ANTIGENICS INC /DE/
Form 10-Q
May 10, 2007
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

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

For the Quarterly Period Ended March 31, 2007

¨ 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. 000-29089

Antigenics Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**06-1562417**
(State of Incorporation)	**(I.R.S. Employer Identification Number)**

162 Fifth Avenue, Suite 900, New York, New York, 10010

(Address of Principal Executive Offices)

(212) 994-8200

(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 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 þ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ

Number of shares outstanding of the registrant s Common Stock as of May 1, 2007: 45,889,301 shares.

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Antigenics Inc.

Quarterly Period Ended March 31, 2007

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PART I FINANCIAL INFORMATION

Item 1 ***Financial Statements***

ANTIGENICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 31, 2007	December 31, 2006
ASSETS		
Cash and cash equivalents	$ 20,937,760	$ 24,218,683
Short-term investments	11,336,340	15,876,302
Accounts receivable	377,250	182,493
Inventories	308,211	438,644
Prepaid expenses	1,992,167	1,307,648
Other current assets	203,270	274,652
Total current assets	35,154,998	42,298,422
Plant and equipment, net of accumulated amortization and depreciation of $19,638,819 and $18,610,317 at March 31, 2007 and December 31, 2006, respectively	17,602,796	18,618,632
Goodwill	2,572,203	2,572,203
Core and developed technology, net of accumulated amortization of $6,708,134 and $6,431,318 at March 31, 2007 and December 31, 2006, respectively	4,364,495	4,641,311
Debt issuance costs, net of accumulated amortization of $543,206 and $470,213 at March 31, 2007 and December 31, 2006, respectively	1,600,577	1,623,570
Other long-term assets	1,672,239	3,197,403
Total assets	$ 62,967,308	$ 72,951,541
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current portion, long-term debt	$ 146,061	$ 146,061
Accounts payable	661,373	1,089,567
Accrued liabilities	5,777,996	7,586,378
Other current liabilities	407,718	255,735
Total current liabilities	6,993,148	9,077,741
Convertible senior notes	75,333,333	75,333,333
Other long-term liabilities	5,831,911	5,933,935
Commitments and contingencies (Note F)		
STOCKHOLDERS DEFICIT		
Preferred stock, par value $0.01 per share; 25,000,000 shares authorized Series A convertible preferred stock; 31,620 shares designated, issued, and outstanding at March 31, 2007 and December 31, 2006; liquidation value of $31,817,625 at March 31, 2007	316	316
Common stock, par value $0.01 per share; 100,000,000 shares authorized; 45,888,686 and 45,843,751 shares issued and outstanding at March 31, 2007 and December 31, 2006, respectively	458,887	458,438
Additional paid-in-capital	444,897,525	444,013,527
Accumulated other comprehensive loss	(7,487)	(21,853)

Accumulated deficit	(470,540,325)	(461,843,896)
Total stockholders deficit	(25,191,084)	(17,393,468)
Total liabilities and stockholders deficit	$ 62,967,308	$ 72,951,541

See accompanying notes to unaudited condensed consolidated financial statements.

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ANTIGENICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the three months ended March 31, 2007 and 2006

(Unaudited)

	Three Months Ended March 31,	
	2007	**2006**
Revenue	$ 2,352,807	$ 60,187
Operating expenses:		
Research and development	(5,962,290)	(8,509,911)
General and administrative	(4,334,752)	(5,875,569)
Restructuring costs		(729,170)
Operating loss	(7,944,235)	(15,054,463)
Other income (expense):		
Interest expense	(1,227,048)	(737,573)
Interest income	474,854	558,002
Net loss	(8,696,429)	(15,234,034)
Dividends on series A convertible preferred stock	(197,625)	(197,625)
Net loss attributable to common stockholders	$ (8,894,054)	$ (15,431,659)
Per common share data, basic and diluted:		
Net loss attributable to common stockholders	$ (0.19)	$ (0.34)
Weighted average number of common shares outstanding, basic and diluted	45,962,041	45,702,369

See accompanying notes to unaudited condensed consolidated financial statements.

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ANTIGENICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the three months ended March 31, 2007 and 2006

(Unaudited)

	Three Months Ended March 31,	
	2007	**2006**
Cash flows from operating activities:		
Net loss	$ (8,696,429)	$ (15,234,034)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,378,311	1,484,571
Stock-based compensation	1,176,891	(184,801)
Write-down of plant and equipment		618,022
Changes in operating assets and liabilities:		
Accounts receivable	(194,757)	45,586
Inventories	130,433	54,228
Prepaid expenses	(684,519)	(1,054,437)
Accounts payable	(438,064)	(595,016)
Accrued liabilities and other current liabilities	(1,771,714)	(2,885,882)
Other operating assets and liabilities	(5,478)	104,616
Net cash used in operating activities	(9,105,326)	(17,647,147)
Cash flows from investing activities:		
Proceeds from maturities of available-for-sale securities	11,800,000	11,850,000
Purchases of available-for-sale securities	(7,245,672)	(1,015,729)
Investment in AGTC	(165,000)	(75,000)
Proceeds from the sale of limited partner interest in AGTC	1,665,000	
Purchases of plant and equipment	(12,666)	(35,798)
Decrease in restricted cash		1,714,312
Net cash provided by investing activities	6,041,662	12,437,785
Cash flows from financing activities:		
Proceeds from exercise of stock options		272,109
Proceeds from employee stock purchases	30,366	137,676
Payment of series A convertible preferred stock dividend	(197,625)	(197,625)
Debt issuance costs	(50,000)	
Payments of long-term debt		(1,475,077)
Net cash used in financing activities	(217,259)	(1,262,917)
Net decrease in cash and cash equivalents	(3,280,923)	(6,472,279)
Cash and cash equivalents, beginning of period	24,218,683	33,216,876
Cash and cash equivalents, end of period	$ 20,937,760	$ 26,744,597

See accompanying notes to unaudited condensed consolidated financial statements.

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ANTIGENICS INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2007

Note A Organization and Basis of Presentation

Antigenics Inc. (including its subsidiaries, also referred to in this Quarterly Report on Form 10-Q as Antigenics , the Company , we , us , and ou is a biotechnology company developing technologies and products to treat cancers and infectious diseases, primarily based on immunological approaches. Our most advanced product candidate is Oncophage® (vitespen), a patient-specific therapeutic cancer vaccine candidate that has been tested, or is currently being tested, in several cancer indications, including in Phase 3 clinical trials for the treatment of renal cell carcinoma, the most common type of kidney cancer, and for metastatic melanoma. Oncophage is also being tested in Phase 1 and Phase 2 clinical trials in a range of indications. Our product candidate portfolio also includes: (1) QS-21 Stimulon® adjuvant, an adjuvant used in numerous vaccines including, hepatitis, human immunodeficiency virus (HIV), influenza, cancer, Alzheimer s disease, malaria, and tuberculosis; (2) AG-707, a therapeutic vaccine program in a Phase 1 clinical trial for the treatment of genital herpes; and (3) Aroplatin , a liposomal chemotherapeutic in a Phase 1 clinical trial for the treatment of solid tumors and B-cell lymphomas. Our related business activities include research and development, regulatory and clinical affairs, clinical manufacturing, business development, marketing, and administrative functions that support these activities.

On March 24, 2006, we announced top-line results from part I of our Phase 3 study of Oncophage in renal cell carcinoma patients who are at high risk of recurrence after surgery, and such results indicated that the trial did not meet its primary endpoint. The analysis was triggered based on the number of events (defined as recurrence of disease or death of a patient prior to recurrence) reported by study investigators. However, an independent review by the trial s Clinical Events Committee revealed that substantially fewer events had actually occurred. The analysis showed a trend in favor of Oncophage for recurrence-free survival (the study s primary endpoint), and a trend against Oncophage for overall survival (a secondary endpoint); however neither finding was statistically significant. The analysis of the overall survival endpoint is considered an interim assessment. It was unclear why opposing trends were observed between recurrence-free survival and overall survival. Importantly, there was no readily apparent adverse safety signal associated with the vaccine that we believe could be contributing to this finding.

Based on these results, we implemented a restructuring plan in April 2006 that refocused our programs and priorities resulting in the temporary discontinuation of all late-stage clinical programs and concentration on Phase 1 and preclinical programs, including those stated above for Aroplatin and AG-707, and AU-801, a novel preclinical application of our proprietary heat shock protein technology as a treatment for autoimmune disorders. In addition, we terminated part II of our Phase 3 renal cell carcinoma trial and our Phase 2 trial of AG-858 for the treatment of chronic myelogenous leukemia. A combination study of Oncophage and ATRA-IV, a liposomal intravenous formulation of all-*trans*-retinoic acid, is also on hold. We continue to support and develop our QS-21 partnering collaborations, with the goal of generating royalties from this product in the 2010 timeframe. To match these priorities, we eliminated 42 positions in April 2006. In September 2006, we temporarily discontinued activities related to AU-801.

On June 5, 2006, we announced the updated results from our Phase 3 trial of Oncophage in metastatic melanoma, and on June 7, 2006, we announced the results of an in-depth analysis of the data from part I of our Phase 3 trial of Oncophage in renal cell carcinoma. Based on these results, we decided to continue to collect data for our Phase 3 trial of Oncophage in renal cell carcinoma before making a decision regarding future pivotal clinical trials or seeking registration of Oncophage.

On July 6, 2006, we entered into expanded license and supply agreements with GlaxoSmithKline Biologicals SA (GSK) for the use of QS-21, an investigational adjuvant used in numerous vaccines under development. QS-21 is a key component included in several proprietary adjuvant systems. A number of vaccine candidates currently under development are formulated with adjuvant systems containing QS-21. Under the terms of the agreements, we have agreed to supply QS-21 to GSK through 2014. In addition, we agreed to transfer manufacturing technologies under the supply agreement. We will receive payments contingent upon successful milestone achievements and royalties on net sales for a period of at least 10 years after the first commercial sale under the supply agreement. In conjunction with our expanded license and supply agreements with GSK, we received a $3.0 million up-front non-refundable payment in July 2006. In February 2007, we achieved a milestone related to the transfer of manufacturing technologies to GSK and received a payment of $2.0 million. During the three months ended March 31, 2007, we recognized revenue of $2.1 million related to these payments. Revenue recognized from collaborative agreements like this is based upon the provisions of Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* and Emerging Issues Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*. Revenue from product sales is recognized at the time of product shipment.

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ANTIGENICS INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

On October 30, 2006, we sold $25.0 million of senior secured convertible notes (2006 Notes) to a group of accredited investors. These 2006 Notes are convertible into our common stock at an initial fixed conversion price of $3.50 per share at the option of the investors. Alternatively, the 2006 Notes can be converted into an interest in a wholly owned subsidiary that holds the rights or patents to QS-21 and AG-707. The 2006 Notes bear interest at 8% (an effective rate of 8.15%) payable semiannually on December 30 and June 30 in cash or, at our option, in additional notes or a combination thereof and mature on August 30, 2011. For further information, refer to Note 15 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the SEC on March 16, 2007.

The accompanying condensed consolidated balance sheet as of December 31, 2006, which has been derived from audited consolidated financial statements, and the unaudited interim condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to 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 annual consolidated financial statements. In the opinion of management, the consolidated financial statements include all normal and recurring adjustments considered necessary for a fair presentation of our consolidated financial position and operating results. All significant intercompany transactions and accounts have been eliminated in consolidation. Certain amounts previously reported have been reclassified in order to conform to the current period s presentation. Operating results for the three-month period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to our consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the SEC on March 16, 2007.

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management bases its estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances. Actual results could differ materially from those estimates.

We have incurred annual operating losses since inception and, as a result, at March 31, 2007 we had an accumulated deficit of $470.5 million. Our operations have been funded principally by sales of equity and convertible debt instruments. We believe that, based on our current plans and activities, our working capital resources at March 31, 2007, along with the estimated proceeds from our license, supply, and collaborative agreements, will be sufficient to satisfy our liquidity requirements into 2008. Satisfying our long-term liquidity needs may require the successful commercialization of product candidates and will require additional capital.

Our lead product candidates require clinical trials and approvals from regulatory agencies, as well as acceptance in the marketplace. We are conducting clinical trials in various cancers and in one infectious disease indication. Although we believe our patents, patent rights, and patent applications are valid, the invalidation of our patents or failure of certain of our pending patent applications to issue as patents could have a material adverse effect upon our business. Part of our strategy is to develop and commercialize some of our product candidates by continuing our existing collaborative arrangements with academic and corporate collaborators and licensees and by entering into new collaborations. Our success depends, in part, on the success of these parties in performing research and preclinical and clinical testing. We compete with specialized biotechnology companies, major pharmaceutical companies, universities, and research institutions. Many of these competitors have substantially greater resources than we do.

Note B Net Loss Per Share

Basic earnings or loss per common share (EPS) is calculated by dividing the net loss attributable to common stockholders by the weighted average number of common shares outstanding and common shares issuable under our directors deferred compensation plan. Diluted EPS is calculated by dividing the net loss attributable to common stockholders by the weighted average common shares outstanding plus the dilutive effect of outstanding stock options, stock warrants, the series A convertible preferred stock, the 5.25% convertible senior notes due 2025, and

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ANTIGENICS INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

the 8% senior secured convertible notes due 2011. Because we have reported a net loss attributable to common stockholders for all periods, diluted loss per common share is the same as basic loss per common share, as the effect of including the outstanding stock options, stock warrants, the Series A convertible preferred stock, the 5.25% convertible senior notes due 2025, and the 8% senior secured convertible notes due 2011 in the calculation would have reduced the net loss per common share. Therefore, shares underlying the 6,231,624 outstanding stock options and nonvested shares, the 8,910 outstanding stock warrants, the 31,620 outstanding shares of series A convertible preferred stock, and the impact of conversion of the 5.25% convertible senior notes due 2025 and the 8% senior secured convertible notes due 2011 are not included in the calculation of diluted net loss per common share.

Note C Inventories

Inventories are stated at cost using the first-in, first-out method. The components of inventories are as follows (in thousands).

	March 31, 2007	December 31, 2006
Work in process	$ 139	$ 344
Finished goods	169	95
	$ 308	$ 439

Note D Stock-Based Compensation

Stock-based compensation expense includes compensation expense for all stock-based options 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 provision of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*. Stock-based compensation expense also includes compensation expense for all stock-based options granted, modified, or settled after January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R, *Share-Based Payment* (SFAS No. 123R). In addition, we have applied the provisions of SAB No. 107, *Share-Based Payment* (SAB No. 107), in accounting for stock-based compensation in accordance with SFAS No. 123R. SAB No. 107 contains the SEC s guidance on SFAS No. 123R and the valuation of share-based payments for public companies.

Stock options granted to non-employees are accounted for based on the fair-value method of accounting in accordance with SFAS No. 123R and EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.* As a result, the non-cash charge to operations for non-employee options with vesting or other performance criteria is affected each reporting period, until the non-employee options vest, by changes in the fair value of our common stock.

Certain of our fully vested options granted to non-employees are outside the scope of SFAS No. 123R and are subject to EITF Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock*, which requires the stock options held by certain non-employee consultants to be accounted for as liability awards. The fair value of the award is remeasured at each financial statement date until the award is exercised or expires. As of March 31, 2007, stock options to acquire approximately 648,000 shares of common stock are held by non-employee consultants and remained unexercised.

We used the Black-Scholes option pricing model to value options for employee populations, as well as our options granted to members of our Board of Directors. The effects of applying SFAS No. 123R, for purposes of recognizing compensation cost under such pronouncement, may not be representative of the effects on our reported results of operations for future years.

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ANTIGENICS INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

All stock option grants have a ten-year term and generally vest ratably over two- to four-year periods. The fair value of each option granted is estimated on the date of grant with the following weighted average assumptions.

	Three Months Ended March 31,	
	2007	2006
Expected volatility	65%	71%
Expected term in years	5	5
Risk-free interest rate	4.67%	4.63%
Dividend yield	0%	0%

A summary of option activity for the three months ended March 31, 2007 is presented below:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2006	5,912,850	$ 7.17		
Granted	98,950	1.91		
Forfeited	(197,792)	9.83		
Outstanding at March 31, 2007	5,814,008	$ 7.00	6.94	$ 692,195
Vested or expected to vest at March 31, 2007	5,039,430	$ 7.38	6.67	$ 497,101
Exercisable at March 31, 2007	2,971,340	$ 9.29	5.28	$ 5,130

The weighted average grant-date fair value of options granted during the three months ended March 31, 2007 and 2006 was $1.30 and $3.11, respectively.

During the first three months of 2007, all options were granted with exercise prices equal to the fair market value of the shares of common stock on the grant date.

As of March 31, 2007, $6.7 million of total unrecognized compensation cost related to stock options granted to employees and directors is expected to be recognized over a weighted-average period of approximately two years.

As of March 31, 2007, unrecognized expense for options granted to outside advisors for which performance (vesting) has not yet been completed but the exercise price of the option is known is approximately $314,000. Such amount is subject to change each reporting period based upon changes in the fair value of our common stock, expected volatility, and the risk free interest rate, until the outside advisor completes his or her performance under the option agreement.

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ANTIGENICS INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Beginning with the year ended December 31, 2006, certain employees have been granted nonvested stock. In accordance with SFAS No. 123R, the fair value of nonvested stock is estimated based on the closing sale price of the Company s common stock on the NASDAQ Global Market on the date of issuance.

A summary of nonvested stock activity for the three months ended March 31, 2007 is presented below:

	Nonvested Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2006	52,670	$ 4.60
Granted	382,484	1.95
Vested	(14,725)	5.13
Forfeited	(2,813)	2.45
Outstanding at March 31, 2007	417,616	$ 2.17

As of March 31, 2007, there was $784,000 of unrecognized stock-based compensation expense related to these nonvested shares. This cost is expected to be recognized over a weighted-average period of two years.

We issue new shares upon option exercises, purchases under the 1999 Employee Stock Purchase Plan (the 1999 ESPP), vesting of nonvested stock, and under the Director s Deferred Compensation Plan. During the three months ended March 31, 2006, 185,660 options were exercised with a weighted average exercise price of $1.47. No options were exercised during the three months ended March 31, 2007. For the three months ended March 31, 2007 and 2006, 19,591 shares and 33,994 shares were issued under the 1999 ESPP, respectively. During the three months ended March 31, 2007, of the 14,725 nonvested shares that vested, 9,689 shares were issued. In addition, 15,629 shares were issued under our Directors Deferred Compensation Plan.

The impact on our results of operations from stock-based compensation was as follows (in thousands).

	Three Months Ended March 31,	
	2007	2006
Research and development	$ 461	$ (791)
General and administrative	716	606
Total share-based compensation expense	$ 1,177	$ (185)

Note E Comprehensive Loss

The following table provides the calculation of comprehensive loss for the three months ended March 31, 2007 and 2006 (in thousands).

	Three Months Ended March 31,	
	2007	2006
Net loss	$ (8,696)	$ (15,234)
Other comprehensive income:		
Unrealized gain on available-for-sale securities, net	14	18
Comprehensive loss	$ (8,682)	$ (15,216)

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ANTIGENICS INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Note F Commitments and Contingencies

Antigenics, our Chairman and Chief Executive Officer, Garo H. Armen, Ph.D., and two investment banking firms that served as underwriters in our initial public offering have been named as defendants in a civil class action lawsuit filed on November 5, 2001 in the Federal District Court for the Southern District of New York on behalf of a class of purchasers of our stock between February 3, 2000 and December 6, 2000. Similar complaints were filed against about 300 other issuers, their underwriters, and in many instances their directors and officers. These cases have been coordinated under the caption *In re Initial Public Offering Securities Litigation*, Civ. No. 21 MC 92 (SAS), by order dated August 9, 2001. The suit against Antigenics and Dr. Armen alleges that the brokerage arms of the investment banking firms charged secret excessive commissions to certain of their customers in return for allocations of our stock in the offering. The suit also alleges that shares of our stock were allocated to certain of the investment banking firms customers based upon agreements by such customers to purchase additional shares of our stock in the secondary market. The complaint alleges that Antigenics is liable under Section 11 of the Securities Act of 1933, as amended (the Securities Act), and Dr. Armen is liable under Sections 11 and 15 of the Securities Act because our registration statement did not disclose these alleged practices. On April 19, 2002, the plaintiffs in this action filed an amended class action complaint, which contains new allegations. Again, similar amended complaints were filed with respect to the other companies. In addition to the claims in the earlier complaint, the amended complaint alleges that Antigenics and Dr. Armen violated Sections 10(b) and 20 of the Securities Exchange Act of 1934, as amended (the Securities Exchange Act) and SEC Rule 10b-5 by making false and misleading statements and/or omissions in order to inflate our stock price and conceal the investment banking firms alleged secret arrangements. The claims against Dr. Armen, in his individual capacity, have been dismissed without prejudice. On July 15, 2002, Antigenics and Dr. Armen joined the Issuer Defendants Motion to Dismiss the Consolidated Amended Complaints. By order of the court, this motion set forth all common issues, i.e., all grounds for dismissal common to all or a significant number of Issuer Defendants. The hearing on the Issuer Defendants Motion to Dismiss and the other Defendants motions to dismiss was held on November 1, 2002. On February 19, 2003, the court issued its opinion and order on the Issuer Defendants Motion to Dismiss. The court granted Antigenics motion to dismiss the Rule 10b-5 and Section 20 claims with leave to amend and denied our motion to dismiss the Section 11 and Section 15 claims. On June 14, 2004, papers formalizing a proposed settlement among the plaintiffs, Issuer Defendants, and insurers were presented to the Federal District Court for the Southern District of New York. On February 15, 2005, the court granted preliminary approval of the settlement. On August 31, 2005, the court issued an order confirming preliminary approval of the settlement. The settlement remains subject to a number of conditions, including final court approval. On December 5, 2006, the Court of Appeals for the Second Circuit reversed the court s October 2004 order certifying a class in six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceeding. Antigenics is not one of the test cases, and it is unclear what impact this will have on Antigenics case. If the settlement becomes effective, Antigenics anticipates that it will not incur significant out-of-pocket costs, after insurance. Accordingly, an accrual has not been recorded at March 31, 2007.

On October 12, 2005, a third party filed a notice of opposition in the European Patent Office to European patent EP 0750513 B1 which has claims relating to AG-702/707, to which we hold the exclusive license. We have filed a response to this opposition. The opposition division of the European Patent Office has subsequently issued a summons to oral proceedings to be held on January 24, 2008, and has issued a preliminary nonbinding opinion that at least claim 1 of the patent is invalid. We believe this patent claims valid subject matter. However, there is no guarantee that we will continue to defend the opposition, that this patent will not be revoked, or that we may not have to amend the claims.

Antigenics and our Chairman and Chief Executive Officer were named as defendants in a purported shareholder class action complaint filed on June 16, 2006 in Federal District Court in New Mexico by Steven J. Tuckfelt on behalf of himself and all others similarly situated (the Plaintiffs). The complaint alleged that certain of our disclosures in connection with the conduct of the Oncophage Phase 3 renal cell carcinoma trial violated Sections 10(b) and 20(a) of the Securities Exchange Act, as well as included purported claims for breach of fiduciary duty. On March 14, 2007, the court dismissed the action without prejudice due to the Plaintiffs failure to prosecute the action. However, there is the possibility the case could be re-filed.

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ANTIGENICS INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

We currently are a party, or may become a party, to other legal proceedings as well. While we currently believe that the ultimate outcome of any of these proceedings will not have a material adverse effect on our financial position, results of operations, or liquidity, litigation is subject to inherent uncertainty. Furthermore, litigation consumes both cash and management attention.

Note G Restructurings

In December 2005, we updated our business strategy and refocused our programs and priorities, including the postponement and deceleration of a number of our projects. To match these priorities, we eliminated 65 positions. In addition to severance charges of $990,000 recorded in December 2005 related to the elimination of these positions, we recorded severance charges of $112,000 during the three months ended March 31, 2006. In addition, during the three months ended March 31, 2006, we wrote-off certain assets that were determined to not be required for our updated business strategy. This resulted in additional restructuring charges of $617,000. In April 2006, we commenced the implementation of a plan to further restructure, refocusing our programs and priorities with the goal of conserving cash, and eliminated 42 additional positions. As of December 31, 2006, there was no liability remaining for our restructuring plan.

Note H License and Supply Agreements

On July 6, 2006, we entered into expanded license and supply agreements with GSK for the use of QS-21 in numerous vaccines. Under the terms of the agreements, we have agreed to supply QS-21 to GSK through 2014. In addition, we agreed to transfer manufacturing technologies under the supply agreement. We will receive payments contingent upon successful milestone achievements and royalties on net sales for a period of at least 10 years after the first commercial sale under the supply agreement. During the three months ended March 31, 2007, we recorded $2.0 million in revenue as a result of the achievement of one of the milestones. We are pursuing the opportunity to enter into a contract manufacturing relationship with a third party in order to meet demand for QS-21 under our license and supply agreements.

Note I Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*, and prescribes a recognition threshold or measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return requiring that we determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted the provisions of FIN 48 as of January 1, 2007. The adoption of FIN 48 did not have an effect on our results of operations or financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 establishes a framework for reporting fair value and expands disclosures about fair value measurements. We are required to adopt SFAS No. 157 as of January 1, 2008. We have not yet determined the impact of adoption of SFAS No. 157 on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 provides companies with the option to measure specified financial instruments and certain other items at fair value. We are required to adopt SFAS No. 159 as of January 1, 2008. We have not yet determined the impact of adoption of SFAS No. 159 on our consolidated financial statements.

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

Overview

We are currently researching and/or developing product candidates to treat cancers and infectious diseases. Since our inception in March 1994, our activities have primarily been associated with the development of our heat shock protein technology and our most advanced product candidate, Oncophage® vaccine, a patient-specific therapeutic cancer vaccine. Our business activities have included product research and development, intellectual property prosecution, manufacturing therapeutic vaccines for clinical trials, regulatory and clinical affairs, corporate finance and development activities, marketing, and integration of our acquisitions.

We have incurred significant losses since our inception. As of March 31, 2007, we had an accumulated deficit of $470.5 million. Since our inception, we have financed our operations principally by sales of equity and convertible debt instruments. We believe that, based on our current plans and activities, our working capital resources at March 31, 2007, along with the estimated proceeds from our license, supply, and collaborative agreements, will be sufficient to satisfy our liquidity requirements into 2008. In addition, we expect to attempt to raise additional funds in advance of depleting our current funds. Satisfying long-term liquidity needs may require the successful commercialization of product candidates and will require additional capital.

On March 24, 2006, we announced top-line results from part I of our Phase 3 study of Oncophage in renal cell carcinoma patients who are at high risk of recurrence after surgery, and such results indicated that the trial did not meet its primary endpoint. The analysis was triggered based on the number of events (defined as recurrence of disease or death of a patient prior to recurrence) reported by study investigators. However, an independent review by the trial s Clinical Events Committee (CEC) revealed that substantially fewer events had actually occurred. The analysis showed a trend in favor of Oncophage for recurrence-free survival (the study s primary endpoint), and a trend against Oncophage for overall survival (a secondary endpoint); however neither finding was statistically significant. The analysis of the overall survival endpoint is considered an interim assessment. It was unclear why opposing trends were observed between recurrence-free survival and overall survival. Importantly, there was no readily apparent adverse safety signal associated with the vaccine that we believe could be contributing to this finding.

Based on these results, we implemented a restructuring plan in April 2006 that refocused our programs and priorities resulting in the temporary discontinuation of all late-stage clinical programs and concentration on Phase 1 and preclinical programs, including Aroplatin for the treatment of solid tumors and B-cell lymphomas, AG-707 for the treatment of genital herpes, and AU-801 for autoimmune disorders. In addition, we terminated part II of our Phase 3 renal cell carcinoma trial and our Phase 2 trial of AG-858 for the treatment of chronic myelogenous leukemia (CML). A combination study of Oncophage and ATRA-IV, a liposomal intravenous formulation of all-*trans*-retinoic acid, was also put on hold. We continue to support and develop our QS-21 Stimulon® adjuvant (QS-21) partnering collaborations, with the goal of generating royalties from this product in the 2010 timeframe. To match these priorities, we eliminated 42 positions in April 2006. In September 2006, we temporarily discontinued activities related to AU-801.

We conducted an in-depth analysis of data from part I of our Phase 3 study of Oncophage in renal cell carcinoma during April and May 2006 and discussed the results with the U.S. Food and Drug Administration (the FDA) and a panel of experts in this medical field. On June 7, 2006, we announced the findings of the analysis. With regard to the primary endpoint, recurrence-free survival, this analysis revealed that in a subgroup of better-prognosis patients in the trial, there was a clinically significant improvement (nominal, two-sided *P* value of 0.018 and hazard ratio of 0.567). The subgroup consisted of 361 patients, or 60% of the 604 patients in the full analysis set (FAS) population. As defined by FDA-issued guidance, the FAS is the set of subjects that is as close as possible to the ideal implied by the intention-to-treat principle. It is derived from the set of all randomized subjects by minimal and justified elimination of subjects. In this case, patients with baseline disease, who were not eligible for the trial per protocol, were excluded from the FAS population. In this 361-patient subgroup, patients receiving Oncophage had a 44% decreased risk of recurrence compared with patients in the observation arm.

Overall survival, the secondary endpoint, was also assessed in the 604 patients in the FAS patient population. The analysis, which is interim for the overall survival endpoint, indicated a trend against Oncophage. We believe that the data are likely to have been influenced by missing information from patients who were lost to follow-up or withdrew consent.

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We continued to collect data per the protocol through March 2007. We are currently performing updated analyses of recurrence-free survival (utilizing investigator-reported information) and overall survival using all of the data collected in the trial through March 2007. We have also opened a subsequent protocol that will continue to follow patients in the format of a registry in order to collect overall survival information, as well as investigator reports of disease recurrence. The continued collection of this data may not affect the acceptability of the overall results of the trial, and even if clinically meaningful, may not meet the requirements of the FDA or other regulatory authorities for submission and approval of a marketing application or similar ex-U.S. applications for product approval. Guidance received from past discussions with the FDA indicate that further clinical studies must be conducted to demonstrate the efficacy and continued safety of Oncophage. We intend to seek a meeting with the FDA to discuss the results of the updated analyses utilizing data through March 2007 to determine whether there is an opportunity to file a biologics license application (BLA) on the basis of these results with appropriate commitments to conduct further clinical investigations to support the efficacy of Oncophage in renal cell carcinoma. Because evidence of clinically significant improvement has been observed in a subgroup analysis and was not demonstrated in the pre-specified analysis of the primary and secondary endpoints of the Phase 3 study of Oncophage in renal cell carcinoma, this trial may not be sufficient to support a BLA for product approval.

We plan to explore the need for further clinical studies to support approval of Oncophage in ex-U.S. markets. This exploration process may include, but is not limited to, formal and informal discussions with international regulatory authorities, key opinion leaders, and consultants with country-specific regulatory experience regarding potential applications for full or conditional marketing approvals and/or named patient programs.

On July 6, 2006, we entered into expanded license and supply agreements with GlaxoSmithKline Biologicals SA (GSK) for the use of QS-21, an investigational adjuvant used in numerous vaccines under development. QS-21 is a key component included in several proprietary adjuvant systems. A number of vaccine candidates currently under development are formulated with adjuvant systems containing QS-21. Under the terms of the agreements, we have agreed to supply QS-21 to GSK through 2014. In addition, we agreed to transfer manufacturing technologies under the supply agreement. We will receive payments contingent upon successful milestone achievements and royalties on net sales for a period of at least 10 years after the first commercial sale under the supply agreement. In conjunction with our expanded license and supply agreements with GSK, we received a $3.0 million up-front non-refundable payment in July 2006. In February 2007, we achieved a milestone related to the transfer of manufacturing technologies to GSK and received a payment of $2.0 million.

We have the right to elect to manufacture some of our product candidates, including QS-21, in our own manufacturing facilities. This would require the investment of substantial funds and the recruitment of qualified personnel in order to build or lease and operate new manufacturing facilities. We are pursuing the opportunity to enter into a contract manufacturing relationship with a third party in order to meet demand for QS-21 under our license and supply agreements.

On October 30, 2006, we sold $25.0 million of senior secured convertible notes (2006 Notes) to a group of accredited investors. These 2006 Notes are convertible into our common stock at an initial fixed conversion price of $3.50 per share at the option of the investors. Alternatively, the 2006 Notes can be converted into an interest in a wholly owned subsidiary that holds the rights or patents to QS-21 and AG-707. The 2006 Notes bear interest at 8% (an effective rate of 8.15%) payable semiannually on December 30 and June 30 in cash or, at our option, in additional notes or a combination thereof and mature on August 30, 2011. For further information, refer to Note 15 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission (SEC) on March 16, 2007.

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Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements. Generally, these statements can be identified by the use of terms like believe, expect, anticipate, plan, may, will, could, estimate, potential, opportunity, future, project, and similar terms. Fo include statements about generating royalty revenue from QS-21 in the 2010 timeframe, our timelines for performing and completing research, preclinical studies and clinical trials, timelines for releasing data from clinical trials, timelines for initiating new clinical trials, expectations regarding research, preclinical studies, clinical trials and regulatory processes, expectations regarding test results, future product research and development activities, the expected effectiveness of therapeutic drugs, vaccines, and combinations in treating diseases, applicability of our heat shock protein technology to multiple cancers and infectious diseases, competitive position, plans for regulatory filings and meetings with regulatory authorities, the sufficiency of our clinical trials in renal cell carcinoma and melanoma, or subgroup analyses of data from these trials, to support a BLA for product approval, possible receipt of future regulatory approvals, the performance of collaborative partners in, and revenue expectations from, our strategic license and partnering collaborations, expected liquidity and cash needs, plans for restructuring, plans to accelerate, decelerate, postpone, discontinue, or resume clinical programs, and reduction of our net cash burn (cash used in operating activities plus cash from investing activities less debt repayments and dividend payments), plans for sales and marketing, implementation of corporate strategy, and future financial performance. These forward-looking statements involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. These risks and uncertainties include, among others, that clinical trials may not demonstrate that our products are both safe and more effective than current standards of care; that the subgroup analyses of our Oncophage clinical trials do not predict survival or efficacy of the product in future studies or use of Oncophage; that we may be unable to obtain the regulatory authorization necessary to conduct additional clinical trials; that we may not be able to enroll sufficient numbers of patients in our clinical trials; that we may be unable to obtain the regulatory review or approval necessary to commercialize our product candidates because the FDA or other regulatory agencies are not satisfied with our trial protocols or the results of our trials; that we may fail to adequately protect our intellectual property or that it is determined that we infringe on the intellectual property of others; our strategic licenses and partnering collaborations may not meet expectations; manufacturing problems may cause product development and launch delays and unanticipated costs; our ability to raise additional capital; our ability to attract and retain key employees; changes in financial markets, regulatory requirements, and geopolitical developments; and the solvency of counter parties under material agreements, subleases, and general real estate risks.

We have included more detailed descriptions of these risks and uncertainties and other risks and uncertainties applicable to our business in Part II-Item 1A. Risk Factors of this Quarterly Report on Form 10-Q. We encourage you to read those descriptions carefully. We caution investors not to place significant reliance on forward-looking statements contained in this document; such statements need to be evaluated in light of all the information contained in this document. Furthermore, the statements speak only as of the date of this document, and we undertake no obligation to update or revise these statements.

Historical Results of Operations

Three Months Ended March 31, 2007 Compared to the Three Months Ended March 31, 2006

Revenue: We generated $2.4 million and $60,000 of research and development revenue during the three months ended March 31, 2007 and 2006, respectively. Revenues from research and development activities include revenues earned on shipments of QS-21 to our QS-21 licensees, license fees earned, and in 2007, $2.0 million earned for the achievement of a milestone related to the transfer of manufacturing technologies to GSK.

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Research and Development: Research and development expenses include the costs associated with our internal research and development activities, including salaries and benefits, occupancy costs, clinical manufacturing costs, administrative costs, and research and development conducted for us by outside advisors, such as sponsored university-based research partners and clinical research organizations. Research and development expense decreased 30% to $6.0 million for the three months ended March 31, 2007 from $8.5 million for the three months ended March 31, 2006. The decrease was partially due to a $1.4 million reduction in payroll and personnel related expenses due mainly to the workforce reduction in April 2006. There was an additional decrease of $1.5 million in our clinical trial-related expenses due to our restructuring plan and temporary discontinuance of late-stage clinical programs. Other expenses decreased $858,000 due to fewer ongoing projects and cost containment efforts. These reductions were partially offset by an increase in non-cash, stock-based compensation expense of $1.3 million recorded in accordance with Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment* (SFAS No. 123R).

General and Administrative: General and administrative expenses consist primarily of personnel costs, facility expenses, and professional fees. General and administrative expenses decreased 26% to $4.3 million for the three months ended March 31, 2007 from $5.9 million for the three months ended March 31, 2006. This decrease is a reflection of our cost-cutting efforts. Specific cost reductions included an $821,000 reduction in payroll and personnel related expenses due mainly to the workforce reduction in April 2006, as well as a reduction in professional fees of $500,000, and other expenses of $330,000. These reductions were partially offset by an increase in non-cash, stock-based compensation expense of $110,000 recorded in accordance with SFAS No. 123R.

Restructuring Costs: In December 2005, we updated our business strategy and refocused our programs and priorities, including the postponement and deceleration of a number of our projects. To match these priorities, we eliminated 65 positions. In addition to severance charges recorded in December 2005 related to the elimination of these positions, we recorded severance charges of $112,000 during the three months ended March 31, 2006. During the three months ended March 31, 2006, we also wrote-off certain assets that were determined to not be required for our updated business strategy. This resulted in additional restructuring charges of $617,000, for a total of $729,000 in restructuring charges during the three months ended March 31, 2006.

Interest Expense: Interest expense increased 66% to $1.2 million for the three months ended March 31, 2007 from $738,000 for the three months ended March 31, 2006. This increase relates primarily to interest on our 2006 Notes due 2011 that were sold on October 30, 2006.

Interest Income: Interest income decreased 15% to $475,000 for the three months ended March 31, 2007 from $558,000 for the same period in 2006. This decrease is primarily attributable to a decrease in cash, cash equivalents, and short-term investments, partially offset by a rise in interest rates earned on our cash, cash equivalents, and short-term investments. Our average interest rate increased from 4.2% for the three months ended March 31, 2006 to 5.2% for the three months ended March 31, 2007.

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Research and Development Programs

Prior to 2002, we did not track costs on a per project basis, and therefore have estimated the allocation of our total research and development costs to our largest research and development programs. During the first quarter of 2007, these research and development programs consisted largely of Oncophage, AG-707, Aroplatin, and QS-21, as indicated in the following table (in thousands).

		Three Months Ended March 31,	Year Ended December 31,				Prior to	
Research and Development Program	**Product**	**2007**	**2006**	**2005**	**2004**	**2003**	**2003**	**Total**
Heat Shock Proteins for Cancer	Oncophage & AG-858	$ 3,749	$ 20,468	$ 37,836	$ 35,462	$ 40,052	$ 91,121	$ 228,688
Heat Shock Proteins for Infectious Diseases	AG-702/707	650	1,986	3,001	2,682	2,376	4,068	14,763
Liposomal Cancer Treatments*	Aroplatin	1,124	2,534	3,214	1,112	1,263	3,503	12,750
Vaccine Adjuvant**	QS-21	257	1,856	310	264	301	3,956	6,944
Other Research and Development Programs		182	1,799	2,719	2,198	2,272	7,550	16,720
Total Research and Development Expenses		$ 5,962	$ 28,643	$ 47,080	$ 41,718	$ 46,264	$ 110,198	$ 279,865

* Prior to 2001, costs were incurred by Aronex Pharmaceuticals, Inc., a company we acquired in July 2001.

** Prior to 2000, costs were incurred by Aquila Biopharmaceuticals, Inc., a company we acquired in November 2000.

Research and development program costs include payroll and other direct costs plus an allocation of indirect costs, based on certain assumptions and our review of the status of each program. Our product candidates are in various stages of development as described below. Significant additional expenditures will be required if we complete our clinical trials, start new trials, apply for regulatory approvals, continue development of our technologies, expand our operations, and bring our product candidates to market. The eventual total cost of each clinical trial is dependent on a number of uncertainties such as trial design, length of the trial, number of clinical sites, and number of patients. The process of obtaining and maintaining regulatory approvals for new therapeutic products is lengthy, expensive, and uncertain. Because the development of our most advanced product candidate, Oncophage, is subject to further evaluation and uncertainty, and because AG-707 and Aroplatin are in early-stage clinical development, we are unable to reliably estimate the cost of completing our research and development programs, the timing of bringing such programs to market, and, therefore, when material cash inflows are likely to commence. Our collaborations involving QS-21 depend on our collaborative partners or licensees successfully completing clinical trials, our entering into a successful contract manufacturing relationship to meet collaborative partner or licensee demand, and our collaborative partners or licensees obtaining regulatory approvals and successfully commercializing product candidates containing QS-21.

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Product Development Portfolio

Below is a table showing the status of our clinical trials.

Product	Phase 3	Phase 2	Phase 1/2
Trials Currently Enrolling Patients:			
AG-707			Genital herpes
Aroplatin			Solid tumors and B-cell lymphomas
Oncophage			Glioma (b)
Trials Closed to Enrollment or Completed:			
Oncophage	Renal cell carcinoma Part I (a) Renal cell carcinoma Part II (a)(c) Metastatic melanoma (a)	Colorectal cancer Non-Hodgkin s lymphoma (NHL) Gastric cancer Metastatic renal cell carcinoma Lung cancer Metastatic melanoma	Pancreatic cancer Metastatic melanoma (d)
Oncophage and ATRA-IV			Renal cell carcinoma (d)
AG-858		CML (a)(c)	
Aroplatin		Colorectal cancer	Solid tumors

(a) Multicenter trials conducted in the U.S., as well as internationally.
(b) Investigator sponsored trial.
(c) Trial has been terminated.
(d) Initiation of this study is on hold.

Oncophage

We started enrolling patients in our first clinical trial studying Oncophage in November 1997. To date, we have treated over 750 cancer patients with Oncophage in our clinical trials. Because Oncophage is a novel therapeutic cancer vaccine that is patient-specific, meaning it is derived from the patient s own tumor, it may experience a long regulatory review process and high development costs, either of which could delay or prevent our commercialization efforts. For additional information regarding regulatory risks and uncertainties, please read the risks identified under Part II-Item 1A. Risk Factors of this Quarterly Report on Form 10-Q.

On March 24, 2006, we announced top-line results from part I of our Phase 3 study of Oncophage in renal cell carcinoma patients who are at high risk of recurrence after surgery, indicating that the trial did not meet its primary endpoint. We also announced the termination of part II of the trial. The analysis was triggered based on the number of events (defined as recurrence of disease or death of a patient prior to recurrence) reported by study investigators. However, an independent review by the trial s CEC revealed that substantially fewer events had actually occurred. The analysis showed a trend in favor of Oncophage for recurrence-free survival (the study s primary endpoint), and a trend against Oncophage for overall survival (a secondary endpoint); however neither finding was statistically significant. The analysis of the overall survival endpoint is considered an interim assessment. It was unclear why opposing trends were observed between recurrence-free survival and overall survival. Importantly, there was no readily apparent adverse safety signal associated with the vaccine that we believe could be contributing to this finding.

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We conducted an in-depth analysis of data from part I of our Phase 3 study of Oncophage in renal cell carcinoma during April and May 2006 and discussed the results with the FDA and a panel of experts in this medical field. On June 7, 2006, we announced the findings of the analysis. With regard to the primary endpoint, recurrence-free survival, this analysis revealed that in a subgroup of better-prognosis patients in the trial, there was a clinically significant improvement (nominal, two-sided *P* value of 0.018 and hazard ratio of 0.567). The subgroup consisted of 361 patients, or 60% of the 604 patients in the FAS population. In this 361-patient subgroup, patients receiving Oncophage had a 44% decreased risk of recurrence compared with patients in the observation arm.

Overall survival, the secondary endpoint, was also assessed in the 604 patients in the FAS patient population. The analysis, which is interim for the overall survival endpoint, indicated a trend against Oncophage. We believe that the data are likely to have been influenced by missing information from patients who were lost to follow-up or withdrew consent.

Because the evidence of clinically significant improvement has been observed in a subgroup analysis and was not demonstrated in the pre-specified analysis of the primary and secondary endpoints of the Phase 3 study of Oncophage in renal cell carcinoma, this trial may not be sufficient to support a BLA for product approval.

We continued to collect data per the protocol through March 2007. We are currently performing updated analyses of recurrence-free survival (utilizing investigator-reported information) and overall survival using all of the data collected in the trial through March 2007. We have also opened a subsequent protocol that will continue to follow patients in the format of a registry in order to collect overall survival information, as well as investigator reports of disease recurrence. The continued collection of this data may not affect the acceptability of the overall results of the trial, and even if clinically meaningful, may not meet the requirements of the FDA or other regulatory authorities for submission and approval of a marketing application or similar ex-U.S. applications for product approval. Guidance received from past discussions with the FDA indicate that further clinical studies must be conducted to demonstrate the efficacy and continued safety of Oncophage. We intend to seek a meeting with the FDA to discuss the results of the updated analyses utilizing data through March 2007 to determine whether there is an opportunity to file a BLA on the basis of these results with appropriate commitments to conduct further clinical investigations to support the efficacy of Oncophage in renal cell carcinoma. Because evidence of clinically significant improvement has been observed in a subgroup analysis and was not demonstrated in the pre-specified analysis of the primary and secondary endpoints of the Phase 3 study of Oncophage in renal cell carcinoma, this trial may not be sufficient to support a BLA for product approval.

We plan to explore the need for further clinical studies to support approval of Oncophage in ex-U.S. markets. This exploration process may include, but is not limited to, formal and informal discussions with international regulatory authorities, key opinion leaders, and consultants with country-specific regulatory experience regarding potential applications for full or conditional marketing approvals and/or named patient programs.

During the quarter ended September 30, 2004, we completed enrollment of our Phase 3 trial in metastatic melanoma. Our overall manufacturing success rate for this trial was approximately 70%, and as a result during 2004 we indicated that we did not believe this trial would qualify as registrational. In October 2005, we announced preliminary survival data from this trial and updated findings were presented on June 5, 2006 at the 39th annual meeting of the American Society of Clinical Oncology (ASCO) meeting. Overall, patients in the intent-to-treat Oncophage arm (M1a, b, and c combined categories as defined by the American Joint Committee on Cancer (AJCC)) fared similarly to those in the physician s choice arm in terms of survival, the primary endpoint. In a subgroup of patients who received at least 10 injections of Oncophage, overall median survival increased by approximately 29% in the Oncophage treated arm as compared with those in the physician s choice treatment arm (16.5 months versus 12.8 months). These findings also noted that in a subgroup of randomized stage IV M1a and M1b combined patients who received at least 10 doses of Oncophage vaccine, median survival increased by approximately 143% in the Oncophage-treated arm compared with those in the physician s choice treatment arm (31.2 months versus 12.8 months; nominal, one-sided *P* value of 0.017 and hazard ratio of 0.452). This analysis was not pre-specified. The physician s choice treatment arm included the current array of therapies such as chemotherapeutics, biological agents, and/or surgery. This overall survival analysis of the primary endpoint on an intent-to-treat basis was not statistically significant.

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AG-858

In December 2002, we reported interim data from a pilot Phase 1 clinical trial conducted at the University of Connecticut School of Medicine using HSPPC-70, a purified HSP70 and its associated antigens, for the treatment of CML. In April 2003, we initiated a Phase 2 trial in CML combining AG-858, our HSP70-based product candidate, with Gleevec® (imatinib mesylate, Novartis) in patients with CML unresponsive to medical treatment with Gleevec. In May 2004, we voluntarily placed enrollment of this study on hold to modify the cell collection procedure. The study resumed on July 24, 2004. Effective April 7, 2006, the study was terminated due to a change in our corporate priorities.

AG-707

The first potential off-the-shelf application of our HSP technology, AG-707, is an investigational therapeutic vaccine product candidate directed at the virus that causes genital herpes (herpes simplex virus-2, or HSV-2). We initiated a proof-of principle Phase 1 trial for AG-702, a monovalent (single-antigen) vaccine and predecessor to AG-707, in the fourth quarter of 2001. AG-707 is a multivalent vaccine containing multiple synthetic HSV-2 peptides. Based on the results of completed toxicology studies and other preclinical activities, we submitted to the FDA an investigational new drug application for AG-707 during the second quarter of 2005 and in October 2005, initiated a Phase 1 clinical trial of AG-707. We do not anticipate further developing AG-702, given that AG-707 has a potential to benefit a larger number of patients with genital herpes.

Aroplatin

We initiated a Phase 2 trial with Aroplatin for advanced colorectal cancer unresponsive to medical treatment in 2002. This single-arm, open-label trial, conducted at the Arizona Cancer Center, was designed to evaluate the effect of Aroplatin alone in patients whose disease is not responsive to standard first-line cancer treatments (5-fluorouracil/leucovorin or capecitabine and irinotecan). In September 2003, the investigators presented findings from this trial at the European Cancer Conference, also known as ECCO. One out of the 15 evaluable patients demonstrated a partial clinical response and two experienced disease stabilization. Researchers observed that Aroplatin appeared well tolerated in this pretreated patient population. Because this was a single-arm study without a comparator arm, statistical significance is not calculable. This trial is closed to enrollment.

In January 2003, we initiated at the John Wayne Cancer Center, in Santa Monica, California, a Phase 1/2 trial of Aroplatin for a variety of advanced solid tumors amenable to platinum therapy. This study is closed to enrollment.

We have developed a new formulation of Aroplatin to enhance its pharmacological (drug reaction) activity. We initiated a Phase 1, dose-escalation trial of Aroplatin in solid tumors and B-cell lymphomas in October 2005. This study is currently enrolling patients.

QS-21

On July 6, 2006, we entered into expanded license and supply agreements with GSK for the use of QS-21, an investigational adjuvant used in numerous vaccines. QS-21 is a key component included in several proprietary adjuvant systems. A number of vaccine candidates currently under development are formulated with adjuvant systems containing QS-21. Under the terms of the agreements, we have agreed to supply QS-21 to GSK through 2014. In addition, we agreed to transfer manufacturing technologies under the supply agreement. We will receive payments contingent upon successful milestone achievements, and royalties on net sales for a period of at least 10 years after the first commercial sale under the supply agreement. We are pursuing the opportunity to enter into a contract manufacturing relationship with a third party in order to meet demand for QS-21 under our license and supply agreements.

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Liquidity and Capital Resources

We have incurred annual operating losses since inception, and we had an accumulated deficit of $470.5 million as of March 31, 2007. We expect to incur significant losses over the next several years if we continue our clinical trials, apply for regulatory approvals, continue development of our technologies, and expand our operations. Phase 3 trials are particularly expensive to conduct. Since our inception, we have financed our operations primarily through the sale of equity and convertible notes, interest income earned on cash, cash equivalents, and short-term investment balances, and debt provided through secured lines of credit. From our inception through March 31, 2007, we have raised aggregate net proceeds of $424.6 million through the sale of equity, the exercise of stock options and warrants, proceeds from our employee stock purchase plan, and the issuance of convertible notes, and borrowed $20.5 million under two credit facilities. At March 31, 2007, we had debt outstanding of $75.5 million, including $25.3 million of 8% senior secured convertible notes maturing August 30, 2011 and $50.0 million of 5.25% convertible senior notes maturing February 20, 2025.

In June 2005, we took steps to improve our operating efficiency through the prioritization of our development portfolio and a streamlining of our infrastructure, resulting in the elimination of 26 positions. During December 2005, we implemented a series of actions to reduce our net cash burn (cash used in operating activities plus cash from investing activities less debt repayments and dividend payments), and preserve our cash. These actions included eliminating 65 positions, additional cost saving activities, and a focusing and streamlining of our research and development activities. In April 2006, we expanded our restructuring plan to further conserve funds. This additional restructuring involved temporarily discontinuing all late-stage clinical programs and concentrating on Phase 1 and preclinical programs, including Aroplatin, AG-707, and AU-801 (in September 2006, we temporarily discontinued activities related to AU-801). These actions also included further reducing our headcount to approximately 130 at the time. As a result of these actions and based on our current plans and activities, we anticipate that our ongoing net cash burn will be between $30 million and $35 million, on an annualized basis. We continue to support and develop our QS-21 partnering collaborations, with the goal of generating royalties from this product in the 2010 timeframe.

We believe, based on our current plans and activities, that our working capital resources at March 31, 2007, along with the estimated proceeds from our license, supply, and collaborative agreements, will be sufficient to satisfy our liquidity requirements into 2008. However, we plan to attempt to raise additional funds prior to that time. In order to fund our operations through 2008 and beyond, we will need to raise additional funds and may attempt to do so by: (1) licensing technologies or products to one or more collaborative partners, (2) renegotiating license agreements with current collaborative partners, (3) completing an outright sale of assets, (4) securing additional debt financing, and/or (5) selling additional equity securities. Our ability to successfully enter into any such arrangements is uncertain, and if funds are not available, or not available on terms acceptable to us, we may be required to revise our planned clinical trials, other development activities, capital expenditures, and/or the scale of our operations. As noted above, we expect to attempt to raise additional funds in advance of depleting our current funds; however, we may not be able to raise funds or raise amounts sufficient to meet the long-term needs of the business. Satisfying long-term liquidity needs may require the successful commercialization of product candidates and will require additional capital as discussed above. Please see the Forward-Looking Statements section and the risks highlighted under Part II Item 1A. Risk Factors of this Quarterly Report on Form 10-Q.

Our future cash requirements include, but are not limited to, supporting our clinical trial and regulatory efforts and continuing our other research and development programs. Since inception, we have entered into various agreements with institutions and clinical research organizations to conduct and monitor our current clinical studies. Under these agreements, subject to the enrollment of patients and performance by the applicable institution of certain services, we have estimated our payments to be $44.9 million over the term of the studies. Through March 31, 2007, we have expensed $44.8 million as research and development expenses and $43.0 million has been paid related to these clinical studies. The timing of expense recognition and future payments related to these agreements are subject to the enrollment of patients and performance by the applicable institution of certain services.

We have entered into sponsored research agreements related to our product candidates that required payments of $6.5 million, all of which has been paid through March 31, 2007. The actual amounts we pay out related to these agreements, if any, will depend on a range of factors outside of our control, including the success of our preclinical

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and clinical development efforts with respect to product candidates being developed which incorporate patents, the content and timing of decisions made by the United States Patent and Trademark Office, the FDA, and other regulatory authorities, the existence and scope of third-party intellectual property, the reimbursement and competitive landscape around such products, and other factors affecting operating results. We plan to enter into additional agreements, and we anticipate significant additional expenditures will be required to complete our clinical trials, apply for regulatory approvals, continue development of our technologies, and bring our product candidates to market. Part of our strategy is to develop and commercialize some of our product candidates by continuing our existing collaborative arrangements with academic and collaborative partners and licensees and by entering into new collaborations. As a result of our collaborative agreements, we will not completely control the efforts to attempt to bring those product candidates to market. We have various agreements, for example, with collaborative partners and/or licensees, that allow the use of our QS-21 adjuvant in numerous vaccines. These agreements grant exclusive worldwide rights in some fields of use and co-exclusive or non-exclusive rights in others. These agreements generally provide us with rights to manufacture and supply QS-21 to the collaborative partner or licensee and also call for royalties to be paid to us on future sales of licensed vaccines that include QS-21, which may or may not be achieved. Significant investment in manufacturing capacity will be required to exercise our manufacturing and supply rights.

Our cash, cash equivalents, and short-term investments at March 31, 2007 were $32.3 million, a decrease of $7.8 million from December 31, 2006. In February 2007, we achieved a milestone related to the transfer of manufacturing technologies to GSK and received a payment of $2.0 million. During the three months ended March 31, 2007, we used cash primarily to finance our operations. Net cash used in operating activities for the three months ended March 31, 2007 and 2006 was $9.1 million and $17.6 million, respectively. The decrease resulted primarily from steps taken in April 2006, when we implemented a restructuring plan that refocused our programs and priorities resulting in the temporary discontinuation of all late-stage clinical programs and concentration on Phase 1 and preclinical programs, including Aroplatin for the treatment of solid tumors and B-cell lymphomas, AG-707 for the treatment of genital herpes, and AU-801 for autoimmune disorders (in September 2006, we temporarily discontinued activities related to AU-801). We also terminated part II of our Phase 3 renal cell carcinoma trial and our Phase 2 trial of AG-858 for the treatment of CML. A combination study of Oncophage and ATRA-IV was also put on hold. We continue to support and develop our QS-21 partnering collaborations, with the goal of generating royalties from this product in the 2010 timeframe. To match these priorities, we eliminated 42 positions. Our future ability to generate cash from operations will depend on achieving regulatory approval of our product candidates, market acceptance of such product candidates, achieving benchmarks as defined in existing collaborative agreements, and our ability to enter into new collaborations. Please see the Forward-Looking Statements section and the risks highlighted under Part II Item 1A. Risk Factors of this Quarterly Report on Form 10-Q.

Net cash provided by investing activities for the three months ended March 31, 2007 was $6.0 million as compared to $12.4 million for the three months ended March 31, 2006. During the three months ended March 31, 2007, we had net maturities of $4.6 million of short-term investments compared with $10.8 million during the three months ended March 31, 2006. We received $1.7 million during the three months ended March 31, 2006 from the release of restrictions on our restricted cash balance. As of December 31, 2006, we did not have any restricted cash.

During December 2006, we entered into a formal plan to sell our limited partner interest in Applied Genomic Technology Capital Fund (AGTC), identified potential buyers, and received offers. On January 9, 2007, we contributed the final capital call of $165,000 to AGTC and on February 2, 2007, we completed the sale of our limited partner interest in AGTC to an accredited investor and received $1.7 million. We made a capital contribution of $75,000 to AGTC during the three months ended March 31, 2006.

Net cash used in financing activities was $217,000 for the three months ended March 31, 2007 as compared to $1.3 million for the three months ended March 31, 2006. During the three months ended March 31, 2006, exercises of stock options totaled $272,000. No options were exercised during the three months ended March 31, 2007. During the three months ended March 31, 2007 and 2006, proceeds from our employee stock purchase plan totaled $30,000 and $138,000, respectively. Dividends paid on our series A convertible preferred stock totaled $198,000 during both periods. Long-term debt of $1.5 million was repaid during the three months ended March 31, 2006. There were no repayments of long-term debt during the three months ended March 31, 2007.

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On October 30, 2006, we sold $25.0 million of our 2006 Notes to a group of accredited investors. These 2006 Notes are convertible into our common stock at an initial fixed conversion price of $3.50 per share at the option of the investors. Alternatively, the 2006 Notes can be converted into an interest in a wholly owned subsidiary that holds the rights or patents to QS-21 and AG-707. The 2006 Notes bear interest at 8% (an effective rate of 8.15%) payable semiannually on December 30 and June 30 in cash or, at our option, in additional notes or a combination thereof and mature on August 30, 2011. During the three months ended March 31, 2007, we paid $50,000 of debt issuance costs related to the issuance of the 2006 Notes.

Effective July 19, 2002, we sublet part of our Framingham manufacturing, research and development, and office space to GTC Biotherapeutics, Inc. (GTC), and we have leased related leasehold improvements and equipment under agreements that were to expire on December 31, 2006. GTC has exercised its option to extend this lease until September 2010. Under the terms of our original lease, we are obligated to pay our landlord approximately 7% of our rental income. Effective March 17, 2004, we sublet an additional part of our Framingham manufacturing, research and development, and office space to PP Manufacturing, whose lease also expires in September 2010. We are contractually entitled to receive rental income of $797,000 during the remainder of 2007, $1.0 million in 2008, $1.0 million in 2009, and $750,000 in 2010. The collection of this income, however, is subject to uncertainty.

We are currently involved in certain legal proceedings as detailed in Note F to our unaudited condensed consolidated financial statements. While we currently believe that the ultimate outcome of any of these proceedings will not have a material adverse effect on our financial position, results of operations, or liquidity, litigation is subject to inherent uncertainty. Furthermore, litigation consumes both cash and management attention.

Related Parties

We have invested $3.0 million in a limited partnership, AGTC. The general partner of AGTC is AGTC Partners, L.P. The management company for AGTC is NewcoGen Group Inc., which is a wholly owned subsidiary of Flagship Venture Management, Inc. (Flagship). Noubar Afeyan, Ph.D., who is one of our directors, is the Managing Partner and Chief Executive Officer of Flagship. During December 2006, we entered into a formal plan to sell our limited partner interest in AGTC, identified potential buyers, and received offers. On February 2, 2007, we completed the sale of our limited partner interest in AGTC to an accredited investor and received $1.7 million.

In March 1995, we entered into a consulting agreement with Dr. Pramod Srivastava, our scientific founder and one of our directors, and upon its expiration in March 2006, we entered into a new consulting agreement (the Agreement), effective March 28, 2006, with Dr. Srivastava. The Agreement with Dr. Srivastava has an initial term of five years and is automatically extended for successive terms of one year unless either party notifies the other at least 90 days prior to the expiration of the original or any extension term that the Agreement is not to be extended. The Agreement may be terminated without cause by us during its term, subject to the payment of compensation for twelve months at the then current rate provided for under the Agreement. In exchange for the timely performance of services, as defined in the Agreement, Dr. Srivastava is entitled to receive compensation to be established by the Compensation Committee of the Antigenics Board of Directors. For the twelve-month period ending March 31, 2008, Dr. Srivastava will receive $50,000. Dr. Srivastava is also eligible to receive an annual bonus and stock options at the discretion of the Compensation Committee of our Board of Directors.

In February 1998, we entered into a research agreement with the University of Connecticut Health Center (UConn) to fund research in Dr. Srivastava s laboratory at UConn. Dr. Srivastava is a member of the faculty of the University of Connecticut School of Medicine. Effective December 31, 2006, this agreement has been terminated, and a termination fee of $250,000 was paid to UConn in January 2007. The termination of this agreement does not affect our existing license rights under our license agreement with UConn.

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Critical Accounting Policies and Estimates

The SEC defines critical accounting policies as those that require the application of management s most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base those estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

The following listing is not intended to be a comprehensive list of all of our accounting policies. Our significant accounting policies are described in Note 2 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the SEC on March 16, 2007. In many cases, the accounting treatment of a particular transaction is dictated by U.S. generally accepted accounting principles, with no need for our judgment in its application. There are also areas in which our judgment in selecting an available alternative would not produce a materially different result. We have identified the following as our critical accounting policies.

Research and Development Clinical Study Accruals

Research and development costs are expensed as incurred and were $6.0 million and $8.5 million for the three months ended March 31, 2007 and 2006, respectively. Research and development expenses include the costs associated with our internal research and development activities, including salaries and benefits, occupancy costs, clinical manufacturing costs, related administrative costs, and research and development conducted for us by outside advisors, such as sponsored university-based research partners and clinical study partners. We account for our clinical study costs by estimating the total cost to treat a patient in each clinical trial and recognizing this cost based on estimates of when the patient receives treatment, beginning when the patient enrolls in the trial. Research and development expenses also include all expenses related to any grant revenue recognized, as well as the cost of clinical trial materials shipped to our research partners. This estimated cost includes payments to the trial site and patient-related costs, including laboratory costs, related to the conduct of the trial. Cost per patient varies based on the type of clinical trial, the site of the clinical trial, and the length of the treatment period for each patient. As we become aware of the actual costs, we adjust our accrual; such a change in estimate may be a material change in our clinical study accrual, which could also materially affect our results of operations. There were no changes to our estimates during the year ended December 31, 2006 or during the first three months of 2007. Clinical study costs included in accrued liabilities on our consolidated balance sheets were $1.8 million and $1.9 million at March 31, 2007 and December 31, 2006, respectively. Clinical study costs that are subject to estimation and included in research and development expenses were $140,000 and $232,000 for the three months ended March 31, 2007 and 2006, respectively. We believe the effects of reasonably likely changes in the key assumptions underlying the clinical study cost estimates would not likely have a material effect on the consolidated financial statements.

Investments

We classify investments in marketable securities at the time of purchase. At March 31, 2007, all marketable securities are classified as available-for-sale and as such, changes in the fair value of the securities are reported as a separate component of accumulated other comprehensive loss until realized. If we were to classify future investments as trading securities rather than available-for-sale, our financial results would be subject to greater volatility. If declines in the fair value of available-for-sale securities are determined to be other than temporary, such losses would be recorded in the consolidated statement of operations.

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Revenue Recognition

Revenue from product sales is recognized at the time of product shipment. Periodically, we enter into collaborative agreements that, among other things, grant to our partners certain development and commercialization rights related to potential products. Revenue under these arrangements typically includes up-front non-refundable fees, milestone payments upon occurrence of certain events, and royalties on product sales, if ever. Revenue recognized from collaborative agreements is based upon the provisions of SEC Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* (SAB No. 104) and Emerging Issues Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF No. 00-21).

We recognize non-refundable up-front license fees as revenue when there is a contractual right to receive such payment, the contract price is fixed or determinable, the collection of the resulting receivable is reasonably assured, and there are no further performance obligations under the license agreement. Multiple element arrangements are analyzed to determine whether the deliverables can be separated or whether they must be accounted for as a single unit of accounting in accordance with EITF No. 00-21. Up-front license payments are recognized as revenue upon the delivery of the license only if the license has standalone value and the fair value of the undelivered performance obligations can be determined. If the license is considered to either: 1) not have standalone value or 2) have standalone value but the fair value of any of the undelivered performance obligations is not determinable, the arrangement is then accounted for as a single unit of accounting and the up-front license payments are recognized as revenue over the estimated period of when the performance obligations are performed. When it is determined that an arrangement should be accounted for as a single unit of accounting, we determine the period over which the performance obligations will be performed. Significant management judgment is required in determining the level of effort required under an arrangement and the period over which the performance obligations are expected to be completed. In conjunction with our expanded license and supply agreements with GSK, we received a $3.0 million up-front non-refundable payment in July 2006. In accordance with the requirements of SAB No. 104, revenue relating to this payment was deferred and is being recognized on a straight-line basis through December 31, 2014.

Collaborations may also contain milestone payments. We recognize milestone payments as revenue upon achievement of the milestone only if the milestone event is deemed to be substantive after considering all of the following conditions: 1) the milestone payment is non-refundable; 2) the achievement of the milestone involves a degree of risk and was not reasonably assured at the inception of the arrangement; 3) substantive effort is involved in achieving the milestone; (4) the amount of the milestone payment is reasonable in relation to the effort expended or the risk associated with achievement of the milestone; and 5) a reasonable amount of time passes between the up-front license payment and the first milestone payment as well as between each subsequent milestone payment. Determination as to whether a milestone meets the aforementioned conditions involves management s judgment. In February 2007, accordingly, we achieved a substantive milestone related to the transfer of manufacturing technologies to GSK and received a payment of $2.0 million, which has been recognized as revenue.

Stock-Based Compensation

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123R, using the modified prospective transition method. Our results of operations for the three months ended March 31, 2007 and March 31, 2006 were impacted by the recognition of non-cash expense related to the fair value of our stock-based compensation awards. During the three months ended March 31, 2007, we recorded a net charge of $1.2 million related to stock-based compensation, of which a charge of $461,000 is included in research and development expense and a charge of $716,000 is included in general and administrative expense. During the three months ended March 31, 2006, we recorded a net credit of $185,000 related to stock-based compensation, of which a credit of $791,000 is included in research and development expense and a charge of $606,000 is included in general and administrative expense. Stock-based compensation expense includes compensation expense for all stock-based options 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 provision of SFAS No. 123, *Accounting for Stock-Based Compensation*. In addition, stock-based compensation expense includes compensation expense for all stock-based options granted, modified, or settled after January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. Under the fair value recognition provisions of SFAS No. 123R, we recognize stock-based compensation net of an estimated forfeiture rate and only recognize compensation cost for those shares expected to vest. Compensation cost is recognized on a straight-line prorated basis over the requisite service period of the award. In March 2005, the SEC issued SAB No. 107, *Share-Based Payment* (SAB No. 107), which contained the SEC s guidan