
Outstanding at December 31, 2010	—	—
Granted	2,196	1.81
Nonvested at March 31, 2011	2,196	$1.81

During 2010, Lexicon granted certain employees restricted stock units with a performance condition. The shares subject to the restricted stock units granted in 2010 vest upon the dosing of the first patient in a pivotal human clinical trial in any country, the results of which could be used to establish safety and efficacy of a pharmaceutical product discovered or developed by Lexicon as a basis for a New Drug Application. Stock-based compensation expense for awards with performance conditions is recognized over the period from the date the performance condition is determined to be probable of occurring through the time the applicable condition is met. The following is a summary of performance-based restricted stock units activity under Lexicon's stock option plans for the three months ended March 31, 2011:

	Shares	Weighted Average Grant Date Fair Value
	(in thousands)	
Outstanding at December 31, 2010	361	$1.90
Nonvested at March 31, 2011	361	$1.90

4. Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2009-13, "Multiple-Deliverable Revenue Arrangements", which amends FASB ASC Topic 605. ASU No. 2009-13 addresses how to determine whether an arrangement involving multiple deliverables contain more than one unit of accounting and how to allocate consideration to each unit of accounting in the arrangement. This pronouncement

replaces all references to fair value as the measurement criteria with the term selling price and establishes a hierarchy for determining the selling price of a deliverable. The pronouncement also eliminates the use of the residual value method for determining the allocation of arrangement consideration, and requires additional disclosures. This pronouncement should be applied prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. Lexicon adopted this pronouncement in 2011 and there was no material impact to its consolidated results of operations and financial condition.

Table of Contents

In April 2010, the FASB issued ASU No. 2010-17, “Milestone Method of Revenue Recognition”, which amends FASB ASC Topic 605. ASU No. 2010-17 provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Research or development arrangements frequently include payment provisions whereby a portion or all of the consideration is contingent upon milestone events such as successful completion of phases in a study or achieving a specific result from the research or development efforts. The amendments in this ASU provide guidance on the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate. ASU 2010-17 is effective for fiscal years and interim periods within those years beginning on or after June 15, 2010, with early adoption permitted. Lexicon adopted this pronouncement in 2011 and there was no material impact to its consolidated results of operations and financial condition.

Table of Contents

5. Cash and Cash Equivalents and Investments

The fair value of cash and cash equivalents and investments held at March 31, 2011 and December 31, 2010 are as follows:

	As of March 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash and cash equivalents	$20,118	$—	$—	$20,118
Securities maturing within one year:				
Certificates of deposit	545	—	—	545
U.S. treasury securities	168,207	43	(3)	168,247
Total short-term investments	$168,752	$43	$(3)	$168,792
Total cash and cash equivalents and investments	$188,870	$43	$(3)	$188,910

	As of December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
Cash and cash equivalents	$47,207	$1	$—	$47,208
Securities maturing within one year:				
Certificates of deposit	545	—	—	545
U.S. treasury securities	163,354	10	(6)	163,358
Total short-term investments	$163,899	$10	$(6)	$163,903
Total cash and cash equivalents and investments	$211,106	$11	$(6)	$211,111

There were no realized gains or losses for the three months ended March 31, 2011 and 2010. The cost of securities sold is based on the specific identification method.

Table of Contents

6. Fair Value Measurements

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

- Level 1 – quoted prices in active markets for identical investments

- Level 2 – other significant observable inputs (including quoted prices for similar investments, market corroborated inputs, etc.)

- Level 3 – significant unobservable inputs (including the Company's own assumptions in determining the fair value of investments)

The inputs or methodology used for valuing securities are not necessarily an indication of the credit risk associated with investing in those securities. The following table provides the fair value measurements of applicable Company assets and liabilities

Table of Contents

that are measured at fair value on a recurring basis according to the fair value levels described above as of March 31, 2011 and December 31, 2010.

	Assets and Liabilities at Fair Value as of March 31, 2011			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets				
Cash and cash equivalents	$20,118	$—	$—	$20,118
Short-term investments	168,792	—	—	168,792
Total cash and cash equivalents and investments	$188,910	$—	$—	$188,910
Liabilities				
Other long-term liabilities	$—	$—	$49,325	$49,325
Total liabilities	$—	$—	$49,325	$49,325

	Assets and Liabilities at Fair Value as of December 31, 2010			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets				
Cash and cash equivalents	$47,208	$—	$—	$47,208
Short-term investments	163,903	—	—	163,903
Total cash and cash equivalents and investments	$211,111	$—	$—	$211,111
Liabilities				
Other long-term liabilities	$—	$—	$48,267	$48,267
Total liabilities	$—	$—	$48,267	$48,267

The Company did not have any Level 3 financial assets during the three months ended March 31, 2011. In 2010, Lexicon held auction rate securities and related rights that permitted Lexicon to require the investment bank that sold Lexicon the auction rate securities to purchase its auction rate securities at par value. On June 30, 2010, Lexicon exercised the rights and the investment bank purchased Lexicon's remaining auction rate securities at par value on July 1, 2010. The table presented below summarizes the change in consolidated balance sheet carrying value associated with these Level 3 financial assets for the three months ended March 31, 2010.

	Short-term Investments
	(in thousands)
Balance at December 31, 2009	$56,034
Unrealized gains included in earnings as gain on investments, net	88
Net sales and settlements	(2,575)
Balance at March 31, 2010	$53,547

The Company's Level 3 liabilities are estimated using a probability-based income approach utilizing an appropriate discount rate. Subsequent changes in the fair value of the Symphony Icon purchase consideration liability are recorded as an increase in Symphony Icon purchase liability in the accompanying consolidated statements of operations. The following table summarizes the change in consolidated balance sheet carrying value associated with Level 3 liabilities for the three months ended March 31, 2011.

Table of Contents

	Other Long-term Liabilities (in thousands)
Balance at December 31, 2010	$48,267
Change in valuation of purchase consideration payable to former Symphony Icon stockholders	1,058
Balance at March 31, 2011	$49,325

The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include goodwill associated with the acquisitions of Coelacanth Corporation in 2001 and Symphony Icon on July 30, 2010 and intangible assets associated with the acquisition of Symphony Icon on July 30, 2010. For these assets, measurement at fair value in periods subsequent to their initial recognition is applicable if one or more is determined to be impaired.

During the three months ended March 31, 2011, the Company determined that one of its buildings was impaired and therefore recorded an impairment loss of $800,000 in addition to an impairment loss of $900,000 recorded in the year ended December 31, 2010, which was recorded as research and development expense in the accompanying consolidated statement of operations. The fair value of the impaired building was estimated using offers received from potential purchasers of the building.

7. Debt Obligations

Mortgage Loan. In April 2004, Lexicon obtained a $34.0 million mortgage on its facilities in The Woodlands, Texas. The mortgage loan has a ten-year term with a 20-year amortization and bears interest at a fixed rate of 8.23%. The mortgage had a principal balance outstanding of $28.2 million as of March 31, 2011. The fair value of Lexicon’s mortgage loan approximates its carrying value. The fair value of Lexicon’s mortgage loan is estimated using discounted cash flow analysis, based on the Company’s current incremental borrowing rate.

8. Arrangements with Symphony Icon, Inc.

On June 15, 2007, Lexicon entered into a series of related agreements providing for the financing of the clinical development of certain of its drug candidates, including LX1031, LX1032 and LX1033, along with any other pharmaceutical compositions modulating the same targets as those drug candidates (the “Programs”). The agreements included a Novated and Restated Technology License Agreement pursuant to which the Company licensed to Symphony Icon, a then wholly-owned subsidiary of Symphony Icon Holdings LLC (“Holdings”), the Company's intellectual property rights related to the Programs. Holdings contributed $45 million to Symphony Icon in order to fund the clinical development of the Programs.

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

Under a Purchase Option Agreement, dated June 15, 2007, among the Company, Symphony Icon and Holdings, the Company received from Holdings an exclusive purchase option (the “Purchase Option”) that gave the Company the right to acquire all of the equity of Symphony Icon, thereby allowing the Company to reacquire all of the Programs. Lexicon originally calculated the value of the Purchase Option as the difference between the fair value of the common stock issued to Holdings of $23.6 million (calculated at the time of issuance) and the $15.0 million in cash received from Holdings for the issuance of the common stock. Lexicon recorded the value of the Purchase Option as an asset, and was amortizing this asset over the four-year option period. Upon the adoption of a new accounting pronouncement regarding variable interest entities (formerly SFAS No. 167) on January 1, 2010, $2.3 million of structuring and legal fees originally allocated to noncontrolling interest was allocated to the value of the Purchase Option. This resulted in a cumulative-effect adjustment to retained earnings of $1.5 million, representing the

additional amortization expense that would have been recorded through December 31, 2009. Upon the exercise of the Purchase Option on July 30, 2010 as discussed below, the remaining balance was amortized immediately. The amortization expense of $678,000 is recorded in other expense, net in the accompanying consolidated statement of operations for the three months ended March 31, 2010.

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

The base payments will be in an amount equal to $50 million less 50% of the expenses Lexicon incurs after its exercise of the Purchase Option for the development of LX1031, LX1032, LX1033 and other pharmaceutical compositions modulating

Table of Contents

the same target as those drug candidates (the "LG103 Programs"), subject to certain exceptions and up to an aggregate reduction of $15 million. The base payments are payable in Lexicon's discretion at any time before July 30, 2013.

The contingent payments will consist of 50% of any consideration Lexicon receives pursuant to any licensing transaction under which Lexicon grants a third party rights to commercialize a drug candidate from the LG103 Programs (a "Licensing Transaction"), subject to certain exceptions and up to a maximum of $30 million plus the amount of any reduction in the base payments for Lexicon's development expenses for the LG103 Programs (the "Recapture Eligible Amount"). The contingent payments will be due if and when Lexicon receives such consideration from a Licensing Transaction. In the event Lexicon receives regulatory approval in the United States for the marketing and sale of any product resulting from the LG103 Programs prior to entering into a Licensing Transaction for the commercialization of such product in the United States, in lieu of any contingent payment from such a Licensing Transaction, Lexicon will pay Holdings the sum of $15 million and any Recapture Eligible Amount attributable to the development of such product, reduced by up to 50% of such sum for the amount of any contingent payments paid prior to such United States regulatory approval attributable to any such Licensing Transaction outside of the United States with respect to such product. In the event Lexicon makes any such payment upon United States regulatory approval, Lexicon will have no obligation to make subsequent contingent payments attributable to any such Licensing Transactions for the commercialization of such product outside the United States until the proceeds of such Licensing Transactions exceed 50% of the payment made as a result of such United States regulatory approval.

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

Lexicon accounted for the exercise of the Purchase Option and acquisition of Symphony Icon as a business combination. In connection with its acquisition of Symphony Icon, Lexicon paid $10.0 million in cash, and has also agreed to pay Holdings additional base and contingent payments as discussed above. The fair value of the base and contingent consideration payments was $45.6 million at the date of acquisition and was estimated by applying a probability-based income approach utilizing an appropriate discount rate. This estimation was based on significant inputs that are not observable in the market, referred to as Level 3 inputs. Key assumptions include: (1) a discount rate of 14% for the base payments; (2) a discount rate of 18% for the contingent payments; and (3) a probability adjusted contingency. Subsequent changes in the fair value of the Symphony Icon purchase consideration liability are recorded as increase in fair value of Symphony Icon purchase liability expense in the accompanying consolidated statements of operations. During the three months ended March 31, 2011, the fair value of the Symphony Icon purchase consideration liability increased by $1.1 million.

9. Commitments and Contingencies

Operating Lease Obligations: A Lexicon subsidiary leases laboratory and office space in Hopewell, New Jersey under an agreement which expires in June 2013. The lease provides for two five-year renewal options at 95% of the fair market rent and includes escalating lease payments. Rent expense is recognized on a straight-line basis over the original lease term. Lexicon is the guarantor of the obligations of its subsidiary under this lease. The maximum potential amount of future payments the Company could be required to make under this agreement is $5.9 million without taking into account the exercise of the renewal options. The Company is required to maintain restricted investments to collateralize a standby letter of credit for this lease. The Company had $0.4 million in restricted investments as collateral as of March 31, 2011 and December 31, 2010. Additionally, Lexicon leases certain equipment under operating leases.

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

10. Other Capital Stock Agreements

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

11. Collaboration and License Agreements

Lexicon has derived substantially all of its revenues from drug discovery and development collaborations, target validation collaborations for the development and, in some cases, analysis of the physiological effects of genes altered in knockout mice,

Table of Contents

government grants and contracts, technology licenses, subscriptions to its databases and compound library sales. Revenues generated from third parties under collaborative arrangements are recorded on a gross basis on the consolidated statements of operations as Lexicon is the principal participant for these transactions for the purpose of accounting for these arrangements.

Lexicon established an alliance with Organon in May 2005 to jointly discover, develop and commercialize novel biotherapeutic drugs. Revenue recognized under this agreement was none and $0.2 million for the three months ended March 31, 2011 and 2010, respectively.

Lexicon established an alliance with Taconic Farms in November 2005 for the marketing, distribution and licensing of certain lines of knockout mice and entered into an expanded collaboration with Taconic in July 2009. Revenue recognized under these agreements was $0.2 million and $0.7 million for the three months ended March 31, 2011 and 2010, respectively.

Table of Contents

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

Overview

We are a biopharmaceutical company focused on the discovery and development of breakthrough treatments for human disease. We have used gene knockout technologies and an integrated platform of advanced medical technologies to identify and validate, in vivo, more than 100 targets with promising profiles for drug discovery. For targets that we believe have high pharmaceutical value, we engage in programs for the discovery and development of potential new drugs. We have four drug candidates for which we have completed or are presently conducting Phase 2 clinical trials. We have initiated a Phase 1 clinical trial of an additional drug candidate, have advanced three other drug candidates into preclinical development and have small molecule compounds from a number of additional drug discovery programs in various stages of preclinical research.

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

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

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

Since our inception, we have incurred significant losses and, as of March 31, 2011, we had an accumulated deficit of $703.0 million. Our losses have resulted principally from costs incurred in research and development, general and administrative costs associated with our operations, and non-cash stock-based compensation expenses associated with

stock options and restricted stock granted to employees and consultants. Research and development expenses consist primarily of salaries and related personnel costs, external research costs related to our preclinical and clinical efforts, material costs, facility costs, depreciation on property and equipment and other expenses related to our drug discovery and development programs. General and administrative expenses consist primarily of salaries and related expenses for executive and administrative personnel, professional fees and other corporate expenses including information technology, facilities costs and general legal activities. In connection with the continued expansion of our drug discovery and development programs, we expect to continue to incur significant research and development costs. As a result, we will need to generate significantly higher revenues to achieve profitability.

Critical Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make judgments, estimates and assumptions in the preparation of our consolidated financial statements and accompanying notes. Actual

Table of Contents

results could differ from those estimates. We believe there have been no significant changes in our critical accounting policies as discussed in our Annual Report on Form 10-K for the year ended December 31, 2010.

Recent Accounting Pronouncements

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

Results of Operations

Revenues

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

	Three Months Ended March 31,	
	2011	2010
Total revenues	$0.6	$1.6
Dollar decrease	$(1.0)	
Percentage decrease	(64)%	

- Collaborative research – Revenue from collaborative research decreased 69% to $0.5 million, primarily due to reduced revenues in the three months ended March 31, 2011 under our alliance with Taconic Farms.

- Subscription and license fees – Revenue from subscriptions and license fees increased to $0.1 million primarily due to an increase in technology license fees.

Research and Development Expenses

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

	Three Months Ended March 31,	
	2011	2010
Total research and development expense	$23.9	$21.1
Dollar increase	$2.8	
Percentage increase	13%	

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

- Personnel – Personnel costs for the three months ended March 31, 2011 increased 10% to $9.0 million, primarily due to severance costs associated with a reduction in our personnel in February 2011. Salaries, bonuses, employee benefits, payroll taxes, recruiting and relocation costs are included in personnel costs.

- Third-party and other services – Third-party and other services increased 27% to $7.5 million, primarily due to an increase in external clinical and preclinical research and development costs.

- Facilities and equipment – Facilities and equipment costs increased 15% to $4.2 million primarily due to an impairment of buildings due to excess capacity.

- Laboratory supplies – Laboratory supplies expense decreased 15% to $1.3 million primarily due to reductions in early-stage research activities.

- Stock-based compensation – Stock-based compensation expense was $0.8 million, consistent with the prior year.

- Other – Other costs increased 6% to $1.1 million.

Table of Contents

Increase in Fair Value of Symphony Icon Liability

The increase in fair value of the Symphony Icon purchase liability was $1.1 million for the three months ended March 31, 2011 (see Note 8, Arrangements with Symphony Icon, Inc., of the Notes to Consolidated Financial Statements, for more information).

General and Administrative Expenses

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

	Three Months Ended March 31,	
	2011	2010
Total general and administrative expense	$4.8	$5.5
Dollar decrease	$(0.8)	
Percentage decrease	(14)%	

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

- Personnel – Personnel costs decreased 9% to $2.5 million primarily due to decreased severance costs. Salaries, bonuses, employee benefits, payroll taxes, recruiting and relocation costs are included in personnel costs.

- Professional fees – Professional fees decreased 46% to $0.7 million primarily due to decreased patent-related and other legal costs.

- Facilities and equipment – Facilities and equipment costs were $0.6 million, consistent with the prior year.

- Stock-based compensation – Stock-based compensation expense increased 27% to $0.6 million.

- Other – Other costs were $0.4 million, consistent with the prior year.

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

Gain on Investments, Net. Gain on investments was $2.2 million for the three months ended March 31, 2010, representing the increase in fair value of our student loan auction rate securities. This gain was offset by a loss on investments of $2.2 million for the three months ended March 31, 2010, representing the decline in fair value of the rights obtained from UBS AG, the investment bank that sold us our auction rate securities. On June 30, 2010, we exercised our rights obtained from UBS AG and UBS purchased our remaining auction rate securities at par value on July 1, 2010.

Interest Income. Interest income decreased 60% to $0.1 million in the three months ended March 31, 2011 from $0.2 million in the corresponding period in 2010, due to lower yield on our investments.

Interest Expense. Interest expense decreased 17% to $0.6 million in the three months ended March 31, 2011 due to decreased expense related to our previous line of credit with UBS Bank USA.

Other Expense, Net. Other expense, net decreased from $0.7 million in the three months ended March 31, 2010 to a slight income in the three months ended March 31, 2011 due to amortization of the Symphony Icon purchase asset in

2010.

Consolidated Net Loss and Consolidated Net Loss per Common Share

Consolidated Net Loss and Consolidated Net Loss per Common Share. Consolidated net loss increased to $29.6 million in the three months ended March 31, 2011 from $26.1 million in the corresponding period in 2010. Consolidated net loss per common share decreased to $0.09 in the three months ended March 31, 2011 from $0.13 in the corresponding period in 2010.

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

Table of Contents

Liquidity and Capital Resources

We have financed our operations from inception primarily through sales of common and preferred stock, contract and milestone payments to us under our drug discovery and development collaborations, target validation, database subscription and technology license agreements, government grants and contracts, and financing obtained under debt and lease arrangements. We have also financed certain of our research and development activities under our agreements with Symphony Icon, Inc. From our inception through March 31, 2011, we had received net proceeds of $787.1 million from issuances of common and preferred stock. In addition, from our inception through March 31, 2011, we received $453.4 million in cash payments from drug discovery and development collaborations, target validation, database subscription and technology license agreements, sales of compound libraries and reagents, and government grants and contracts, of which $440.2 million had been recognized as revenues through March 31, 2011. As of March 31, 2011, we had $188.9 million in cash, cash equivalents and investments. As of December 31, 2010, we had $211.1 million in cash, cash equivalents and investments. We used cash of $21.5 million in operations in the three months ended March 31, 2011. This consisted primarily of the consolidated net loss for the period of $29.6 million, partially offset by a net increase in other operating liabilities net of assets of $3.5 million, non-cash charges of $1.5 million related to stock-based compensation expense, $1.3 million related to depreciation expense, $1.1 million related to the increase in fair value of the Symphony Icon purchase liability and $0.8 million related to impairment of fixed assets. Investing activities used cash of $5.3 million in the three months ended March 31, 2011, primarily due to net purchases of investments of $4.9 million and purchases of property and equipment of $0.5 million. Financing activities used cash of $0.2 million due to net repayment of debt borrowings of $0.3 million, partially offset by net proceeds from issuance of common stock of $0.2 million.

Invus Securities Purchase Agreement. In June 2007, we entered into a securities purchase agreement with Invus, L.P., under which Invus, L.P. made an initial investment of approximately $205.5 million to purchase 50,824,986 shares of our common stock in August 2007. Under the securities purchase agreement, as amended and supplemented, and after accounting for the $181.5 million in net proceeds from our public offering and concurrent private placement of common stock in March 2010, Invus, L.P. and its affiliate Invus C.V., which we collectively refer to as Invus, have the right to require us to initiate a pro rata rights offering to our stockholders, which would provide all stockholders with non-transferable rights to acquire shares of our common stock, in an aggregate amount of up to approximately $163.0 million. The price per share of the rights offering would be designated by Invus in a range between $4.50 and a then-current average market price of our common stock. All stockholders would have oversubscription rights with respect to the rights offering and Invus would be required to purchase its pro rata portion of the offering. Invus may exercise its right to require us to conduct such a rights offering by giving us notice within a period of one year beginning on February 28, 2011, which will be extended by the number of days during such period that Invus is not permitted under the securities purchase agreement to initiate the rights offering as a result of any “blackout period” in connection with certain public offerings of our common stock.

Under the securities purchase agreement, until the later of the completion of the rights offering or the expiration of the period during which Invus may require us to initiate the rights offering, we have agreed not to issue any of our common stock for a per share price of less than $4.50 without the prior written consent of Invus, except pursuant to an employee or director stock option, incentive compensation or similar plan or to persons involved in the pharmaceutical industry in connection with simultaneous strategic transactions involving such persons in the ordinary course. In addition, if we notify Invus of a proposed public offering for an offering above $4.50 per share during the period in which Invus may require us to initiate the rights offering, Invus will have a period of 10 business days in which to exercise its right to require us to conduct the rights offering, in which case we would be required to forego the proposed public offering and proceed with the rights offering.

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

outstanding shares of our common stock, is entitled to certain minority protections.

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

Table of Contents

Upon the recommendation of Symphony Icon's development committee, which was comprised of an equal number of representatives from us and Symphony Icon, Symphony Icon's board of directors had the right to require us to pay Symphony Icon up to $15 million for Symphony Icon's use in the development of the programs in accordance with a specified development plan and related development budget. Through July 2010, Symphony Icon's board of directors requested us to pay Symphony Icon $9.3 million under the agreement, all of which was paid prior to the exercise of the purchase option in July 2010.

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

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

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

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

Facilities. In April 2004, we obtained a $34.0 million mortgage on our facilities in The Woodlands, Texas. The mortgage loan has a ten-year term with a 20 year amortization and bears interest at a fixed rate of 8.23%. The mortgage had a principal balance outstanding of $28.2 million as of March 31, 2011. In May 2002, our subsidiary Lexicon Pharmaceuticals (New Jersey), Inc. leased a 76,000 square-foot laboratory and office space in Hopewell, New Jersey. The term of the lease extends until June 30, 2013. The lease provides for an escalating yearly base rent payment of $1.3 million in the first year, $2.1 million in years two and three, $2.2 million in years four to six, $2.3 million in years seven to nine and $2.4 million in years ten and eleven. We are the guarantor of the obligations of our subsidiary under the lease.

Our future capital requirements will be substantial and will depend on many factors, including our ability to obtain drug discovery and development collaborations and other collaborations and technology license agreements, the amount and timing of payments under such agreements, the level and timing of our research and development expenditures, market acceptance of our products, the resources we devote to developing and supporting our products and other factors. Our capital requirements will also be affected by any expenditures we make in connection with license agreements and acquisitions of and investments in complementary technologies and businesses. We expect to devote substantial capital resources to continue our research and development efforts, to expand our support and product development activities, and for other general corporate activities. We believe that our current unrestricted

cash and investment balances and cash and revenues we expect to derive from drug discovery and development collaborations, other collaborations and technology licenses and other sources will be sufficient to fund our operations for at least the next 12 months. During or after this period, if cash generated by operations is insufficient to satisfy our liquidity requirements, we will need to sell additional equity or debt securities or obtain additional credit arrangements. Additional financing may not be available on terms acceptable to us or at all. The sale of additional equity or convertible debt securities may result in additional dilution to our stockholders.

Table of Contents

Disclosure about Market Risk

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

We had approximately $188.9 million in cash and cash equivalents and short-term investments as of March 31, 2011. We believe that the working capital available to us will be sufficient to meet our cash requirements for at least the next 12 months.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Item 4. Controls and Procedures

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

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

Table of Contents

Part II -- Other Information

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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

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

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

- Invus, L.P. and its affiliate Invus C.V., our largest stockholders, may decline to grant their consent which is required for us to conduct additional equity offerings at prices less than $4.50 per share. In addition, we can provide no assurance that Invus will exercise its rights to require us to initiate a pro rata rights offering in which it would be obligated to purchase its pro rata portion of the offering.

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

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

Risks Related to Discovery and Development of Our Drug Candidates

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

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

Risks Related to Regulatory Approval of Our Drug Candidates

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

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

Risks Related to Commercialization of Products

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

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

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

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

Table of Contents

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

Risks Related to Our Relationships with Third Parties

- We are dependent in many ways upon our collaborations with major pharmaceutical companies. If milestone are not achieved under our collaborations or if our collaborators' efforts fail to yield pharmaceutical products on a timely basis, our opportunities to generate revenues and earn royalties will be reduced.

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

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

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

Risks Related to Our Intellectual Property

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

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

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

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

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

Risks Related to Employees, Advisors and Facilities Operations

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

- Our collaborations with outside scientists may be subject to restriction and change.

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

Risks Related to Environmental and Product Liability

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

- We may be sued for product liability.

Risks Related to Our Common Stock

- Our stock price may be extremely volatile.

- Invus' ownership of our common stock and its other rights under our stockholders' agreement we entered into in connection with Invus, L.P.'s $205.5 million initial investment in our common stock provide Invus with substantial influence over

Table of Contents

matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, as well as other corporate matters.

- We may engage in future acquisitions, which may be expensive and time consuming and from which we may not realize anticipated benefits.

- Future sales of our common stock may depress our stock price.

- If we are unable to meet Nasdaq continued listing requirements, Nasdaq may take action to delist our common stock.

For additional discussion of the risks and uncertainties that affect our business, see “Item 1A. Risk Factors” included in our annual report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission.

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

The following table provides information about our purchases of shares of our common stock during the three months ended March 31, 2011:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs [3]
January 1-31, 2011	—	$—	—	—
February 1-28, 2011	59,825 [1]	$1.81 [2]	—	—
March 1-31, 2011	—	$—	—	—

(1) Represents shares retained by us at the election of recipients of stock bonus awards granted in February 2011 under our Equity Incentive Plan in satisfaction of their withholding tax obligations with respect to such stock bonus awards.

(2) Represents the market price of our common stock on the date of grant of such stock bonus awards, calculated in accordance with the process for determination of fair market value under our Equity Incentive Plan.

(3) In the future, we may grant additional equity securities under our Equity Incentive Plan for which the recipient's tax withholding obligations with respect to the grant or vesting of such securities may be satisfied by our retention of a portion of such securities. Further, for any such equity securities which are subject to vesting conditions, the number of equity securities which we may retain in satisfaction of the recipient's tax withholding obligations may be dependent on the continued employment of such recipient or other performance-based conditions. Accordingly, we cannot predict with any certainty either the total amount of equity securities or the approximate dollar value of such securities that we may purchase in future years.

Item 6. Exhibits

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

Certification of Principal Executive and Principal Financial Officers Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

Signatures

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

Lexicon Pharmaceuticals, Inc.

Date:	May 5, 2011	By:	/s/ Arthur T. Sands Arthur T. Sands, M.D., Ph.D. President and Chief Executive Officer
Date:	May 5, 2011	By:	/s/ Jeffrey L. Wade Jeffrey L. Wade Executive Vice President, Corporate Development and Chief Financial Officer

Table of Contents

Index to Exhibits

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