Ligand Pharmaceuticals (NASDAQ: LGND): Institutional holders wasting no time dumping stock in response to mounting insolvency and bankruptcy risks

Ligand's largest Shareholder BVF, Inc. sells 484,524 shares

Overview

Raising prospects for a continued deterioration in the stock price of Ligand Pharmaceuticals (NASDAQ: LGND), the largest shareholder in the company has moved to unload shares of the troubled company in a private transactions. Earlier this week, on August 19, BVF, Inc., the company's largest shareholder, offloaded 484,524 shares in a private transaction, the terms of which are both costly and indicative of institutional sentiment.

Lemelson Capital has built a substantial short position in Ligand since the firm's original June 16, 2014 research report, which recounted that the company was essentially insolvent, offensively overvalued and facing severe competitive threats to its limited and contracting revenue streams. As predicted in Lemelson Capital's June 16 and subsequent reports, large institutional shareholders, likely fearing imminent substantial downward corrections in the stock and possible bankruptcy, are moving to sell in non-open market transactions at extraordinary cost to remaining shareholders. The BVF sale is likely only the first of a series of such transactions.

Lemelson Capital's previous research reports (PDF versions) on Ligand can be found here, here and here.

A Prescient Interview

Last week, on August 13, 2014, Rev. Father Emmanuel Lemelson, Founder and President of the Lantern Foundation and Chief Investment Officer of Lemelson Capital Management, appeared on Benzinga's Pre-Market Prep show in which he discussed and reiterated the firm's short position in Ligand Pharmaceuticals (NASDAQ: LGND), which the firm first announced on June 16, 2014.

In the interview, Lemelson commented:

> *You read these press releases carefully, and you have to ask yourself, why is the company doing press releases? Do you think it is for institutional holders? I don't think so. These guys have a direct line to the CEO and the board of directors. Those things are for retail investors. If you read it carefully, it looks a lot like institutional holders trying to get out of the common equity.*

REV. EMMANUEL LEMELSON, CIO OF LEMELSON CAPITAL MANAGEMENT – PRE-MARKET PREP
AUGUST 13, 2014

Lemelson's August 13 Benzinga interview, including his comments on Ligand, can be heard here.

On August 14, 2014, Lemelson Capital published its report on LGND's new debt issuance, which concluded that:

> *The real purpose of the transaction appears to be to enable large institutional Ligand shareholders to unload large numbers of shares in private transactions that will not negatively affect the prices of the shares traded in public markets…*
>
> *Large, institutional common equity holders are trading in unsecured securities for secured debt instruments, which have an upfront payment of 15 percent.*

"LEMELSON CAPITAL SAYS LIGAND PHARMACEUTICALS' (NASDAQ: LGND) $225M DEBT ISSUANCE SOLIDIFIES COMPANY'S INSOLVENCY, SUBSTANTIALLY RAISES SPECTER OF BANKRUPTCY"
AUGUST 14, 2014

On August 18, Ligand filed a form 8-K with the Securities and Exchange Commission (SEC), revealing that the company had issued $245 million in new debt against the company's tangible equity of just $21,000, giving rise to a debt to tangible equity ratio of 11,667-to-1 (that is to say, $11,667 dollars in debt for every $1 dollar in tangible common shareholder equity).

Six days earlier the company stated:

> *Ligand intends to use a portion of the net proceeds from the offering of the notes to pay the cost of certain convertible note hedge transactions, taking into account the proceeds to Ligand of certain warrant transactions and to repurchase up to $45 million of shares of Ligand's common stock in privately negotiated transactions…*

"Ligand Announces Proposed Offering of $225 Million of Convertible Senior Notes and Announces $200 Million Share Repurchase Program,"
August 12, 2014

Debt at Usury Rates: The SEC Filings

According to Ligand's August 18 SEC filing, the company spent $6 million of the $245 Million of debt (approximately 2.4%) on initial purchaser's discounts and commissions. The company then spent a further $36.5 million of the proceeds (a figure substantially higher than the $32.5 million the company originally reported in its August 12 release on the terms of the debt offering) to pay the cost of privately-negotiated convertible note hedge transactions.

These privately-negotiated convertible note hedge transactions, which represent a stunning expense of approximately 15 percent of the total proceeds, afford no benefit to either the note or common equity holder. When combined with the 2.4 percent in commission and the 0.75 percent annual coupon, they create a sum total transaction cost of the bond offering in the first year of a whopping 18.5 percent.

Ligand's August 18 SEC filing included the following statement:

The Convertible Note Hedge Transactions and the Warrant Transactions are separate transactions, in each case, entered into by the Company with the Option Counterparties, and are not part of the terms of the Notes and will not affect any holder's rights under the Notes. ***Holders of the Notes will not have any rights*** *with respect to the Convertible Note Hedge Transactions or the Warrant Transactions.*

LIGAND PHARMACEUTICALS INC. – FORM 8-K
AUGUST 18, 2014

The real upfront cost of the new debt was $45.3 million, or six times the company's trailing twelve months (TTM) net earnings, which had already been fully consumed (and then some) by stock awards to Ligand management. As such, it would take six years of operations at current profitability (which itself is unsustainable) to pay for just the transaction costs of the new debt issued by the company.

Alternatively, Ligand could have simply contacted Capital One and applied for a consumer credit card with a very large line of credit, which undoubtedly would have had a lower lending cost. Indeed, the cost of Ligand's debt issuance exceeds that offered by most loan sharks and payday lenders, both of which would have likely offered more favorable terms.

Why then did the company go through all of the trouble of a formal bond offering with extraordinarily complex, privately-negotiated derivative transactions? Answer: To accommodate a few large institutional shareholders in private, out-of-market transactions, that would not affect Ligand's quoted prices in the open market while allowing large blocks of Ligand shares to be unloaded and a select group of common shareholders to get out of the troubled company at great expense ($45.3 million to be exact) to remaining and ongoing common shareholders.

As the August 14 Lemelson Capital research report anticipated, buyers of the Ligand bonds would be the very same common shareholders who want to hastily unload Ligand shares. In other words, the institutions lending Ligand the money through the bond offering have done so with a mandate that the company use these funds to buy out their shares. This leaves Ligand's remaining common shareholders, mostly retail investors, to pay a premium ~$45 million to facilitate the company's intent to permit a few large institutions to sell their shares in private, out-of-market transactions. In case there is any doubt regarding the drivers of Ligand's recent high cost debt offering, consider the following:

> *…approximately $37.8 million of the net proceeds [from the bond offering] to repurchase shares of the Company's common stock from purchasers of the Notes in privately negotiated transactions concurrently with the offering*

LIGAND PHARMACEUTICALS INC. – FORM 8-K
AUGUST 18, 2014

Wasting No Time

On August 21, the SEC published form 13G/A filed by BVF, Inc., which revealed that Ligand's largest shareholder was reporting that, pursuant to SEC rule 13-d, the company had sold 484,524 shares of Ligand stock as of August 19, the first date that funds from Ligand's new debt became available.

> *Holders of the notes will have the right to require Ligand to repurchase all or some of their notes at 100% of their principal amount, plus any accrued and unpaid interest, upon the occurrence of certain corporate events.*

"LIGAND PRICES OFFERING OF $225 MILLION OF CONVERTIBLE SENIOR NOTES,"
AUGUST 13, 2014

There is no question that the cost of this preferential treatment of a few large Ligand shareholders at the expense of remaining investors places a burden on Ligand and its shareholders that is both unsustainable and further deepens the company's insolvency and likelihood of liquidation or reorganization under Chapter 7 or Chapter 11 of the bankruptcy code under which remaining Ligand common shareholders have only the protection of $21,000 in tangible equity to shield them from $245 million in debt.

Should the call feature of Ligand's debt be exercised, as is possible and even likely, common shareholders would be wiped out immediately.