

NTT DOCOMO INC
Form 6-K
May 28, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

**REPORT OF FOREIGN PRIVATE ISSUER PURSUANT TO RULE 13a-16 OR
15d-16 UNDER THE SECURITIES EXCHANGE ACT OF 1934**

For the month of May 2014.

Commission File Number: 001-31221

Total number of pages: 62

NTT DOCOMO, INC.

(Translation of registrant's name into English)

Sanno Park Tower 11-1, Nagata-cho 2-chome

Chiyoda-ku, Tokyo 100-6150

Japan

(Address of principal executive offices)

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Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F **Form 40-F**

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

SIGNATURES

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

NTT DOCOMO, INC.

Date: May 28, 2014

By: /S/ MUTSUO YAMAMOTO
Mutsuo Yamamoto

Head of Investor Relations

Information furnished in this form:

1. English translation of Notice of Convocation of the 23rd Ordinary General Meeting of Shareholders

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Notice of Convocation of the 23rd Ordinary

General Meeting of Shareholders

NTT DOCOMO, INC.

This is an English translation of the Notice of Convocation of the Ordinary General Shareholders Meeting for the 23rd Fiscal Year (the Notice) of NTT DOCOMO, INC. and its subsidiaries (DOCOMO, the Company, we, or our Group). This translation includes a translation of the audit report of KPMG AZSA LLC, DOCOMO 's independent auditor, of the financial statements included in the original Japanese language Notice. KPMG AZSA LLC has not audited and makes no warranty as to the accuracy or otherwise of the translation of the financial statements or other financial information included in this translation of the Notice.

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MESSAGE FROM THE PRESIDENT

Dear Shareholders:

I am delighted to present this convocation notice for the general shareholders meeting for the 23rd fiscal year (from April 1, 2013 to March 31, 2014).

In the mobile communications market, besides the intense competition that we engage in with other Japanese telecommunications carriers, we are also facing competition with new players that offer a wide range of Internet-based services. In this new competitive landscape, we have worked to thoroughly improve our offerings in our core mobile business and develop attractive services in new business fields with an aspiration to realize *smart life* that brings greater convenience and affluence to customers' everyday life. As a concrete step toward this goal, we have taken steps to reinforce our comprehensive strengths by addressing the four key areas of *devices* (handsets), *network*, *services* and *billing plans* and sales channels.

In the fiscal year ending March 31, 2015, we will continue to brush up our offerings in these four areas with the aim of establishing a new growth track. In April 2014, we unveiled a new billing plan, called *Kake-hodai & Pake-aeru*, which was developed based on the concept of allowing customers to use our services at affordable rates for a long period of time by selecting an option suited for the different stages of life. The new billing plan, which was developed in anticipation of future trends, can be applied to a wide variety of products including smartphones, feature phones, tablets and peripheral devices. We believe the new plan will help boost our smartphone sales and facilitate customers to utilize multiple mobile devices, thereby contributing to a new growth in our core mobile business.

As for our actions in the new business fields, we plan to expand the services that combine mobile with various physical services used for different purposes of life in an effort to strengthen our competitiveness through new value creation. As part of this undertaking, we launched *ddelivery* home food delivery service in May 2014. In addition, to enable stress-free access to our services, we will continue to expand our LTE network coverage and move ahead with its speed enhancements.

Going forward, we will implement measures that will bring greater *happiness* to the lives of our customers, their family and society, so we can be chosen by customers as a *partner* for a *smart life* and garner their usage for a long period of time.

As always, I ask for your continued goodwill and support.

May 2014

Kaoru Kato
President and CEO

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Corporate Vision

Pursuing Smart Innovation

HEART

Harmonize Social contribution beyond borders, across generations

Evolve Evolution of service and network

Advance Advance industries through convergence of services

Relate Creating joy through connections

Trust Support for safe, secure and comfortable living

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Tokyo Stock Exchange: 9437

New York Stock Exchange: DCM

May 28, 2014

To Shareholders

NTT DOCOMO, INC.

11-1, Nagata-cho 2-chome

Chiyoda-ku, Tokyo, Japan

President and CEO: Kaoru Kato

**NOTICE OF CONVOCATION OF
THE 23rd ORDINARY GENERAL MEETING OF SHAREHOLDERS**

Notice is hereby given that the 23rd Ordinary General Meeting of Shareholders of the Company (the Meeting) will be held as described below.

Details

1. Date and Time: Thursday, June 19, 2014 at 10:00 a.m. (Japan Standard Time)

2. Place of the Meeting: Tsuru-no-ma, The Main Banquet Floor
Hotel New Otani
4-1, Kioi-cho, Chiyoda-ku, Tokyo, Japan

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3. Matters to be dealt with at the Meeting:

Matters to be reported:

- 1) Report on Business Report, Consolidated and Non-Consolidated Financial Statements for the 23rd Fiscal Year (from April 1, 2013 to March 31, 2014).
- 2) Report on Results of Audit of Consolidated Financial Statements by Registered Public Accountants and Audit & Supervisory Board.

Matters to be resolved:

First Item of Business: Appropriation of Retained Earnings

Second Item of Business: Election of Fifteen (15) Directors

Third Item of Business: Election of Two (2) Audit & Supervisory Board Members

A copy of the Business Report and our Consolidated and Non-Consolidated Financial Statements and a certified copy of the Independent Auditor's Report and the Audit Report of Audit & Supervisory Board for the 23rd Fiscal Year required to be attached are included as pages 16-59 hereto.

In accordance with the applicable laws and regulations, and the provisions of Article 16 of the Company's Articles of Incorporation, we have posted the Notes to the Consolidated and Non-Consolidated Financial Statements, which comprise the Attachments to this Notice of Convocation of the 23rd Ordinary General Meeting of Shareholders, at the Company's following web site: (<https://www.nttdocomo.co.jp/english/corporate/ir/event/meeting/index.html>) instead of including them herein.

Our Consolidated and Non-Consolidated Financial Statements included in the Attachments to the Notice of Convocation of the 23rd Ordinary General Meeting of Shareholders are part of our Consolidated and Non-Consolidated Financial Statements audited by the Independent Auditor in preparing the Independent Auditor's Report.

Should any revision be needed with regard to the Reference Materials for the Ordinary General Meeting of Shareholders, Business Report or Consolidated and Non-Consolidated Financial Statements, the Company will publish such revision on its website: <https://www.nttdocomo.co.jp/english/corporate/ir/event/meeting/index.html>

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REFERENCE MATERIALS FOR THE ORDINARY GENERAL MEETING OF SHAREHOLDERS

Items of Business and Matters for Reference

First Item of Business: Appropriation of Retained Earnings

Items relating to year-end dividends

Taking into account the consolidated results of operations and consolidated dividend payout ratio, the Company distributes dividends with the aim of providing continuous stable dividends while trying to enhance its financial condition and secure internal reserves. The Company proposes to pay the year-end dividend for the 23rd fiscal year as follows:

(1) Type of Dividend Asset
Cash

(2) Proposed Appropriation of Dividend Assets to Shareholders and Total Amount of Dividend Payment
¥30 per share of common stock of the Company

Total Amount of Dividend Payment: ¥124,402,803,000

(The Company conducted a 1:100 stock split with an effective date of October 1, 2013. If adjusted to take into consideration of this stock split, the interim dividend of ¥3,000 paid in November 2013 would be equivalent to ¥30 per share. Accordingly, the aggregate amount of annual dividends for this fiscal year, i.e., the sum of interim and year-end dividends, will be ¥60 per share.)

(3) Effective Date of the Appropriation of Dividends from Retained Earnings
Friday, June 20, 2014

Table of Contents**Second Item of Business:** Election of Fifteen (15) Directors

As the terms of office of fourteen (14) Directors will expire at the close of this meeting, it is proposed that fifteen (15) Directors be elected, adding one (1) director with the aim of further reinforcing the Company's management structure.

The candidates for positions as Directors are as follows:

Candidate Number	Name (Date of Birth)	History, Positions, Responsibilities and Principal Concurrent Positions	Number of Company Shares Owned
1	Kaoru Kato (May 20, 1951)	April 1977 July 2007 June 2008 April 2009 July 2009 June 2012	27,200
	<Reappointed>	Entered NTT Public Corporation Executive Vice President, Managing Director of Corporate Strategy and Planning Department, Member of the Board of Directors of NTT DoCoMo Kansai, Inc. Executive Vice President, Managing Director of Corporate Strategy and Planning Department, Member of the Board of Directors of the Company Executive Vice President, Managing Director of Corporate Strategy and Planning Department and Managing Director of Mobile Society Research Institute, Member of the Board of Directors of the Company Executive Vice President, Managing Director of Corporate Strategy and Planning Department, Member of the Board of Directors of the Company President and Chief Executive Officer, Member of the Board of Directors of the Company (To the present)	

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Candidate Number	Name (Date of Birth)	History, Positions, Responsibilities and Principal Concurrent Positions		Number of Company Shares Owned
2	Kazuhiro Yoshizawa (June 21, 1955)	April 1979	Entered NTT Public Corporation	15,800
	<Reappointed>	July 2003	Senior Director of Corporate Strategy and Planning Department of the Company	
		June 2007	Senior Vice President, Managing Director of Corporate Marketing Department II of the Company	
		June 2011	Senior Vice President, Managing Director of Human Resources Management Department, Member of the Board of Directors of the Company	
		June 2012	Executive Vice President, Managing Director of Corporate Strategy and Planning Department, Responsible for Mobile Society Research Institute, Member of the Board of Directors of the Company	
		February 2013	(Concurrent position) President and Chief Executive Officer of NTT DOCOMO Ventures, Inc. (To the present)	
		July 2013	Executive Vice President, Managing Director of Corporate Strategy and Planning Department and Managing Director of Structural Reform Office, Responsible for Mobile Society Research Institute, Member of the Board of Directors of the Company (To the present)	
3	Yoshikiyo Sakai (October 10, 1956)	April 1980	Entered NTT Public Corporation	6,400
	<Newly appointed>	July 2002	Senior Director of Accounts and Finance Department of the Company	
		June 2005	Managing Director of Investor Relations Department of the Company	

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July 2008	Managing Director of Public Relations Department of the Company
June 2009	Senior Vice President, Managing Director of Public Relations Department of the Company
June 2012	Senior Vice President, Director of Finance and Accounting Department, Member of the Board of Directors of NIPPON TELEGRAPH AND TELEPHONE CORPORATION (NTT) (To the present)

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Candidate Number	Name (Date of Birth)	History, Positions, Responsibilities and Principal Concurrent Positions		Number of Company Shares Owned
4	Akira Terasaki (January 20, 1952)	April 1976	Entered Ministry of Posts and Telecommunications	1,000
	<Newly appointed>	July 2008	Vice-Minister for Policy Coordination, Ministry of Internal Affairs and Communications	
		July 2010	Special Advisor to the Ministry of Internal Affairs and Communications	
		October 2010	Professor, Graduate School of Science and Engineering, Tokyo Institute of Technology (To the present)	
		July 2011	Advisor, Nomura Research Institute, Ltd. (To the present)	
5	Seizo Onoe (May 12, 1957)	April 1982	Entered NTT Public Corporation	15,100
	<Reappointed>	December 2005	Managing Director of IP Radio Network Development Department and Managing Director of Radio System Development of the Company	
		July 2006	Managing Director of Radio Access Network Development Department of the Company	
		June 2008	Senior Vice President, Managing Director of R&D Strategy Department and Managing Director of Radio Access Network Development Department of the Company	
		July 2008	Senior Vice President, Managing Director of R&D Strategy Department of the Company	
		June 2012	Executive Vice President, Managing Director of R&D Center, Member of the Board of Directors of the Company (To the present)	

6	Hiroataka Sato	April 1982	Entered NTT Public Corporation	11,300
	(November 18, 1958)	July 2004	Senior Director of System Marketing Department III of the Company	
	<Reappointed>	June 2005	Senior Director of Accounts and Finance Department of the Company	
		July 2008	Vice President of Finance and Accounting Department of NIPPON TELEGRAPH AND TELEPHONE CORPORATION (NTT)	
		June 2011	Senior Vice President, Managing Director of Corporate Marketing Department I of the Company	
		June 2012	Senior Vice President, Managing Director of Accounts and Finance Department, Member of the Board of Directors of the Company (To the present)	

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Candidate Number	Name (Date of Birth)	History, Positions, Responsibilities and Principal Concurrent Positions		Number of Company Shares Owned
7	Kazuhiro Takagi (June 29, 1956)	April 1982	Entered NTT Public Corporation	6,700
	<Reappointed>	July 2001	Senior Director of i-mode Business Department of the Company	
		May 2002	Senior Director of Procurement and Supply Department of the Company	
		July 2005	Senior Director of Human Resources Management Department of the Company	
		July 2008	Managing Director of Frontier Services Department of the Company	
		June 2012	Senior Vice President, Managing Director of Human Resources Management Department, Member of the Board of Directors of the Company (To the present)	
8	Hiroyasu Asami (September 8, 1956)	April 1980	Entered NTT Public Corporation	9,700
	<Newly appointed>	June 2009	Senior Vice President, Managing Director of Consumer Services Department of the Company	
		April 2011	Senior Vice President, Managing Director of Smart Communication Services Department of the Company	
		June 2012	Senior Vice President, Managing Director of Smart Communication Services Department, Engages in Multimedia of the Company	
		March 2013	Executive Vice President, Responsible for Multimedia Services of the Company	

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		July 2013	Executive Vice President, Managing Director of Smart-life Business Division of the Company (To the present)	
9	Shoji Suto (March 4, 1957)	April 1980	Entered NTT Public Corporation	9,000
	<Newly appointed>	June 2008	Senior Vice President, Managing Director of Sales Promotion Department of the Company	
		June 2009	Executive Vice President, Managing Director of Marketing Business Department, Member of the Board of Directors of DOCOMO Business Net Inc.	
		July 2009	Executive Vice President, Managing Director of Marketing Division, Member of the Board of Directors of DOCOMO Business Net Inc.	
		June 2010	Executive Vice President, Managing Director of Corporate Marketing Division, Member of the Board of Directors of DOCOMO Business Net Inc.	
		June 2011	Senior Vice President, Managing Director of Shikoku Regional Office of the Company (To the present)	

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Candidate Number	Name (Date of Birth)	History, Positions, Responsibilities and Principal Concurrent Positions		Number of Company Shares Owned
10	Kiyohiro Omatsuzawa (June 22, 1957) <Newly appointed>	April 1981	Entered NTT Public Corporation	12,800
		June 2005	General Manager of Yamanashi Branch of the Company	
		June 2006	Managing Director of Radio Access Network Engineering Department of the Company	
		July 2009	Managing Director of Procurement and Supply Department and Member of Corporate Strategy and Planning Department of the Company	
		June 2010	Senior Vice President, Managing Director of Procurement and Supply Department of the Company	
		June 2012	Senior Vice President, Managing Director of Chugoku Regional Office of the Company (To the present)	
11	Toshiki Nakayama (January 29, 1958) <Newly appointed>	April 1981	Entered NTT Public Corporation	4,000
		June 2007	Senior Manager, Medium-Term Management Strategy Development Office of NIPPON TELEGRAPH AND TELEPHONE CORPORATION (NTT), Member of the Board of Directors of the Company	
		June 2008	Vice President of Strategic Business Development Division of NTT	
		June 2011	Senior Vice President of Strategic Business Development Division of NTT	
		June 2012	Senior Vice President, Managing Director of Frontier Services Department of the Company	

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July 2013

Senior Vice President, Managing Director of Smart-life Solutions Department of the Company (To the present)

January 2014

(Concurrent position) Representative Director and President of ABC HOLDINGS Co., Ltd. (To the present)

(Concurrent position) Representative Director and Senior Executive Vice President of ABC Cooking Studio Co. Ltd. (To the present)

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Candidate Number	Name (Date of Birth)	History, Positions, Responsibilities and Principal Concurrent Positions		Number of Company Shares Owned
12	Hajime Kii (April 20, 1960) <Newly appointed>	April 1983	Entered NTT Public Corporation	4,000
		December 2005	Senior Vice President of Global Business Strategy Office, Department I of NIPPON TELEGRAPH AND TELEPHONE CORPORATION (NTT)	
		July 2007	General Manager of Mobility Design Business Group of the Company	
		July 2008	Deputy Managing Director of Global Business Division of the Company	
		June 2010	Managing Director of Global Business Division of the Company	
		June 2012	Senior Vice President, Managing Director of Global Business Division of the Company (to the present)	
			(Principal Concurrent Positions)	
			Member of the Board of Tata Teleservices Limited (India)	
13	Makoto Tani (November 2, 1961) <Newly appointed>	April 1984	Entered NTT Public Corporation	2,100
		January 2004	Senior Manager of Personnel Department of NIPPON TELEGRAPH AND TELEPHONE WEST CORPORATION (NTT West)	
		July 2006	Senior Manager of Department V and Vice President of Business Process Reform Office, Department V of NIPPON TELEGRAPH AND TELEPHONE CORPORATION (NTT)	

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June 2007	Vice President of General Affairs Department of NTT
October 2009	Vice President of President's Office, General Affairs Department of NTT
August 2013	Senior Vice President, Managing Director of Corporate Marketing Department II of the Company (To the present)

14	Teruyasu Murakami (October 15, 1945) <Reappointed> <Outside Director> <Independent Director>	April 1968	Entered Nomura Research Institute, Ltd. (NRI)	5,400
		April 2001	Representative Director, Executive Managing Director, Member of the Board of NRI	
		April 2002	Chief Corporate Counselor of NRI	
		June 2008	Independent Director of Benesse Holdings, Inc.	
		April 2012	Director of Research Institute for Industrial Strategy (To the present)	
		June 2013	Member of the Board of Directors of the Company (To the present)	
			(Principal concurrent positions)	
	Director of Research Institute for Industrial Strategy			

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Candidate Number	Name (Date of Birth)	History, Positions, Responsibilities and Principal Concurrent Positions		Number of Company Shares Owned
15	Takashi Nakamura (May 15, 1964)	April 1987	Entered NIPPON TELEGRAPH AND TELEPHONE CORPORATION (NTT)	1,000
	<Reappointed>	January 1999	Manager of Department IV, NTT-Holding Provisional Headquarters of NTT	
	<Outside Director>	October 2002	Senior Manager of Department IV of NTT	
		April 2005	Senior Manager of Accounts and Finance Department of NIPPON TELEGRAPH AND TELEPHONE WEST CORPORATION (NTT West)	
		July 2008	Senior Manager of Personnel Department of NTT West	
		July 2011	Senior Manager of Finance and Accounting Department of NTT (To the present)	
		June 2013	Member of the Board of Directors of the Company (To the present)	
			(Principal concurrent positions)	
			Senior Manager of Finance and Accounting Department of NTT	

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Note:

1. NIPPON TELEGRAPH AND TELEPHONE CORPORATION (NTT) is the parent of the Company. NIPPON TELEGRAPH AND TELEPHONE WEST CORPORATION (NTT West) is a subsidiary of NTT.NTT DOCOMO Ventures, Inc., DOCOMO Business Net Inc. and ABC HOLDINGS Co., Ltd. are subsidiaries of the Company. ABC Cooking Studio Co. Ltd. is a subsidiary of ABC HOLDINGS Co., Ltd. NTT DoCoMo Kansai, Inc. was a subsidiary of the Company, but was dissolved in July 2008 upon the merger with NTT DOCOMO, Inc., the surviving company.
2. Mr. Yoshikiyo Sakai is currently a member of the board of NTT, but is expected to resign from the position on June 26, 2014. If his election is approved, Mr. Sakai is expected to assume the position on June 26, 2014.
3. Mr. Akira Terasaki, who currently is Professor of Graduate School of Science and Engineering, Tokyo Institute of Technology and Advisor of Nomura Research Institute, Ltd., is expected to resign from these positions on September 30, 2014 and June 18, 2014, respectively.
4. Mr. Teruyasu Murakami and Mr. Takashi Nakamura are candidates for outside directors. The company filed with the Tokyo Stock Exchange, Inc. (TSE) the notification of Mr. Teruyasu Murakami as an independent director as defined by TSE regulations. An independent director is defined as an outside director or audit & supervisory board member who is unlikely to have conflicts of interest with general investors. The appointment of independent director is obliged by TSE for the purpose of protecting general investors.
5. Mr. Teruyasu Murakami is nominated as a candidate for an outside director due to his long engagement and career in corporate management in information industries, and the Company's expectations that he will perform a supervisory function from a standpoint independent of business execution and incorporating management insight from a broader perspective based on his extensive experience and knowledge. Mr. Takashi Nakamura is nominated as a candidate for an outside director due to his long career and engagement in businesses pertaining to telecommunications, and the Company's expectations that he will perform a supervisory function from a standpoint independent of business execution as an outside director, based on his extensive experience and knowledge.
6. Mr. Takashi Nakamura has received wages, etc., from NTT as an employee of NTT during the past two years, and is expected to continue receiving wages, etc., as an employee of NTT.
7. The candidates for outside directors, Mr. Teruyasu Murakami and Mr. Takashi Nakamura, shall have served as outside directors of the Company for one year at the conclusion of this ordinary general meeting of shareholders.
8. If the election of Mr. Murakami and Mr. Nakamura is approved, in accordance with the provisions of Article 427, Section 1 of the Companies Act of Japan, the Company plans to continue a limited liability contract with Mr. Murakami and Mr. Nakamura, which sets forth the upper limit of damage compensation liability as provided in Article 423 Section 1 of the Companies Act of Japan, so that they can properly fulfill the roles expected for an outside director of the Company.

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Third Item of Business: Election of Two (2) Audit & Supervisory Board Members

As two (2) Audit & Supervisory Board Members, Mr. Takanori Utano and Mr. Kenji Ota, will resign at the close of this Meeting, it is proposed that two (2) Audit & Supervisory Board Members, Mr. Tooru Kobayashi as substitute for Mr. Takanori Utano and Mr. Toshimune Okihara as substitute for Mr. Kenji Ota, be elected.

The candidates for Audit & Supervisory Board Member, to whom the Audit & Supervisory Board has given its approval, are as follows:

Candidate Number	Name (Date of Birth)	History, Positions, Responsibilities and Principal Concurrent Positions		Number of Company Shares Owned
1	Tooru Kobayashi (August 8, 1952) <Newly appointed>	April 1976	Entered NTT Public Corporation	15,800
		June 2007	Executive Vice President, Managing Director of Sales Department and General Manager of Nagoya Branch, Member of the Board of Directors of NTT DoCoMo Tokai, Inc.	
		July 2008	Executive Vice President, Managing Director of Tokai Regional Office of the Company	
		June 2011	Representative Director and Executive Vice President, Member of the Board of Directors of Sumitomo Mitsui Card Co. Ltd.	
		April 2012	Representative Director and Senior Executive Vice President, Member of the Board of Directors of Sumitomo Mitsui Card Co. Ltd.	
		June 2013	President and Chief Executive Officer, Member of the Board of Directors of DOCOMO Service, Inc. (To the present)	
2	Toshimune Okihara (August 29, 1954) <Newly appointed>	April 1979	Entered NTT Public Corporation	1,000
		September 2004	General Manager, Manufacturing & Supply Chain Sales Department I, First Enterprise Sales Division of NTT Communications Corporation (NTT Com)	
		June 2006		

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<Outside Audit & Supervisory Board
Member>

Senior Vice President, General Manager of
System Engineering Department, Member of
the Board of Directors of NTT Com

August 2006

Senior Vice President, General Manager of
System Engineering Department, Enterprise
Sales Division Member, Member of the Board
of Directors of NTT Com

June 2010

Executive Vice President, General Manager of
System Engineering Department, Enterprise
Sales Division, Member of the Board of
Directors of NTT Com

June 2011

President and Chief Executive Officer,
Member of the Board of Directors of NTT
Com Technology Corporation

(To the present)

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Notes:

1. DOCOMO Service Inc. is a subsidiary of the Company. NTT Communications Corporation (NTT Com) is a subsidiary of our parent company, NTT. NTT Com Technology Corporation is a subsidiary of NTT Com. NTT DoCoMo Tokai, Inc. was a subsidiary of the Company, but was dissolved in July 2008 upon the merger with NTT DOCOMO, Inc., the surviving company.
2. Mr. Tooru Kobayashi is expected to resign from the Board of Directors of DOCOMO Service Inc. on June 17, 2014. During the past five years, Mr. Kobayashi has served as President and Chief Executive Officer of Business Expert Inc., a subsidiary of DOCOMO Service Inc., and currently serves as President and Chief Executive Officer of Business Expert Inc., but is expected to resign from the position on June 12, 2014.
3. Mr. Toshimune Okihara is expected to resign from the Board of Directors of NTT Com Technology Corporation on June 17, 2014.
4. Mr. Toshimune Okihara is a candidate for outside audit & supervisory board member of the Company.
5. Mr. Toshimune Okihara is nominated as candidate due to his long career and engagement in businesses pertaining to telecommunications and corporate management, and the Company's expectations that he will perform an audit and supervisory function based on his extensive knowledge and experience.
6. Mr. Toshimune Okihara has received compensation, etc., from NTT Com and NTT Com Technology Corporation as a member of the Board of Directors during the past two years. Mr. Okihara is expected to receive compensation, etc., as member of the Board of Directors of NTT Com Technology Corporation.
7. If the election of Mr. Toshimune Okihara as an outside audit & supervisory board member is approved, in accordance with the provisions of Article 427, Section 1 of the Companies Act of Japan, the Company plans to enter into a limited liability contract with Mr. Okihara, which sets forth the upper limit of damage compensation liability as provided in Article 423 Section 1 of the Companies Act of Japan, so that he can properly fulfill the roles expected for an outside audit & supervisory board member.

-end-

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BUSINESS REPORT

(For the fiscal year from April 1, 2013 to March 31, 2014)

Note: The term FY2013 hereinafter refers to the fiscal year ended March 31, 2014, and other fiscal years are referred to in a corresponding manner. All non-consolidated figures regarding results of operations in this report were prepared in accordance with accounting principles generally accepted in Japan (Japanese GAAP), unless otherwise stated herein. Consolidated results contained herein were prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP), unless otherwise noted.

1. Business Matters of the Corporate Group

(1) Main Business Activities (As of March 31, 2014)

The main business activities of our Group are summarized in the table below.

Business Segment	Main Business Areas
Mobile phone business	Cellular (Xi and FOMA) services, international services, satellite mobile communications services, and sales of handsets and equipment for each service, etc.
All other businesses	Credit services, home shopping services, music software sales, Internet access service for hotel facilities, mobile advertisement business, etc.

(2) Developments and Results of Operations

<<Summary of the principal initiatives>>

In the mobile telecommunications market, besides the intense competition that we engage in with other Japanese telecommunications carriers due to active movement of subscribers using the Mobile Number Portability (MNP) system, we are also facing competition with new players offering a wide variety of Internet-based services that transcend the scope of traditional telecommunications businesses.

In this new competitive landscape, we have been taking steps to reinforce our competitiveness in the mobile business by thoroughly improving our offerings and developing attractive services in our new business fields, based on our medium-term business plan: Medium-Term Vision 2015: Shaping a Smart Life.

In the fiscal year ended March 31, 2014, we strived to boost our comprehensive strengths by focusing on the four key areas of devices (handsets), network, services and billing plans and sales channels, with the goal of being chosen by a large number of customers and garnering their usage over a long period of time.

Furthermore, in order to propel the expansion of our new businesses going forward, we pursued collaboration and alliances with external partners to provide new services in such fields as healthcare and learning.

Meanwhile, to accelerate the initiatives mentioned above, we endeavored to strengthen our managerial foundation through structural reforms, stepping up cost-cutting efforts and shifting management resources to new business domains.

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Furthermore, in April 2014, we unveiled a new billing plan called *Kake-hodai & Pake-aeru* that offers unlimited domestic voice calls for a flat monthly rate and enables users to share their packet-data quota among family members, and introduced a new discount for young customers up to the age of 25 and discounts according to the number of years of use, with the goal of enabling customers to utilize our services at affordable rates for a long period of time by selecting a plan appropriate for their individual needs in different stages of life.

Going forward, we will continue our efforts to bring greater happiness to the lives of our customers and their families, and to society, with the goal of becoming a *Partner for a Smart Life*, chosen and patronized by customers for a long period of time.

<<Results of operations for the FY2013 >>

(Billions of yen)

Item	22nd Fiscal Year (FY2012)	23rd Fiscal Year (FY2013)	Year-on-Year Change
Operating revenues	4,470.1	4,461.2	-0.2%
Operating income	837.2	819.2	-2.1%
Income before income taxes	833.3	833.0	-0.0%
Net income attributable to NTT DOCOMO, INC.	491.0	464.7	-5.4%

Notes: Results for the 22nd Fiscal Year have been revised due to the reinstatement of the equity method for an investee.

For the fiscal year ended March 31, 2014, operating revenues decreased by ¥8.9 billion from the previous fiscal year to ¥4,461.2 billion due mainly to a decrease in mobile communications services revenues by ¥212.7 billion as a result of the impacts of penetration of the *Monthly Support* discount program, despite increases in equipment sales and other operating revenues of ¥113.9 billion and ¥89.9 billion respectively, driven by our active sales promotion of smartphones and the expansion of profit in our new business fields.

Operating expenses increased by ¥9.1 billion from the previous fiscal year to ¥3,642.0 billion due mainly to the increase in depreciation expense related to our upgrade of equipment for our Xi network and an increase in cost related to our expansion of profit in new business fields, despite our efforts to promote cost reduction with the goal of further strengthening our management structure.

As a result of the foregoing, operating income was below ¥840.0 billion, the forecast for the fiscal year ended March 31, 2014, and decreased by ¥18.0 billion from the previous fiscal year to ¥819.2 billion. Net income attributable to NTT DOCOMO, INC. was ¥464.7 billion (a decrease of ¥26.3 billion from the previous fiscal year) due to the ¥39.5 billion decrease of equity in net income of affiliates.

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n Mobile Phone Business

<<Number of Subscriptions for Principal Services>>

(Thousands of subscriptions)

Category	22nd Fiscal Year (FY2012)	23rd Fiscal Year (FY2013)	Increase or Decrease	Year-on-Year Change
Cellular services	61,536	63,105	1,569	2.6%
Xi services	11,566	21,965	10,399	89.9%
FOMA services	49,970	41,140	-8,830	-17.7%
Packet flat-rate services	38,704	40,148	1,444	3.7%
sp-mode services	18,285	23,781	5,497	30.1%
i-mode services	32,688	26,415	-6,273	-19.2%
Number of smartphones sold (Thousand units)	13,290	13,780	490	
Churn rate (%)	0.82%	0.87%	0.05point	

Notes:

1. Number of subscriptions to Cellular services and Cellular (FOMA) services includes Communication Module services subscriptions.
2. Effective March 3, 2008, FOMA subscription became mandatory for subscription to 2in1 services, and those FOMA subscriptions are included in the number of FOMA subscriptions.

<<Summary of the principal initiatives>>

<Devices>

We have made efforts to enhance the lineup of smartphones specific to DOCOMO that are available for customers to choose in order to respond to the diversified needs of customers.

Introduction of iPhone*1

We started carrying Apple Inc.'s iPhone to respond to the needs of our customers, and launched dmarket and various other DOCOMO-proprietary services on the iPhone in an attempt to allow our users to utilize these services.

Performance Enhancement of Android Smartphones

We endeavored to evolve our Android smartphones with enrichment of a number of features in order to realize further convenience of our customers, e.g., implementation of a quad-core CPU*2 that enables the smooth operation of applications and a large-capacity battery that enables more than 3-day continuous usage without recharging and improvement of various operability.

Smartphones Targeting Broader User Segments

We released smartphones equipped with designs and features for broad user segments, including the elderly and children, such as the Raku-Raku SMARTPHONE equipped with a large touch-panel and the Smartphone for Junior preinstalled with a rich set of safety/security functions for young users.

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*1: TM and © 2014 Apple Inc. All rights reserved. iPhone is a trademark of Apple Inc. The iPhone trademark is used under a license from AIPHONE CO., LTD.

*2: A Central Processing Units, or CPUs, are embedded inside PCs, smartphones and other devices to perform complicated numerical calculations, information processing, mechanical control and other tasks.

<Network>

We aimed to provide a robust LTE*1 network that utilizes DOCOMO's technical strengths in pursuit of breadth, speed and convenience.

Expansion of Xi LTE Service Areas

We increased the total number of Xi LTE base stations to 55,300 stations across Japan as of March 31, 2014 (an increase of 30,900 stations compared to the number a year ago) and realized broader area coverage than before. We took meticulous efforts to expand the LTE service areas, to areas such as subway/Shinkansen bullet train stations, commercial facilities, schools and the Mt. Fuji*2 area, which was recently registered as a World Heritage site, so as our customers are able to use their mobile phones in various locales.

Xi LTE Speed Enhancement

We commenced high-speed service that offers a maximum download speed of 150Mbps*3 in Tokyo, Nagoya and Osaka metropolitan areas, while expanding the service areas of our maximum 112.5Mbps downlink speed service to all 47 prefectures of Japan.

Operation of Quad-Band LTE*4

We started operating Quad-Band LTE service that allows us to realize large-capacity transmission for comfortable access through efficient utilization of four different spectrum bands.

Installation of 6-Sector Base Stations*5

In order to improve the communication quality in urban centers and other areas of high usage, we moved ahead with the installation of 6-sector base stations that can handle the same capacity as six regular base stations with a single site.

*1: Abbreviation for Long Term Evolution. A mobile communications system specified by the international standard development organization, 3GPP (3rd Generation Partnership Project).

*2: Service provided during the climbing season in July-August 2013.

*3: A communications speed measurement unit that represents what volume of data can be transmitted in one second. The bigger the number, the faster the communications speed.

*4: The four spectrum bands of 800MHz, 1.5GHz, 1.7GHz and 2GHz are used for the provision of service. Service areas are constructed utilizing 2GHz and 800MHz bands for building coverage, the 1.5GHz band for delivering speed and the 1.7GHz for even faster transmission speeds in metropolitan areas.

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*5: Base stations equipped with a technology that divides an area ordinarily covered by a single base station into six smaller sectors. This technology enables meticulous tuning based on the varying characteristics of each area.

<Services>

With a focus on our dmarket service, we provided more convenient services to entice even more customers to choose us.

Enrichment of dmarket Stores

Aiming to have broad segments of users enjoy our dmarket services, we launched a number of new stores on dmarket . In the fiscal year ended March 31, 2014, we launched dcreators (an online market where various handmade items can be put up for sale or purchased), d fashion (a fashion e-commerce site), dkids (an education content service targeting families with infants) and dtravel (a travel service that provides customers with comprehensive support).

Expansion of dmarket User Base

We took efforts to prove more attractive services for each store on dmarket. As of March 31, 2014, the cumulative subscriptions to dvideo, dhits, danime store and dkids services which deliver content for a fixed monthly subscription fee, grew to 7.69 million.

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Provision of docomo mail

We began providing a mail service which is easy to use for our smartphone customers, and commenced docomo mail cloud-based email service, after renovating the conventional sp-mode mail service for smartphones in pursuit of improved ease of use. We also added a function that allows users to access their mobile phone mail address from PCs or other devices.

Use of docomo ID

We enhanced the functionality of docomo ID, an account identification provided for user authentication, to enable the use of the same ID for services on multiple devices, and even enable customers who do not have a mobile phone subscription contract with DOCOMO to use dmarket and other services via various Internet-enabled devices.

Provision of Service Packages

Based on the concept of affordable and worry-free use, we introduced service packages to offer an assortment of services that enjoy good reviews by customers. As of March 31, 2014, the Osusume Pack, which bundles the Sugotoku-Contents and other recommended services that allow customers to utilize their smartphones in various convenient ways, garnered 2.92 million subscriptions, and the Anshin Pack, which combines the Mobile Phone Protection & Delivery and various other services designed to ensure worry-free use of smartphones, garnered 4.46 million subscriptions.

Introduction of Petfit

As part of our endeavors to enrich our M2M* offerings that can provide useful solutions for customers everyday activities, we started a new service called Petfit, which allows users to check their pet dog's health condition or location via smartphones or other devices using a tag with built-in communications capabilities.

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*: Abbreviation for Machine-to-Machine. A system that provides automatic communication between machines with built-in communications capability such as vehicles, vending machines and information appliances and the server or other network equipment.

<Billing Plans and Sales Channels>

In response to the proliferation of smartphones, we have endeavored to develop sales channels and provide rates reflective of changes in what customers desire and in how they use their smartphones.

Various Discount Services

We launched various discount programs and campaigns, such as the Arigato 10 Years Smartphone Discount program for customers who have used DOCOMO for over 10 years, and a student discount program that offers discounts on basic monthly charges and other privileges to students purchasing a new smartphone, as well as their families.

Reinforcement of Customer Contact Points

To ensure smooth customer service at docomo Shops, we increased the number of customer counters and introduced tablet devices that can accept changes to customers' contract details, etc., during the time before customers are guided to the counter. We also introduced a reservation service* which a customer can use when visiting My Shop, the docomo Shop which a customer has registered as their preferred DOCOMO store, increased the procedures that can be completed online and reinforced our call centers' capabilities for handling smartphone-related inquiries.

*: Some stores are not offering this service. Also, depending on how busy a store is on a particular day, service may not be offered in the normal timely manner that is expected.

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Announcement of New Billing Plan

In April 2014, we announced the introduction of a new billing plan called *Kake-hodai & Pake-aeru* to allow customers to utilize our smartphones and feature phones at affordable rates for a long period of time by selecting plans appropriate to their needs in different stages of life.

<Overview of New Billing Plan>

Zutto DOCOMO Discount	A service that offers graduated discounts based on the length of subscription
	Offers discounts on data communication charges to all family members based on user with the longest subscription length in the family

U25 Ouen Discount	A service that offers helpful discounts not only to students but to all customers of age 25 or younger
	Provides a discount of ¥500/month on a user phone bill
	Also offers free bonus packets of 1GB

Kake-hodai	Unlimited domestic voice calling for a flat monthly rate to any destination, including to other DOCOMO phones or to users of other mobile/fixed-line networks, with no restrictions on the number of calls or their duration
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Pake-aeru	Allows packet data-quota sharing among family members or among multiple devices owned by a single user
	Allows waste-free data usage through the sharing of a data quota among family members after selecting a plan suited for the family's total packet consumption
	Additional packets can be purchased on an as-needed basis in months of heavy usage

<Initiatives for Corporate Marketing>

Through our smartphones and cloud services, we provide solutions that create new value for business users, addressing the unique challenges of our corporate clients. The following is a summary of the principal new initiatives undertaken during the fiscal year ended March 31, 2014:

Release of Business Smartphone

We released a smartphone for corporate users, the *F-04F*, equipped with easy-to-use basic communications features including telephone and email as well as advanced security functions.

Introduction of Business Plus

We started offering Business Plus, a package of cloud-based enterprise services including groupware*, network address book, attendance management and other features.

*: Software designed to help improve the productivity of business operations. Groupware generally comes with email/schedule-sharing and other capabilities.

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<Global Business Expansion>

We have taken steps to ensure that customers are able to use our mobile phones worry-free in foreign countries and promoted global expansion of services in new business fields through investments and alliances. The following is a summary of the principal actions undertaken during the fiscal year ended March 31, 2014:

Launch of Global 1day Pake Service

We started offering a new one-day (24-hour) flat-rate data communications billing plan for customers traveling overseas, the Global 1day Pake service, which provides users with more inexpensive packet access defined for each country/region.

Launch of LTE-based International Roaming Service

We commenced LTE-based international roaming service that can be applied with Global 1day Pake and other billing plans, to enable high-speed data access using LTE connections even when traveling abroad.

Reinforcement of New Businesses in Europe

We acquired all of the shares of fine trade gmbh, an Austria-based e-commerce trading solution provider, making it a wholly-owned subsidiary with the aim of providing various payment options in the online retail market for consumer goods in Europe.

n All other businesses

Our undertakings in all other businesses also include efforts aimed at expanding new business fields through the rollout of new services in such fields as healthcare and learning or the making of investments and the formation of alliances. The principal actions undertaken in all other businesses during the fiscal year ended March 31, 2014, are summarized below:

docomo Healthcare, Inc.

We launched a new healthcare support service dubbed Watashi Move (WM). We also commenced services that provide users with advice based on acquired health data, Karada no Kimochi and Karada no Tokei WM, and released a wristband-type wearable device, Move Band.

Nihon Ultmarc Inc.

With the goal of creating new services that link customers with medical care, we made an investment in Nihon Ultmarc Inc., a company that operates Japan's largest medical database and possesses special resources in this field, making it into a subsidiary.

ABC HOLDINGS Co., Ltd.

With a focus on cuisine and dining, we transformed ABC HOLDINGS Co., Ltd. into a subsidiary with the goal of creating new lesson styles that enrich customers' lifestyles and provide convenience, and expanding the business of cooking classes in the future.

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MAGASseek Corporation

We commenced the d fashion fashion e-commerce site, in which users can make payments for purchased items together with their monthly phone bill or use docomo Points as a payment option.

Operating revenues and income (loss) in each business segment in the fiscal year ended March 31, 2014 are indicated in the table below.

(Billions of yen)

Category	22nd Fiscal Year (FY2012)		23rd Fiscal Year (FY2013)		Year-on-Year Change
Operating revenues					
Mobile phone business	4,275.2	(95.6)	4,235.9	(94.9)	-0.9%
Voice	1,274.6	(28.5)	10,65.2	(23.9)	-16.4%
Packet	1,893.9	(42.4)	1,890.6	(42.4)	-0.2%
All other businesses	195.0	(4.4)	225.3	(5.1)	15.6%
Total	4,470.1	(100.0)	4,461.2	(100.0)	-0.2%
Operating income (loss)					
Mobile phone business	868.3	(-)	835.5	(-)	-3.8%
All other businesses	-31.1	(-)	-16.3	(-)	47.8%
Total	837.2	(-)	819.2	(-)	-2.1%
Notes:					

1. Figures in parentheses indicate revenues as a percentage of total operating revenues.
2. Operating revenues for the voice mobile phone business include circuit-switching data communication.
- (3) Trend of Capital Expenditures

The principal capital investments made during the fiscal year ended March 31, 2014 are summarized below.

<Expansion of Telecommunications Facilities>

Expansion of Network Facilities

We increased significantly the installation of base stations to further improve the area coverage of our Xi LTE service. Also, in order to accommodate the growth of data traffic* resulting from the expanded uptake of smartphones, we worked on the capacity buildup of servers, switches and other equipment.

Actions for the Launch of New Services

We strived to reinforce our cloud infrastructure to ensure compatibility with docomo ID authentication and docomo mail service.

*: The total volume of transmissions which occurred by means of data communication.

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<Initiatives Aimed at Efficiency and Cost Reduction>

Efficient Use of Capital Expenditure

We pursued cost efficiency improvement toward the goal of further strengthening our management foundation through the integration and/or capacity expansion of equipment, the improvement of the efficiency of construction and the reduction of equipment procurement costs.

Efficient Service Area Construction

We also structured our service areas and achieved quality improvement in an efficient manner, choosing the best equipment among various options taking into consideration the surrounding environment and geography, data transmission volume and other factors when establishing base stations.

As a result of the above measures, the total capital expenditures for the fiscal year ended March 31, 2014, decreased by 6.7% from the previous fiscal year to ¥703.1 billion.

(4) Financing Activities

During the fiscal year ended March 31, 2014, we obtained long-term financing through the issuance of corporate bonds in the amount of ¥50 billion, to be used for the redemption of outstanding corporate bonds.

(5) Research and Development Activities

We have engaged in the development of technology that will make communication and services used via smartphones more convenient and in R&D directed at establishing communication standards for the future, from a long-term perspective.

<Development of the Handsets and Services>

High functioning Xi Handsets

With the Xi service, we began to offer smartphones and mobile Wi-Fi routers compatible with Quad band LTE that supports downlink transmission at 150Mbps.

Strengthening of Cloud Service

We began to offer a service that uses the cloud for docomo mail and the like. We developed and began to offer a docomo ID compatible service base and server management technology that shortens up to 50% the cloud service response time, with the aim of improving service usability.

Establishing an API providing site

While providing our own technologies used in our smartphones, such technology as text recognition and voice recognition as API*1, we also established docomo Developer support, an API providing site that widely supports service developers, including development support tools like SDK*2.

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*1: An abbreviation for Application Programming Interface. An interface required for calling up a function or database when applications are developed.

*2: An abbreviation for Software Development Kit. It facilitates easier programming by developers.
<Technical Developments to be Implemented>

Development of VoLTE*

We are engaged in the development of VoLTE, a voice service on the LTE network, which is 3GPP standardized.

Development of LTE-Advanced

Newly developed Smart Vertical MIMO, a wireless transmission technology aimed at LTE-Advanced, which is 4th generation mobile communications standard. The traveling transmission test was successful outdoors at an excess of 1.2Gbps with one base station antenna.

Development of Application for Wearable Device

We initiated the development of intelligent glass, an application for eyeglass-type terminals which displays counterpart information transmitted by others stored in the Internet and allows users to move virtual icons displayed in their field of vision as if they are moving actual physical objects.

*: An abbreviation for Voice over LTE. This is a voice IP service which leverages LTE technology.
<Future Technology Initiatives>

Next Generation Communications (5G)

With the goal of realizing ultra-high speed communications that exceed 10Gbps and ultra-high data transmission volumes that are at least 1,000 times greater than LTE, we conducted research and development related to next generation communications (5G).

Network Virtualization

We are engaged in research and development related to network virtualization that aims to increase the efficiency of network structure and operations. We have confirmed by experimentation that this technology can handle the complexity of larger scale traffic concentration both economically and rapidly.

As a result of the above, the total research and development costs for the fiscal year ended March 31, 2014, decreased by 8.3% from the previous fiscal year to ¥102.0 billion.

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(6) CSR Activities

In accordance with our medium-term business plan, Medium-Term Vision 2015, we are working to provide a stable, high quality network and services and to engage in the persistent creation of new value as a Partner for a Smart Life for our customers.

We believe it is the corporate social responsibility CSR of DOCOMO to contribute to the realization of a society that enables people to lead abundant lives with comfort, safety, and security by resolving various social issues and surpassing the confines of countries, regions, and generations. Accordingly, we have positioned CSR at the core of our corporate management.

<Realizing a Safe, Secure Society>

Use of Safe, Secure Services by Young People

We have enhanced the Anshin-mode (safe-mode) function of our service for the safe and secure use of smartphones by young people and have enabled the application of our filtering service to Internet access via Wi-Fi provided by other companies as well as through the DOCOMO network. Approximately 6,900 sessions of the Mobile Safety Class were conducted for young people, guardians, and educators nationwide this period to explain precautionary items, manners and other facets of using mobile phones safely and securely.

Services that Seniors Can Use with Confidence

We began offering Tsunagari-Hotto Support , an application to reassure seniors, and enabled the status of smartphone use (pedometer, battery charge remaining, etc.) to be conveniently emailed to a family member designated in advance through normal use of the smartphone.

Services that are Easy for Anyone to Use

The eligibility of application for Hearty Discounts has been expanded to also enable people with disabilities or people who suffer from intractable diseases to use our services with assurance. 70 sessions of our Mobile Useful Class were also conducted this fiscal year to explain to people with disabilities how to use mobile phones conveniently.

Manners when Using a Smartphone

We produced a logo and animated video stressing the dangers of using a smartphone while walking and posted these in various advertisements and on the Internet. We also enhanced the features of the Anshin-mode function and provided a function that will prevent use of a smartphone while walking.

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<Initiatives in Global Environmental Protection>

Designing Environmentally Friendly Communications Equipment

We have made steady progress on steps to reduce electricity usage while working to enhance network equipment by developing and introducing energy-saving LTE compact base stations and Green base stations that use renewable energy.

Consideration for the Environment in docomo Shops

We have begun to install LED lighting in docomo Shops. We have also endeavored to provide a digital catalog in order to achieve a reduction of the use of paper resources for catalogs. In addition, we have developed and equipped docomo Shops with equipment for the safe and proper deletion of smartphone personal information no longer needed by customers as well as by crushing them for recycling.

Activities Directed at Preservation of the Natural Environment

We have rolled out activities to establish docomo Woods in 50 locations throughout the 47 prefectures nationwide as a locally rooted activity that will preserve the natural environment. This activity was held 50 times during this fiscal year, with roughly 2,600 employees participating alongside local volunteer groups and others.

<For the Recovery of Disaster-stricken Areas>

Activities to Provide Aid Along with Customers

A Disaster Charity Site enabling donations via DOCOMO cell phones was set up five times this period and approximately 35 million yen was donated for the restoration of the areas stricken by natural disasters. In addition, DOCOMO-original Goods made from timber from thinning forests were sold on dshopping and via other venues and a portion of the proceeds was used for forest conservation as one part of the initiative directed at assisting in the recovery of Minamisanriku in Miyagi Prefecture.

Employee Participation in Activities

Interested employees were solicited and dispatched to areas stricken by the Great East Japan Earthquake to participate in volunteer activities. A total of around 340 employees participated in 20 trips this period.

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(7) Consolidated Financial Results and Assets

	20th Fiscal Year (FY 2010)	21st Fiscal Year (FY 2011)	22nd Fiscal Year (FY 2012)	23rd Fiscal Year (FY 2013)
Operating revenues (millions of yen)	4,224,273	4,240,003	4,470,122	4,461,203
Operating income (millions of yen)	844,729	874,460	837,180	819,199
Income before income taxes (millions of yen)	835,338	876,958	833,342	833,049
Net income attributable to NTT DOCOMO, INC. (millions of yen)	490,485	463,912	491,026	464,729
Earnings per share attributable to NTT DOCOMO, INC. (yen)	117.97	111.87	118.41	112.07
Total assets (millions of yen)	6,791,593	6,948,082	7,169,725	7,508,030
NTT DOCOMO, INC. shareholders' equity (millions of yen)	4,850,436	5,062,527	5,368,475	5,643,366

Notes:

- Results for the 22nd Fiscal Year have been revised due to the reinstatement of the equity method for an investee.
- We conducted a 1:100 stock split with an effective date of October 1, 2013. Earnings per share attributable to NTT DOCOMO, INC. for each fiscal year are calculated based on the number of shares after the stock split.

(8) Issues to be addressed by the Group

Under the slogan of becoming a Partner for a Smart Life, we have moved ahead with the initiatives aimed at improving our competitiveness in the mobile phone business and accelerating the expansion of new businesses.

In the fiscal year ended March 31, 2014, we enriched our dmarket portal that offers a wide variety of convenient content and pursued collaboration and alliances with external partners to provide new services in various sectors such as healthcare and learning. Also, to add momentum to these initiatives, we strived to strengthen our managerial foundation through structural reforms, stepping up cost-cutting efforts and shifting management resources to new business fields.

In the fiscal year ending March 31, 2015, we will work to enhance our comprehensive strengths by further accelerating our existing efforts primarily in the four areas of devices (handsets), networks, services and billing plans and sales channels.

As part of our actions for devices, we will endeavor to expand the number of smartphone users even further and promote the use of a second mobile device, e.g., a mobile phone plus a tablet, toward the goal of achieving further increase in packet revenues.

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In the area of networks, we will concentrate resources on LTE for the purpose of building the strongest area coverage through the deployment of Quad-Band LTE network, rolling out an additional 40,000 LTE base stations within the fiscal year ending March 31, 2015. We plan to launch VoLTE service in the summer of 2014 to offer enhanced voice quality. Furthermore, the verification trial of LTE-Advanced is also scheduled to begin in the fiscal year ending March 31, 2015, with the aim of commencing its commercial service at an early date.

As for services, while working to add more variety to market to make the market place even more attractive and to increase the volume of its business, we will aim to grow its subscriber base to 10 million as quickly as possible. Leveraging the relationship we have constructed with overseas carriers hitherto and our strengths we have cultivated in Japanese market, we will pursue revenue expansion opportunities abroad by deploying the services grown in Japan into overseas markets. Through these undertakings, we will work to achieve ¥1 trillion in new business revenues in the fiscal year ending March 31, 2016.

With respect to billing plans and sales channels, in June 2014, we will launch a new billing plan called Kake-hodai & Pake-aeru, which offers unlimited domestic voice calls for a flat monthly rate and enables users to share packet-data quota among family members and introduced a new discount for young customers up to the age of 25 and discounts according to the number of years of use. While brushing up our sales channel including call centers and other customer interfaces that are sources of strength for DOCOMO, we will work in unison to facilitate the uptake of the new billing plan.

Through these initiatives, we will strive to expand our smartphone user base, boost packet usage and lower the churn rate so as to put the mobile phone business on a path to new growth, while taking the lead in service differentiation in order to expand revenues and income from new businesses.

In order to establish a new path towards growth, we will also aim to achieve significant cost efficiency improvement by properly controlling the Monthly Support discounts, sales expenses, network costs and other expenditures.

Meanwhile, we will also work to reinforce our management foundation through structural reforms. In addition to actions aimed at improving our operational efficiency and speeding up our decision-making process, we will implement group structural reforms effective July 1, 2014, to further improve customer services by creating a specialist driven and community-based organization and shifting resources to strengthen certain areas of our business (new businesses and corporate sales fields) through the slimming of branch offices.

Considering shareholder returns as one of the most important issues in our corporate management, we will endeavor to continue stable dividend payments while taking into consideration our consolidated financial results and consolidated dividend payout ratio.

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(9) Principal Offices (As of March 31, 2014)

(a) Headquarters: 11-1, Nagata-cho, 2-chome, Chiyoda-ku, Tokyo, Japan

(b) Regional Offices:

Hokkaido Regional Office: Chuo-ku, Sapporo, Hokkaido Prefecture

Tohoku Regional Office: Aoba-ku, Sendai, Miyagi Prefecture

Tokai Regional Office: Higashi-ku, Nagoya, Aichi Prefecture

Hokuriku Regional Office: Kanazawa, Ishikawa Prefecture

Kansai Regional Office: Kita-ku, Osaka, Osaka Prefecture

Chugoku Regional Office: Naka-ku, Hiroshima, Hiroshima Prefecture

Shikoku Regional Office: Takamatsu, Kagawa Prefecture

Kyushu Regional Office: Chuo-ku, Fukuoka, Fukuoka Prefecture

(10) Employees (As of March 31, 2014)

Number of Employees (change from March 31, 2013)	Average Age	Average Length of Employment
24,860 (increase of 970)	40.7	15.6 years

Notes:

1. The number of employees includes 390 employees seconded from companies other than the Company or its subsidiaries, but does not include 689 employees seconded to companies other than the Company or its subsidiaries.
2. In calculating the average age of employees, employees at overseas subsidiaries are not included.
3. In calculating the average length of service for employees transferred from NIPPON TELEGRAPH AND TELEPHONE CORPORATION (NTT), other companies in the NTT Group, the former NTT Central Personal Communications Network, Inc., or the eight regional companies in the Personal Communications Network, years of employment at their respective prior employers are included in the calculation. Employees seconded from companies other than the Company or its consolidated subsidiaries and employees at overseas subsidiaries are not included in the calculation.

(11) Status of Parent Company and Principal Subsidiaries

(a) Relationship with Parent Company

NTT, our parent company, currently owns 2,764,000,000 shares of our company (66.65% of all shares*) as of March 31, 2014. The company conducts business mainly in the mobile communication field under its own managerial responsibilities within the NTT Group.

The company and NTT have concluded an agreement on the content of services and benefits provided by NTT to the Company and the compensation with respect to basic research and development by NTT.

*: The percentage of shares held is calculated excluding treasury shares.

(b) Principal Subsidiaries

There are no subsidiaries that are considered to be principal subsidiaries as of March 31, 2014.

There were 194 subsidiaries and 35 affiliates as of March 31, 2014.

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(c) Acquisition and disposal of shares of other companies

<Investment in MCV*>

We acquired 100% of the shares of MCV, the largest provider of cable television and Internet in Guam and the Northern Mariana Islands, and made it a subsidiary with the goal of improving quality and expanding services in the region.

*: MCV Guam Holding Corp.

<Investment in ABC Holdings >

We acquired a 51% interest in the outstanding shares of ABC Holdings Co., Ltd., and made it a subsidiary with the goal of providing new services that utilize the cloud for video cooking lessons and other content.

(d) Material contracts for management of the company

We have entered into a basic agreement for billing and collection activities for communications services charges, as well as a receivables assignment agreement pursuant that agreement, with NTT Finance Corporation (NTT Finance). Under these agreements we have assigned the receivables associated with our communications services to NTT Finance.

(12) Principal Creditors of the Corporate Group (as of March 31, 2014)

There were no principal creditors as of March 31, 2014

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- (1) Total number of authorized shares: 17,460,000,000 shares
- (2) Total number of issued shares: 4,365,000,000 shares
- (3) Number of shareholders: 327,818
- (4) Principal Shareholders

Shareholders	Holdings in the Company	
	Number of Shares Held	Shareholding Ratio (%)
NIPPON TELEGRAPH AND TELEPHONE CORPORATION	2,764,000,000	66.65
THE MASTER TRUST BANK OF JAPAN, LTD. (TRUST ACCOUNT)	68,624,500	1.65
JAPAN TRUSTEE SERVICES BANK, LTD. (TRUST ACCOUNT)	58,200,100	1.40
BARCLAYS CAPITAL INC.	50,168,300	1.21
THE BANK OF NEW YORK MELLON SA/NV 10	34,839,646	0.84
THE BANK OF NEW YORK MELLON AS DEPOSITARY BANK FOR DEPOSITARY RECEIPT HOLDERS	24,669,549	0.59
STATE STREET BANK WEST CLIENT TREATY	19,218,137	0.46
STATE STREET BANK AND TRUST COMPANY 505225	18,516,023	0.45
JAPAN TRUSTEE SERVICES BANK, LTD. (TRUST ACCOUNT 6)	16,954,400	0.41
JAPAN TRUSTEE SERVICES BANK, LTD. (TRUST ACCOUNT 5)	16,928,700	0.41

Notes:

1. The Company's holding of treasury stock (218,239,900 shares) is not included in the above.
2. The Shareholding Ratio calculation excludes treasury stock.
- (5) Other Principal Issues on the Company Shares

In response to the Action Plan for Consolidating Trading Units announced by stock exchanges of Japan, we conducted a 1:100 stock split and adopted a unit share system in which 100 shares constitute one share-trading unit, effective October 1, 2013. This increased the total number of authorized shares by 17,271,870,000 to 17,460,000,000 shares and increased the total number of issued shares by 4,321,350,000 to 4,365,000,000 shares.

Please note that there will be no effective change in the investment units due to the stock split and adoption of the unit share system.

Table of Contents**3. Directors, Corporate Officers and Audit & Supervisory Board Members**

(1) Directors and Audit & Supervisory Board Members (as of March 31, 2014)

Position	Name	Primary Responsibilities and Affiliations
President and CEO	Kaoru Kato	
Member of the Board of Directors		
Senior Executive Vice President	Kazuto	Responsible for Global Business and Corporate
Member of the Board of Directors	Tsubouchi	Member of the Board of Directors of Tata Teleservices Limited (India)
Senior Executive Vice President	Fumio	Responsible for Multimedia and Technology
Member of the Board of Directors	Iwasaki	
Executive Vice President	Tsutomu	Managing Director of Corporate Marketing Division and Managing Director of TOHOKU Reconstruction Support Office
Member of the Board of Directors	Shindou	
Executive Vice President	Takashi	Responsible for Consumer Sales and Branches in Kanto and Koshinetsu areas
Member of the Board of Directors	Tanaka	
Executive Vice President	Kazuhiro	Managing Director of Corporate Strategy & Planning Department and Managing Director of Structural Reform Office
Member of the Board of Directors	Yoshizawa	Responsible for Mobile Society Research Institute
Executive Vice President	Seizo	Managing Director of R&D Center
Member of the Board of Directors	Onoe	
Executive Vice President	Wataru	Responsible for CSR
Member of the Board of Directors	Kagawa	Managing Director of General Affairs Department, Managing Director of Corporate Social Responsibility Department and Managing Director of Business Process Improvement Office
Executive Vice President	Kiyoshi	Responsible for Network
Member of the Board of Directors	Tokuhiro	Managing Director of Network Department
		Member of the Board of Directors of Tata Teleservices Limited (India)
Senior Vice President	Hiroataka	Managing Director of Accounts and Finance Department
Member of the Board of Directors	Sato	

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Senior Vice President	Kazuhiro	Managing Director of Human Resources Management Department
Member of the Board of Directors	Takagi	
Member of the Board of Directors	Ryuji	Chief Strategic Advisor
	Yamada	

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Position	Name	Primary Responsibilities and
		Affiliations
Member of the Board of Directors	Teruyasu	Director of Research Institute for Industrial Strategy
	Murakami	
Member of the Board of Directors	Takashi	Senior Manager of Finance and Accounting Department of NTT
	Nakamura	
Full-time Audit & Supervisory Board Member	Takanori	
	Utano	
Full-time Audit & Supervisory Board Member	Kenji	
	Ota	
Full-time Audit & Supervisory Board Member	Haruo	
	Morosawa	
Full-time Audit & Supervisory Board Member	Naoto	
	Shiotsuka	
Audit & Supervisory Board Member	Eiko	Professor of Accounting, Faculty of Business & Commerce, Waseda University
	Tsujiyama	Outside Audit & Supervisory Board Member of Mitsubishi Corporation Outside Director of ORIX Corporation Outside Audit & Supervisory Board Member of LAWSON, INC. Outside Audit & Supervisory Board Member of Shiseido Company, Limited

Notes:

- Members of the Board of Directors and Audit & Supervisory Board Members who resigned or retired during the fiscal year ended March 31, 2014 are as follows:

Name	Retirement date	Reason	Position/responsibility at time of retirement
Kiyohito Nagata	June 18, 2013	resigned	Senior Vice President, Managing Director of Strategic Marketing Department
Hiroo Kusumoto	June 18, 2013	resigned	Member of the Board of Directors
Shuro Hoshizawa	June 18, 2013	resigned	Full-time Audit & Supervisory Board Member
Kyouichi Yoshizawa	June 18, 2013	resigned	Audit & Supervisory Board Member

- Members of the Board of Directors elected at the 22nd Annual General Meeting of Shareholders held on June 18, 2013 are as follows:

Name	Position	Responsibility
Kiyoshi Tokuhira		Responsible for Network

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Executive Vice President and Member of the Board of Directors Managing Director of Network Department

Teruyasu Murakami Member of the Board of Directors

Takashi Nakamura Member of the Board of Directors

Kenji Ota Full-time Audit & Supervisory Board Member

Naoto Shiotuska Full-time Audit & Supervisory Board Member

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3. Changes in responsibilities of the Members of the Board of Directors during the fiscal year ended March 31, 2014 are as follows:

Name	Current Positions and Responsibilities	Previous Positions and Responsibilities	Effective date
Kazuto Tsubouchi	Senior Executive Vice President, Responsible for Global Business and Corporate, Member of the Board of Directors	Senior Executive Vice President, Responsible for Global Business, Corporate and CSR, Member of the Board of Directors	June 18, 2013
Fumio Iwasaki	Senior Executive Vice President, Responsible for Multimedia and Technology, Member of the Board of Directors	Senior Executive Vice President, Responsible for Multimedia, Network and Technology, Member of the Board of Directors	June 18, 2013
Tsutomu Shindou	Executive Vice President, Managing Director of Corporate Marketing Division, Managing Director of Corporate Marketing Department II and Managing Director of TOHOKU Reconstruction Support Office, Member of the Board of Directors	Executive Vice President, Managing Director of Corporate Marketing Division and Managing Director of TOHOKU Reconstruction Support Office, Member of the Board of Directors	June 18, 2013
	Executive Vice President, Managing Director of Corporate Marketing Division and Managing Director of TOHOKU Reconstruction Support Office, Member of the Board of Directors	Executive Vice President, Managing Director of Corporate Marketing Division, Managing Director of Corporate Marketing Department II and Managing Director of TOHOKU Reconstruction Support Office, Member of the Board of Directors	August 1, 2013
Kazuhiro Yoshizawa	Executive Vice President, Managing Director of Corporate Strategy & Planning Department and Managing Director of Structural Reform Office, Responsible for Mobile Society Research Institute, Member of the Board of Directors	Executive Vice President, Managing Director of Corporate Strategy & Planning Department, Responsible for Mobile Society Research Institute, Member of the Board of Directors	July 1, 2013
Wataru Kagawa	Executive Vice President, Responsible for CSR, Managing Director of General Affairs Department, Managing Director of Corporate Social Responsibility Department and Managing Director of Business Process Improvement Office, Member of the Board of Directors	Senior Vice President, Managing Director of General Affairs Department, Managing Director of Corporate Social Responsibility Department and Managing Director of Business Process Improvement Office, Member of the Board of Directors	June 18, 2013

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4. Board members Teruyasu Murakami and Takashi Nakamura are outside directors as provided in Article 2, Item15 of the Companies Act.
5. NIPPON TELEGRAPH AND TELEPHONE CORPORATION, which employs outside director Takashi Nakamura, is our parent company.
6. Full-time audit & supervisory board members Haruo Morosawa, Naoto Shiotsuka and audit & supervisory board member Eiko Tsujiyama are outside audit & supervisory board members as provided in Article 2, Item16 of the Companies Act.
7. Outside audit & supervisory board member Naoto Shiotsuka has experience in corporate management and extensive knowledge pertaining to finance and accounting through his career in the Finance Department of NTT DATA Corporation.
8. Outside audit & supervisory board member Eiko Tsujiyama has considerable knowledge in finance and accounting gained through her years of experience as a university professor and outside director of private companies, along with being a Certified Public Accountant and as an outside director on corporate boards.
9. Outside audit & supervisory board member Eiko Tsujiyama also serves as an outside audit & supervisory board member with Lawson, Inc., a company with which we have business alliance. In addition, we have no special relationship with other firms where Ms. Tsujiyama is concurrently serving and with Research Institute for Industrial Strategy where a member of the board of directors Teruyasu Murakami is acting as director.
10. We have designated outside director Teruyasu Murakami and outside audit & supervisory board members Haruo Morosawa and Eiko Tsujiyama as independent director/audit & supervisory board members pursuant to the Securities Listing Regulations of Tokyo Stock Exchange, and we have notified the Tokyo Stock Exchange of such designation.

(2) Policies concerning, and total compensation of, directors and audit & supervisory board members

(a) Policies

Matters concerning compensation for directors are decided by the Board of Directors.

Compensation for directors (excluding outside directors) consists of a monthly salary and bonuses. Monthly salaries are paid based on the scope of roles and responsibilities of each director. Bonuses are paid taking into account the Company's business results for the current term. Also, directors make monthly contributions of at least a certain amount for the purchase of the Company's shares through the Director Shareholding Association to encourage a medium- to long-term perspective. Purchased shares are owned by the directors during their terms in office.

Compensation for audit & supervisory board members is determined by resolution of the Audit & Supervisory Board and, in order to maintain a high level of independence, consists only of a monthly salary that is not linked to financial performance.

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(b) Total Compensation for Directors and Audit & Supervisory Board Members for the Fiscal Year Ended March 31, 2014

Position	Number of Persons	Total Compensation (Millions of yen)
Director	14	495
Audit & Supervisory Board Member	7	124
Total	21	619

Notes:

- Upper limits on compensation for directors and audit & supervisory board members were set at ¥600 million annually for directors and ¥150 million annually for audit & supervisory board members at the 15th ordinary general meeting of shareholders held on June 20, 2006.
 - The above includes one director and two audit & supervisory board members who retired at the conclusion of the 22nd ordinary general meeting of shareholders held on June 18, 2013.
 - Compensation for directors includes ¥93 million in bonuses paid in the fiscal year ended March 31, 2014.
- (3) Outside Directors and Outside Audit & Supervisory Board Members

(a) Principal activities of outside directors and outside audit & supervisory board members

Position	Name	Principal Activities
Outside Director	Teruyasu	After his appointment in June 2013, he attended all 12 of the Board of Directors meetings held during the fiscal year ended March 31, 2014 and used his extensive experience in corporate management in the ICT and information industries to make appropriate comments from a perspective independent from the Company's business operations.
	Murakami	
Outside Director	Takashi	After his appointment in June 2013, he attended 11 of the 12 of the Board of Directors meetings held during the fiscal year ended March 31, 2014 and used his extensive experience in the telecommunications business to make appropriate comments from a perspective independent from the Company's business operations.
	Nakamura	
Outside Audit & Supervisory Board Member	Haruo	He attended all 14 of the Board of Directors meetings and all 14 of the Audit & Supervisory Board meetings held in the fiscal year ended March 31, 2014 and made appropriate comments from his expert perspective gained through his work experience in the Board of Audit of Japan.
	Morosawa	
Outside Audit & Supervisory Board Member	Naoto	After his appointment in June 2013, he attended all 12 of the Board of Directors meetings and all 9 of the Audit & Supervisory Board meetings held in the fiscal year ended March 31, 2014 and made appropriate comments from his extensive knowledge pertaining to finance and accounting in addition to his experience in corporate management and financial department of a company.
	Shiotsuka	

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Outside Audit & Supervisory Board Member	Eiko Tsujiyama	She attended 12 of the 14 of the Board of Directors meetings and all 14 Audit & Supervisory Board meetings held in the fiscal year ended March 31, 2014 and made appropriate comments from her expert perspective in finance and accounting as a Certified Public Accountant and gained through her years of experience as a university professor and as an outside director on corporate boards.
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(b) Indemnity agreements

The Company has concluded agreements with outside directors and outside audit & supervisory board members to indemnify them for personal liability as provided in Article 423, Section 1 of the Companies Act in accordance with Article 427, Section 1 of the Companies Act. The compensation of liability is the minimum amount in accordance with Article 425, Section 1 of the Companies Act.

(c) Total compensation to outside directors in the fiscal year ended March 31, 2014

Number of persons	Total compensation (Millions of yen)
5	71

Notes: The above includes one audit & supervisory board member who retired at the conclusion of the 22nd ordinary general meeting of shareholders held on June 18, 2013.

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4. Independent Auditor

(1) Name of independent auditor
KPMG AZSA LLC

(2) Audit fees paid to the independent auditor in the fiscal year ended March 31, 2014

Details	Amount (Millions of yen)
Audit fees for the independent auditor in the fiscal year ended March 31, 2014	681
Total monetary and other financial benefits payable by the Company and its subsidiaries	853

Notes:

- The audit contract between the Company and the independent auditor does not distinguish among audit fees paid for audits performed pursuant to the Companies Act, audit fees paid for audits performed pursuant to the Financial Instruments and Exchange Act and audit fees paid for audits performed pursuant to the U.S. Securities Exchange Act, and since it is not practically possible to make such a distinction, the amounts indicated in the audit fees paid to the independent auditor in the fiscal year ended March 31, 2014 above are totals.
- Consideration is paid to the independent auditor for services other than the services specified in Article 2, Paragraph 1 of the Certified Public Accountants Act (non-audit services). The non-audit services are advisory services and other service relating to international financial reporting standards.
- Policies concerning decisions to discharge or not reappoint independent auditors
In the event that the circumstances set forth in any of the items of Article 340, Section 1 of the Companies Act apply to the independent auditor, the independent auditor is to be discharged by a unanimous resolution of the Audit & Supervisory Board.

In addition, if the Company determines that it would be difficult for the independent auditor to perform proper audits, the Board of Directors may, with the agreement of the Audit & Supervisory Board or upon request from the Audit & Supervisory Board, propose to the general meeting of shareholders that the independent auditor be discharged or that the independent auditor not be reappointed.

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5. Systems for Ensuring the Propriety of the Company's Business Activities

A summary of the Board of Directors resolutions concerning the development of systems to ensure the propriety of the Company's business activities (internal control systems) is set forth below.

(1) Basic stance on fortifying internal control systems

- a) In fortifying the internal control systems, the Company aims to achieve legal compliance, management of loss risk and appropriate and efficient business operations and consider various measures, including regulations, organizational and structural improvement, formulation of action plans and the monitoring of activities.
- b) An internal control committee will be formed as an entity overseeing efforts to have the internal control systems function more efficiently. The committee will aim to fortify internal control systems from the cross-departmental perspective; upon assessing efficacy, necessary improvements will be carried out.
- c) Appropriate efforts will be made with regard to ensuring the reliability of the internal control systems, which will be involved with the financial reporting based on the U.S. Sarbanes-Oxley Act and the Financial Instruments and Exchange Act.
- d) The Board of Directors will approve the basic policy on fortifying internal control systems (the Basic Policy), receive regular reports on the progress of the initiative to fortify internal control systems, and oversee and monitor the internal control systems of the Company.
- e) As chief executive officer, the president and representative director will oversee the efforts to build the internal control systems based on the Basic Policy approved by board members.

(2) Fortifying structure relating to internal control systems

- a) System to ensure that the performance of duties by directors and employees conform with laws and regulations and the Company's Articles of Incorporation

We institute the NTT DOCOMO Group Code of Ethics and compliance-related regulations and create requisite systems for ethical and legal compliance. In addition, when preparing financial statements, officers responsible for finance, audit & supervisory board members, and independent auditors hold preliminary discussions of significant accounting policies, and for disclosure of company information including financial statements in a manner that conforms with securities-related laws and regulations, matters are decided at meetings of the Board of Directors after the necessary internal procedures pursuant to in-house regulations have been completed. Also, internal audit staff conducts audits of the company's overall business activities to ensure conformity with laws and regulations and in-house regulations.

- b) System for storage and maintenance of information relating to the performance of duties by directors

Information relating to the performance of duties by directors is recorded and stored in accordance with rules stipulating the methods of storage and administration of documents and administrative information.

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c) Regulations and other systems relating to the management of loss risks

Executive directors responsible for risk management periodically summarize information relating to risks in their organizations in accordance with rules concerning risk management, and the internal control committee made up of directors, senior vice presidents, and others identifies risks as necessary for companywide risk management, and decide management policy for identified risks to prevent risks from occurring and to take rapid countermeasures in the event that risks do occur.

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- d) System to ensure that the performance of duties by directors is conducted efficiently

The efficiency of the performance by directors of their duties is ensured by such means as decision-making rules based on internal regulations and the specification of powers relating to their duties, the formulation of medium-term management policies and business plans by the Board of Directors, and the establishment of committees composed of directors, senior vice presidents, and others.

- e) System to ensure the propriety of the business activities of the corporate group consisting of the Company, its parent company, and its subsidiaries

Based on rules governing fundamental matters relating to the management of our Group companies, group companies discuss important business matters with the Company or report them to the Company. In addition, officers with responsibility for corporate ethics who are appointed at subsidiaries report to the Company in a timely manner on the state of problems involving senior management, and the Company provides necessary guidance. With respect to unusual transactions with the parent company, investigations are conducted by legal personnel and audits are conducted by audit & supervisory board members. Further, audits by internal audit personnel are directed to cover its subsidiaries, and whenever necessary they obtain and assess the results of the internal audits of those companies.

- f) Matters relating to employees who assist audit & supervisory board members in the performance of their duties and the independence of those employees from the directors

The Audit & Supervisory Board Member's Office is established as an organization dedicated to assisting the audit & supervisory board members with the performance of their duties, and specialist staff are assigned to it. We provide the Audit & Supervisory Board with advance explanations concerning matters such as appointments and transfers of these personnel and their job assignments, and pay respectful attention to the board's opinions before acting on such matters.

- g) System for reporting to audit & supervisory board members by directors and employees

Directors, senior vice presidents, and employees report promptly to the audit & supervisory board members and to the Audit & Supervisory Board concerning matters prescribed by laws and regulations as well as requested matters necessary for the performance by the audit & supervisory board members of their duties.

- h) Other systems for ensuring that auditing by audit & supervisory board members is conducted effectively

Representative directors and the Audit & Supervisory Board hold regular meetings and develop an auditing environment necessary for enabling the audit & supervisory board members to perform their duties. In addition, the internal audit staff and independent auditor hold regular/occasional meetings with audit & supervisory board members respectively.

Throughout this report, amounts prepared based on domestic accounting standards are rounded down to the nearest unit. Amounts prepared in accordance with U.S. accounting standards are rounded up or down to the nearest unit.

Table of Contents**CONSOLIDATED BALANCE SHEET [U.S. GAAP]**

	Millions of yen March 31, 2014
ASSETS	
Current assets:	
Cash and cash equivalents	¥ 526,920
Short-term investments	19,561
Accounts receivable	281,509
Receivables held for sale	787,459
Credit card receivables	220,979
Other receivables	315,962
Allowance for doubtful accounts	(15,078)
Inventories	232,126
Deferred tax assets	61,592
Prepaid expenses and other current assets	95,732
Total current assets	2,526,762
Property, plant and equipment:	
Wireless telecommunications equipment	4,975,826
Buildings and structures	897,759
Tools, furniture and fixtures	553,497
Land	201,121
Construction in progress	158,173
Accumulated depreciation and amortization	(4,228,610)
Total property, plant and equipment, net	2,557,766
Non-current investments and other assets:	
Investments in affiliates	424,531
Marketable securities and other investments	171,875
Intangible assets, net	665,960
Goodwill	262,462
Other assets	629,174
Deferred tax assets	269,500
Total non-current investments and other assets	2,423,502
Total assets	¥ 7,508,030
LIABILITIES AND EQUITY	
Current liabilities:	
Current portion of long-term debt	¥ 248
Short-term borrowings	9,495
Accounts payable, trade	798,315
Accrued payroll	54,294
Accrued interest	346
Accrued income taxes	175,683
Other current liabilities	167,605
Total current liabilities	1,205,986
Long-term liabilities:	

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Long-term debt (exclusive of current portion)	220,603
Accrued liabilities for point programs	113,001
Liability for employees' retirement benefits	160,666
Other long-term liabilities	114,261
Total long-term liabilities	608,531
Total liabilities	1,814,517
Redeemable noncontrolling interests	14,869
Equity:	
NTT DOCOMO, INC. shareholders' equity	
Common stock	949,680
Additional paid-in capital	732,875
Retained earnings	4,328,389
Accumulated other comprehensive income (loss)	9,590
Treasury stock	(377,168)
Total NTT DOCOMO, INC. shareholders' equity	5,643,366
Noncontrolling interests	35,278
Total equity	5,678,644
Total liabilities and equity	¥ 7,508,030

(Note) Amounts are rounded off to the nearest 1 million yen.

Table of Contents**CONSOLIDATED STATEMENT OF INCOME [U.S.GAAP]**

	Millions of yen Year ended March 31, 2014 (April 1, 2013 - March 31, 2014)	
Operating revenues:		
Mobile communications services	¥	2,955,788
Equipment sales		872,000
Other operating revenues		633,415
Total operating revenues		4,461,203
Operating expenses:		
Cost of services (exclusive of items shown separately below)		1,059,619
Cost of equipment sold (exclusive of items shown separately below)		785,209
Depreciation and amortization		718,694
Selling, general and administrative		1,078,482
Total operating expenses		3,642,004
Operating income		819,199
Other income (expense):		
Interest expense		(1,211)
Interest income		1,680
Other, net		13,381
Total other income (expense)		13,850
Income before income taxes and equity in net income (losses) of affiliates		833,049
Income taxes:		
Current		319,683
Deferred		(11,704)
Total income taxes		307,979
Income before equity in net income (losses) of affiliates		525,070
Equity in net income (losses) of affiliates		(69,117)
Net income		455,953
Less: Net (income) loss attributable to noncontrolling interests		8,776
Net income attributable to NTT DOCOMO, INC.	¥	464,729

(Note) Amounts are rounded off to the nearest 1 million yen.

Table of Contents**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY [U.S. GAAP]**

For the Fiscal Year Ended March 31, 2014 (April 1, 2013 - March 31, 2014)

(Millions of yen)

	NTT DOCOMO, INC. shareholders' equity					Total NTT DOCOMO, INC. shareholders equity	Non controlling interests	Total equity
	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock			
Balance at March 31, 2013	¥ 949,680	¥ 732,609	¥ 4,112,466	¥ (49,112)	¥ (377,168)	¥ 5,368,475	¥ 42,090	¥ 5,410,565
Cash dividends declared to NTT DOCOMO, INC. shareholders			(248,806)			(248,806)		(248,806)
Cash distributions to noncontrolling interests							(1,032)	(1,032)
Acquisition of new subsidiaries							2,588	2,588
Changes in interest in subsidiaries		266				266		266
Others							215	215
Net income			464,729			464,729	(8,776)	455,953
Other comprehensive income (loss)				58,702		58,702	193	58,895
Balance at March 31, 2014	¥ 949,680	¥ 732,875	¥ 4,328,389	¥ 9,590	¥ (377,168)	¥ 5,643,366	¥ 35,278	¥ 5,678,644

(Note) Amounts are rounded off to the nearest 1 million yen.

Table of Contents**(Reference) CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME [U.S.GAAP]**

	Millions of yen	
	Year ended March 31,	
	2014	
	(April 1, 2013	March 31, 2014)
Net income	¥	455,953
Other comprehensive income (loss):		
Unrealized holding gains (losses) on available-for-sale securities, net of applicable taxes		8,667
Unrealized gains (losses) on cash flow hedges, net of applicable taxes		(17)
Foreign currency translation adjustment, net of applicable taxes		37,663
Pension liability adjustment, net of applicable taxes		12,582
Total other comprehensive income (loss)		58,895
Comprehensive income		514,848
Less: Comprehensive (income) loss attributable to noncontrolling interests		8,583
Comprehensive income attributable to NTT DOCOMO, INC.	¥	523,431

(Note) Amounts are rounded off to the nearest 1 million yen.

Table of Contents**(Reference) CONSOLIDATED STATEMENT OF CASH FLOWS [U.S.GAAP]**

	Millions of yen
	Year ended
	March 31, 2014
	(April 1, 2013
	March 31, 2014)
Cash flows from operating activities:	
Net income	¥ 455,953
Adjustments to reconcile net income to net cash provided by operating activities	
Depreciation and amortization	718,694
Deferred taxes	(11,704)
Loss on sale or disposal of property, plant and equipment	34,303
Impairment loss on marketable securities and other investments	3,055
Equity in net (income) losses of affiliates	69,117
Dividends from affiliates	17,415
Changes in assets and liabilities:	
(Increase) / decrease in accounts receivable	(9,269)
(Increase) / decrease receivables held for sale	(149,310)
(Increase) / decrease in credit card receivables	(13,849)
(Increase) / decrease in other receivables	(21,875)
Increase / (decrease) in allowance for doubtful accounts	(2,815)
(Increase) / decrease in inventories	(50,849)
(Increase) / decrease in prepaid expenses and other current assets	(7,661)
(Increase) / decrease in non-current receivables held for sale	(53,276)
Increase / (decrease) in accounts payable, trade	65,083
Increase / (decrease) in accrued income taxes	39,691
Increase / (decrease) in other current liabilities	(40,422)
Increase / (decrease) in accrued liabilities for point programs	(27,854)
Increase / (decrease) in liability for employees' retirement benefits	(10,732)
Increase / (decrease) in other long-term liabilities	(32,977)
Other, net	29,924
Net cash provided by operating activities	1,000,642
Cash flows from investing activities:	
Purchases of property, plant and equipment	(498,668)
Purchases of intangible and other assets	(213,508)
Purchases of non-current investments	(16,186)
Proceeds from sale of non-current investments	5,235
Acquisitions of subsidiaries, net of cash acquired	(19,213)
Purchases of short-term investments	(39,084)
Redemption of short-term investments	68,937
Proceeds from redemption of long-term bailment for consumption to a related party	10,000
Short-term bailment for consumption to a related party	(70,000)
Proceeds from redemption of short-term bailment for consumption to a related party	70,000
Other, net	(1,093)
Net cash used in investing activities	(703,580)
Cash flows from financing activities:	
Proceeds from long-term debt	50,000
Repayment of long-term debt	(74,989)
Proceeds from short-term borrowings	13,740

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Repayment of short-term borrowings	(26,132)
Principal payments under capital lease obligations	(2,128)
Dividends paid	(248,814)
Contributions from noncontrolling interests	193
Other, net	18,337
Net cash provided by (used in) financing activities	(269,793)
Effect of exchange rate changes on cash and cash equivalents	5,977
Net increase (decrease) in cash and cash equivalents	33,246
Cash and cash equivalents at beginning of year	493,674
Cash and cash equivalents at end of year	¥ 526,920
Supplemental disclosures of cash flow information:	
Cash received during the fiscal year for:	
Income tax refunds	¥ 886
Cash paid during the fiscal year for:	
Interest, net of amount capitalized	1,578
Income taxes	280,434
Non-cash investing and financing activities:	
Assets acquired through capital lease obligations	1,513

(Note) Amounts are rounded off to the nearest 1 million yen.

Table of Contents**NON-CONSOLIDATED BALANCE SHEET (As of March 31, 2014)**

(Millions of yen)

ASSETS	
Non-current assets	
Non-current assets for telecommunication businesses	
Property, plant and equipment	
Machinery and equipment	¥ 961,039
Antenna facilities	594,482
Telecommunications line facilities	33,026
Pipe and hand holes	12,847
Building	346,363
Structures	80,620
Other machinery and equipment	3,077
Vehicles	194
Tools, furniture and fixtures	98,143
Land	197,667
Lease assets	928
Construction in progress	127,812
Total property, plant and equipment	2,456,203
Intangible assets	
Rights to use utility facilities	12,629
Software	551,508
Patents	306
Leasehold rights	56,921
Lease assets	45
Other intangible assets	51,939
Total intangible assets	673,351
Total non-current assets for telecommunication businesses	3,129,555
Investments and other assets	
Investment securities	374,832
Shares of affiliated companies	377,773
Other investments in affiliated companies	40,129
Contributions in affiliated companies	5,632
Long-term loan receivable	129
Long-term loan receivable in affiliated companies	36,840
Long-term prepaid expenses	20,587
Long-term accounts receivable, other	216,289
Long-term deposits	240,000
Deferred tax assets	148,083
Other investments and other assets	87,728
Allowance for doubtful accounts	(807)
Total investments and other assets	1,547,218
Total non-current assets	4,676,773
Current assets	

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Cash and bank deposits	85,591
Notes receivable	3
Accounts receivable, trade	514,983
Accounts receivable, other	1,067,596
Securities	20,000
Inventories and supplies	245,058
Advances	7,745
Prepaid expenses	32,973
Deposits	346,911
Deferred tax assets	34,794
Other current assets	54,185
Allowance for doubtful accounts	(9,245)
Total current assets	2,400,599
Total assets	¥ 7,077,373
LIABILITIES	
Long-term liabilities	
Bonds	¥ 220,000
Lease obligations	939
Liability for employees' retirement benefits	141,251
Accrued liabilities for loyalty programs	154,774
Asset retirement obligations	3,258
Other long-term liabilities	2,244
Total long-term liabilities	522,467
Current liabilities	
Accounts payable, trade	271,163
Lease obligations	564
Accounts payable, other	528,563
Accrued expenses	12,777
Accrued income taxes	168,357
Advances received	5,643
Deposits received	61,093
Other current liabilities	34,842
Total current liabilities	1,083,006
Total liabilities	1,605,474
NET ASSETS	
Shareholders' equity	
Common stock	949,679
Capital surplus	
Capital legal reserve	292,385
Other capital surplus	393,092
Total capital surplus	685,477
Earned surplus	
Earned legal reserve	4,099
Other earned surplus	
Accelerated depreciation reserve	95
General reserve	358,000

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Earned surplus brought forward	3,807,976
Total earned surplus	4,170,172
Treasury stock	(377,167)
Total shareholders' equity	5,428,160
Valuation and translation adjustments	
Net unrealized holding gains or losses on securities	43,738
Total valuation and translation adjustments	43,738
Total net assets	5,471,898
Total liabilities and net assets	¥ 7,077,373

(Note) Amounts are rounded down to the nearest 1 million yen.

Table of Contents**NON-CONSOLIDATED STATEMENT OF INCOME**

For the Year ended March 31, 2014 (April 1, 2013- March 31, 2014)

(Millions of yen)

Recurring profits and losses			
Operating revenues and expenses			
Telecommunication businesses			
Operating revenues			
Voice transmission services	¥ 1,028,439		
Data transmission services	1,984,697		
Other	42,810	¥	3,055,947
Operating expenses			
Sales expenses	841,973		
Facility maintenance expenses	335,346		
General expenses	53,023		
Administrative expenses	62,872		
Research expenses	62,490		
Depreciation and amortization	683,638		
Loss on disposal of property, plant and equipment and intangible assets	61,778		
Communication network charges	206,175		
Taxes and public dues	40,415		2,347,713
Operating income from telecommunication businesses			708,234
Supplementary businesses			
Operating revenues			1,377,032
Operating expenses			1,232,135
Operating income (losses) from supplementary businesses			144,897
Total operating income			853,131
Non-operating revenues and expenses			
Non-operating revenues			
Interest income	1,887		
Interest income-securities	273		
Dividend income	33,723		
Rental income	5,678		
Miscellaneous income	11,887		53,449
Non-operating expenses			
Interest expense	146		
Interest expense-bonds	3,037		
Write-downs of investment securities	2,274		
Miscellaneous expenses	1,836		7,294
Recurring profit			899,287
Extraordinary Loss			
Write-downs of investment in shares of affiliated companies	82,800		82,800
Income before income taxes			816,486

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Income taxes-current	303,100
Income taxes-deferred	30,153
Net income	¥ 483,232

(Note) Amounts are rounded down to the nearest 1 million yen.

Table of Contents**NON-CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS**

For the Year ended March 31, 2014 (April 1, 2013 - March 31, 2014)

(Millions of yen)

	Common stock	Capital surplus			Shareholders equity			Total earned surplus	Treasury stock	Total shareholders equity	
		Capital legal reserve	Other capital surplus	Total capital surplus	Earned legal reserve	Accelerated depreciation reserve	Other earned surplus General reserve				
Balance at April 1, 2013	¥ 949,679	¥ 292,385	¥ 393,092	¥ 685,477	¥ 4,099	¥ 120	¥ 358,000	¥ 3,573,524	¥ 3,935,744	¥ (377,167)	¥ 5,193,733
Changes during the annual period											
Reversal of accelerated depreciation reserve						(25)		25			
Dividends from surplus								(248,805)	(248,805)		(248,805)
Net income								483,232	483,232		483,232
Net changes other than shareholders equity											
The total amount of changes during the annual period						(25)		234,452	234,427		234,427
Balance at March 31, 2014	¥ 949,679	¥ 292,385	¥ 393,092	¥ 685,477	¥ 4,099	¥ 95	¥ 358,000	¥ 3,807,976	¥ 4,170,172	¥ (377,167)	¥ 5,428,160

(Note) Amounts are rounded down to the nearest 1 million yen.

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(Millions of yen)

	Valuation and translation adjustments			
	Net unrealized holding gains or			
	losses on	Total valuation and translation	Total net assets	
	securities	adjustments		
Balance at April 1, 2013	¥ 48,736	¥ 48,736	¥	5,242,469
Changes during the annual period				
Reversal of accelerated depreciation reserve				
Dividends from surplus				(248,805)
Net income				483,232
Net changes other than shareholders' equity	(4,998)	(4,998)		(4,998)
The total amount of changes during the annual period	(4,998)	(4,998)		229,428
Balance at March 31, 2014	¥ 43,738	¥ 43,738	¥	5,471,898

(Note) Amounts are rounded down to the nearest 1 million yen.

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[English Translation of the Auditors' Report Originally Issued in the Japanese Language]

Independent Auditor's Report

May 7, 2014

The Board of Directors
NTT DOCOMO, INC.

KPMG AZSA LLC
Hiroto Kaneko (Seal)
Designated Limited Liability Partner
Engagement Partner
Certified Public Accountant
Hiroshi Miura (Seal)
Designated Limited Liability Partner
Engagement Partner
Certified Public Accountant
Kotetsu Nonaka (Seal)
Designated Limited Liability Partner
Engagement Partner
Certified Public Accountant

We have audited the consolidated financial statements, comprising the consolidated balance sheet, the consolidated statement of income, the consolidated statement of changes in equity and the related notes of NTT DOCOMO, INC. as at March 31, 2014 and for the year from April 1, 2013 to March 31, 2014 in accordance with Article 444-4 of the Companies Act.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with the second sentence of Article 120-2-1 of the Ordinance of Companies Accounting that prescribes some omissions of disclosure items required under U.S. generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audit as independent auditor. We conducted our audit in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, while the objective of the financial statement audit is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above, which were prepared in accordance with the second sentence of Article 120-2-1 of the Ordinance of Companies Accounting that prescribes some omissions of disclosure items required under U.S. generally accepted accounting principles, present fairly, in all material respects, the financial position and the results of operations of NTT DOCOMO, INC. and its consolidated subsidiaries for the period, for which the consolidated financial statements were prepared.

Other Matter

Our firm and engagement partners have no interest in the Company which should be disclosed pursuant to the provisions of the Certified Public Accountants Law of Japan.

Notes to the Reader of Independent Auditor's Report:

The Independent Auditor's Report herein is the English translation of the Independent Auditor's Report as required by the Companies Act.

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Independent Auditor s Report

May 7, 2014

The Board of Directors
NTT DOCOMO, INC.

KPMG AZSA LLC
Hiroto Kaneko (Seal)
Designated Limited Liability Partner
Engagement Partner
Certified Public Accountant
Hiroshi Miura (Seal)
Designated Limited Liability Partner
Engagement Partner
Certified Public Accountant
Kotetsu Nonaka (Seal)
Designated Limited Liability Partner
Engagement Partner
Certified Public Accountant

We have audited the non-consolidated financial statements, comprising the non-consolidated balance sheet, the non-consolidated statement of income, the non-consolidated statement of changes in net assets and the related notes, and the supplementary schedules of NTT DOCOMO, INC. as at March 31, 2014 and for the year from April 1, 2013 to March 31, 2014 in accordance with Article 436-2-1 of the Companies Act.

Management s Responsibility for the non-consolidated Financial Statements and Others

Management is responsible for the preparation and fair presentation of the non-consolidated financial statements and the supplementary schedules in accordance with accounting principles generally accepted in Japan, and for such internal control as management determines is necessary to enable the preparation of non-consolidated financial statements and the supplementary schedules that are free from material misstatements, whether due to fraud or error.

Auditor s Responsibility

Our responsibility is to express an opinion on the non-consolidated financial statements and the supplementary schedules based on our audit as independent auditor. We conducted our audit in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the non-consolidated financial statements and the supplementary schedules are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the non-consolidated financial statements and the supplementary schedules. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the non-consolidated financial statements and the supplementary schedules, whether due to fraud or error. In making those risk

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assessments, we consider internal control relevant to the entity's preparation and fair presentation of the non-consolidated financial statements and the supplementary schedules in order to design audit procedures that are appropriate in the circumstances, while the objective of the non-consolidated financial statement audit is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the non-consolidated financial statements and the supplementary schedules.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the non-consolidated financial statements and the supplementary schedules referred to above present fairly, in all material respects, the financial position and the results of operations of NTT DOCOMO, INC. for the period, for which the non-consolidated financial statements and the supplementary schedules were prepared, in accordance with accounting principles generally accepted in Japan.

Other Matter

Our firm and engagement partners have no interest in the Company which should be disclosed pursuant to the provisions of the Certified Public Accountants Law of Japan.

Notes to the Reader of Independent Auditor's Report:

The Independent Auditor's Report herein is the English translation of the Independent Auditor's Report as required by the Companies Act.

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[English Translation]

Audit Report of Audit & Supervisory Board

Based on audit reports from each audit & supervisory board member, and following due discussion at meetings, the Audit & Supervisory Board has prepared this audit report regarding the execution of the duties of the Board of Directors in the 23rd fiscal year from April 1, 2013 to March 31, 2014. The Board reports as follows.

1. Outline of Audit Methodology

The Audit & Supervisory Board established an auditing plan and received reports from each audit & supervisory board member on the status of the implementation of audits and the results thereof, as well as reports from the Board of Directors and the Independent Auditors regarding the status of execution of their duties, and requested explanations as necessary.

Also, on the basis of the Audit & Supervisory Board Rules established by the Audit & Supervisory Board, and in accordance with its auditing plan, the audit & supervisory board members sought mutual understanding with the Directors, the internal auditing department, other employees and the Independent Auditors in their efforts to collect information, and carried out the audit as follows:

- (1) attended meetings of the Board of Directors and other important meetings, and received reports from Directors and employees regarding performance of their duties, requested explanations as necessary, perused important documents regarding decisions and approvals made and investigated the status of operations and the financial position at the company's head office and major offices of business;
- (2) carried out an audit and verification of the particulars of Board of Directors resolutions relating to the establishment of structures necessary to ensure that the Board of Directors' performance of its duties is in conformity with laws and regulations and the Company's Articles of Incorporation and to otherwise ensure the appropriateness of the business of a *kabushiki kaisha*, as well as the structures established pursuant to such resolutions (internal control system);
- (3) regarding the subsidiaries, the Audit & Supervisory Board sought to achieve a mutual understanding and exchange of information with directors and other persons and audit & supervisory board members of the subsidiaries, and, where necessary, received business reports from the subsidiaries; and
- (4) audited and verified whether the Independent Auditors maintained their independence and carried out their audits appropriately, received reports from the Independent Auditors regarding the execution of their duties and, where necessary, requested explanations. Also, the Audit & Supervisory Board received notification from the Independent Auditors to the effect that the structure to ensure that duties are executed appropriately has been established and requested explanations as necessary.

Based on the above methodology, the Audit & Supervisory Board evaluated business reports, supplementary schedules, the non-consolidated financial statements related to the fiscal year ended March 31, 2014 (the non-consolidated balance sheet, the non-consolidated statement of income, the non-consolidated statement of changes in net assets, and the related notes), and the supplementary schedules as well as the consolidated financial statements (the consolidated balance sheet, the consolidated statement of income, the consolidated statement of changes in equity and the related notes).

2. Audit Results

- (1) Results of the audit of the Business Report

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- i. We find that the Business Report and its supplementary schedules accurately reflect the conditions of the company in accordance with laws and regulations and the Articles of Incorporation.
- ii. No inappropriate conduct concerning the execution of duties by Directors or material facts in violation of law or the Articles of Incorporation were found.
- iii. We find that the particulars of Board of Directors resolutions concerning the internal control systems are appropriate. Further, no matters requiring note on our part were found with respect to Directors execution of duties in regards to the internal control system.

(2) Results of the audit of performance of the duties by the Independent Auditors
No matters requiring note on our part were found with respect to the structure for ensuring the proper execution of duties by the Independent Auditor, KPMG AZSA LLC.

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(3) Results of the audit of the non-consolidated financial statements, supplementary schedules and the consolidated financial statements
We find that the methodology and results of the audit by the Independent Auditor, KPMG AZSA LLC, are appropriate.

May 9, 2014

Audit & Supervisory Board Members of NTT DOCOMO, INC.

Takanori Utano, Full-time Audit & Supervisory Board Member seal

Kenji Ota, Full-time Audit & Supervisory Board Member seal

Haruo Morosawa, Full-time Audit & Supervisory Board Member seal

Naoto Shiotsuka, Full-time Audit & Supervisory Board Member seal

Eiko Tsujiyama, Audit & Supervisory Board Member seal

Note: Full-time audit & supervisory board members, Mr. Haruo Morosawa and Mr. Naoto Shiotsuka and audit & supervisory board member, Ms. Eiko Tsujiyama are outside audit & supervisory board members as provided in Article 2, Item 16 of the Companies Act.

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Companies listed on the NYSE must comply with certain standards regarding corporate governance under Section 303A of the NYSE Listed Company Manual. However, listed companies that are foreign private issuers, such as the Company, are permitted to follow home country practice in lieu of certain provisions of Section 303A.

We have posted on our corporate website the significant differences between the corporate governance practices followed by NYSE-listed U.S. companies under Section 303A of the NYSE Listed Company Manual and those followed by the Company (<https://www.nttdocomo.co.jp/english/corporate/ir/management/governance/nyse.html>).

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=> Director and Chairman of the Board of Directors

Richard W. Dugan(2)

64 Director

Brian K. Halak, Ph.D.(2),(3)

35 Director

H. Thomas Watkins(1),(3)

54 Director

David Ramsay(2)

43 Director

James B. Tananbaum, M.D.(1)

43 Director

(1) Member of compensation committee.

(2) Member of audit committee.

(3) Member of nominating/governance Committee.

Mihael H. Polymeropoulos, M.D. has served as Chief Executive Officer and a Director of Vanda since May of 2003. Prior to joining Vanda, Dr. Polymeropoulos was Vice President and Head of the Pharmacogenetics Department at Novartis from 1998 to 2003. Prior to his tenure at Novartis, he served as Chief of the Gene Mapping Section, Laboratory of Genetic Disease Research, National Human Genome Research Institute, from 1992 to 1998. Dr. Polymeropoulos is the co-founder of the Integrated Molecular Analysis of Genome Expression (IMAGE) Consortium. Dr. Polymeropoulos holds a degree in Medicine from the University of Patras.

Paolo Baroldi, M.D., Ph.D. has served as a Senior Vice President and Chief Medical Officer at Vanda since July 2006. Prior to joining Vanda, Dr. Baroldi served as Vice President – Corporate Drug Development at Chiesi Farmaceutici SpA, in Parma, Italy, from 2003 to 2006. Prior to his tenure at Chiesi, Dr. Baroldi was the Global Head of Clinical Pharmacology at Novartis AG from 1998 to 2002. Dr. Baroldi holds degrees in Medicine and Surgery and a Ph.D. in Clinical Pharmacology from the University of Milan, and an Executive Masters in Business Administration from Harvard University.

William D. Chip Clark has served as Senior Vice President and Chief Business Officer of Vanda since September of 2004 and served as a Director of Vanda from 2003 to 2004. Prior to joining Vanda, Mr. Clark was a Principal at Care Capital, LLC, a venture capital firm investing in biopharmaceutical companies, from 2000 to 2004. Prior to his tenure at Care Capital, he served in a variety of commercial roles at SmithKline Beecham (now part of GlaxoSmithKline), from 1990 to 2000. Mr. Clark holds a B.A. from Harvard University and an M.B.A. from The

Wharton School at the University of Pennsylvania.

Steven A. Shallcross has served as Senior Vice President, Chief Financial Officer and Treasurer of Vanda since November of 2005. From October 2001 to November 2005, Mr. Shallcross was the Senior Vice President, Chief Financial Officer and Treasurer at Advancis Pharmaceutical Corporation, a specialty pharmaceutical company. Mr. Shallcross was the Vice President of Finance and Chief Financial Officer at Bering Truck Corporation, a truck manufacturer, from 1997 to 2001. From 1994 to 1997, Mr. Shallcross served as Vice President of Operations at Precision Scientific, Inc., a manufacturer of scientific laboratory equipment. He was the Controller of Precision Scientific from 1993 to 1994. Mr. Shallcross has over 20 years of senior financial and operations experience in emerging organizations, including acquisitions and restructurings. Mr. Shallcross received a bachelor's degree in accounting from the University of Illinois and an M.B.A. from the University of Chicago, Graduate School of Business. Mr. Shallcross is also a certified public accountant.

Thomas Copmann, Ph.D. has served as Vice President of Regulatory Affairs at Vanda since April of 2005. Prior to joining Vanda, Dr. Copmann served as Senior Director of Regulatory Affairs at Eli Lilly, from 2000 to 2005 and as a Director from 1995 to 2000. Prior to his tenure at Eli Lilly, Dr. Copmann was the Associate Vice President for Regulatory Affairs and Executive Director for the Commission on Drugs for Rare Diseases at the Pharmaceutical Manufacturers Association, from 1989 to 1995. Dr. Copmann holds an M.S. in Endocrinology and a Ph.D. in Physiology from Kent State University.

Deepak Phadke, Ph.D. has served as Vice President of Manufacturing at Vanda since August of 2005. Prior to joining Vanda, Dr. Phadke served as Executive Director of Pharmaceutical Sciences at Beckloff Associates, a pharmaceutical research and development consulting company located in the Kansas City area, from 1998 to 2005. Prior to his tenure at Beckloff Associates, Dr. Phadke served as a manager and research scientist in the formulation development departments at Hoechst Marion Roussel and its predecessor companies in Kansas City and Indianapolis, from 1986 to 1998. Dr. Phadke also worked as a senior pharmaceutical chemist at Rorer Group Inc. in Fort Washington, Pennsylvania from 1983 to 1986. Dr. Phadke holds a B.S. and an M.S. in Pharmacy and Pharmaceutics, respectively, from Nagpur University in India, and a Ph.D. in Pharmaceutics from Rutgers University.

Argeris N. Karabelas, Ph.D. has served as a Director and Chairman of the Board since 2003, when he co-founded Vanda with Dr. Polymeropoulos. Dr. Karabelas has served as a Partner of Care Capital, LLC since 2001. Prior to his tenure at Care Capital, Dr. Karabelas was the Founder and Chairman of the Novartis BioVenture Fund, from July 2000 to December 2001. From 1998 to 2000, he served as Head of Healthcare and CEO of Worldwide Pharmaceuticals for Novartis. Prior to joining Novartis, Dr. Karabelas was Executive Vice President of SmithKline Beecham responsible for U.S. operations, European operations, Regulatory, and Strategic Marketing, from 1981 to 1998. He is a member of the Scientific Advisory Council of the Massachusetts General Hospital, the Harvard-MIT Health Science and Technology Visiting Committee, Chairman of Human Genome Sciences, Inc., Chairman and interim Chief Executive Officer of NitroMed, Inc., Chairman of SkyePharma plc, Chairman of Inotek, Inc., a director of Renovo, plc and a Trustee of Fox Chase Cancer Center and the Philadelphia University of the Sciences. Dr. Karabelas holds a Ph.D. in Pharmacokinetics from the Massachusetts College of Pharmacy.

Richard W. Dugan has served as a Director of Vanda since December of 2005. From 1976 to September 2002, Mr. Dugan served as a Partner with Ernst & Young, LLP, where he served in a variety of managing and senior partner positions, including Mid-Atlantic Area Senior Partner from 2001 to 2002, Mid-Atlantic Area Managing Partner from 1989 to 2001 and Pittsburgh Office Managing Partner from 1979 to 1989. Mr. Dugan retired from Ernst & Young, LLP in September 2002. Mr. Dugan currently serves on the board of directors of two other publicly-

traded pharmaceutical companies, Advancis Pharmaceutical Corporation and Critical Therapeutics, Inc. and on the board of directors of a privately-owned pharmaceutical company, Xanthus Pharmaceuticals, Inc. Mr. Dugan holds a B.S.B.A. from Pennsylvania State University.

Brian K. Halak, Ph.D. has served as a Director of Vanda since 2004. Dr. Halak has served as a Principal at Domain Associates, a venture capital firm based in Princeton, New Jersey, since 2001 and became a Partner in January 2006. Prior to joining Domain Associates, he served as an Associate of the venture capital firm Advanced Technology Ventures, from 2000 to 2001. Dr. Halak serves on the Investment Advisory Council for Ben Franklin Technology Partners and BioAdvance, both seed stage investment groups in Philadelphia. Dr. Halak holds a B.S.E. from the University of Pennsylvania and a Ph.D. in Immunology from Thomas Jefferson University.

H. Thomas Watkins has served as a Director of Vanda since September 2006. Mr. Watkins has served as the President and Chief Executive Officer of Human Genome Sciences, Inc. and as a member of its board of directors since 2004. Prior to his tenure at Human Genome Sciences Inc., Mr. Watkins served as President of TAP Pharmaceutical Products, Inc. Mr. Watkins previously held a series of executive positions over the course of nearly twenty years with Abbott Laboratories. Mr. Watkins also serves on the Board of Trustees of the College of William and Mary Foundation, and is a member of the College of William and Mary Mason School of Business Foundation. He holds a bachelor's degree from the College of William and Mary, and a master's degree in business administration from the University of Chicago Graduate School of Business.

David Ramsay has served as a Director of Vanda since 2004. Mr. Ramsay has served as a Partner of Care Capital, LLC, which he co-founded in 2000. Prior to founding Care Capital, Mr. Ramsay served as a Managing Director of the Rhône Group, LLC, from 1997 to 2000 and co-founded Rhône Capital, LLC, a private equity investment fund. Mr. Ramsay previously worked at Morgan Stanley Capital Partners. Mr. Ramsay holds an A.B. in Mathematics from Princeton University and an M.B.A. from the Stanford University Graduate School of Business.

James B. Tananbaum, M.D. has served as a Director of Vanda since 2004. Dr. Tananbaum has served as a Managing Partner of Prospect Venture Partners II, a dedicated life science venture fund group which he co-founded in 2000. Prior to co-founding Prospect Venture Partners, he co-founded and served as Chief Executive Officer of Theravance, Inc. from 1997 to 2000. Dr. Tananbaum also served as a Partner at Sierra Ventures, from 1993 to 1997. Dr. Tananbaum co-founded GelTex Pharmaceuticals, Inc. in 1991. He is an officer of the Young Presidents Organization, Golden Gate Chapter and a member of the World Economic Forum and the Harvard-MIT Health Science and Technology Visiting Committee. Dr. Tananbaum serves as a director of numerous public and private healthcare companies, including Cogentus Pharmaceuticals, Inc., Jazz Pharmaceuticals, Inc., PathWorks, Inc. and Novavax, Inc. Dr. Tananbaum holds a bachelor's degree and a B.S.E.E. from Yale University and an M.D. and an M.B.A. from Harvard University.

Election of officers

Our officers are elected by our board of directors on an annual basis and serve until their successors are duly elected and qualified. There are no family relationships among any of our officers or directors.

Board composition

Our amended and restated certificate of incorporation provides for a classified board of directors consisting of three classes of directors, each serving a staggered three-year term. As a result, a portion of our board of directors are elected each year. Dr. Tananbaum and Messrs. Ramsay and Watkins have been designated Class I directors whose term will expire at

the 2007 annual meeting of stockholders. Dr. Halak and Mr. Dugan have been designated Class II directors whose term will expire at the 2008 annual meeting of stockholders. Drs. Polymeropoulos and Karabelas have been designated Class III directors whose term expires at the 2009 annual meeting of stockholders. Our amended and restated bylaws provide that the number of authorized directors may be changed only by resolution of a number of directors that is more than half of the number of directors then authorized (including any vacancies). Any additional directorships resulting from an increase in the number of authorized directors will be distributed among the three classes so that, as nearly as reasonably possible, each class will consist of one-third of the directors. The classification of the board of directors may have the effect of delaying or preventing changes in control of our company.

We believe that each of our board members other than Dr. Polymeropoulos is an independent director under Nasdaq Marketplace Rule 4200(a)(15).

Committees of the board of directors

Our board of directors has a compensation committee, an audit committee and a nominating/corporate governance committee.

Compensation committee. Three directors comprise the compensation committee of the board of directors: Argeris N. Karabelas, Ph.D., James B. Tananbaum, M.D. and H. Thomas Watkins. Dr. Karabelas chairs the compensation committee.

The compensation committee reviews and makes recommendations to the board of directors regarding the overall compensation strategy and policies for the Company. Specifically, the committee reviews and makes recommendations to the board of directors regarding corporate performance goals and objectives relevant to the compensation of our executive officers and other senior management; reviews and makes recommendations to the board of directors regarding the compensation and other terms of employment of our Chief Executive Officer and other executive officers; reviews and makes recommendations to the board of directors regarding the individual bonus programs in effect for the Chief Executive Officer, other executive officers and key employees for each fiscal year; recommends to the board of directors the compensation of the directors; recommends to the board of directors the adoption or amendment of equity and cash incentive plans; recommends to the board of directors amendments to such plans; grants (subject to the ratification of the full board of directors in the case of the Company's executives) stock options and other stock-related awards; and administers our Second Amended and Restated Management Plan and 2006 Equity Incentive Plan. A more detailed description of the committee's functions can be found in our compensation committee charter. The charter is published in the corporate governance section of our website at www.vandapharma.com.

The compensation committee met five times during the fiscal year. The Chief Executive Officer does not participate in the determination of his own compensation or the compensation of directors. However, he makes recommendations to the committee regarding the amount and form of the compensation of the other executive officers and key employees, and he often participates in the committee's deliberations about their compensation. No other executive officers participate in the determination of the amount or form of the compensation of executive officers or directors.

The compensation committee retained Towers Perrin as its independent compensation consultant for a compensation review in November 2006. The consultant served at the pleasure of the committee, and the consultant's fees were approved by the committee. The consultant provided the committee with a report regarding the compensation paid by the Company's competitors

and other employers who compete with the Company for executives. The Towers Perrin report is described below in Executive compensation benchmarking of base compensation and equity holdings.

Audit committee. The members of our audit committee are Messrs. Dugan and Ramsay and Dr. Halak. Mr. Dugan chairs the audit committee. Mr. Dugan serves as our audit committee financial expert and is an independent director under applicable SEC and Nasdaq rules. Our audit committee, among other duties:

appoints a firm to serve as independent accountant to audit our financial statements

discusses the scope and results of the audit with the independent accountant, and reviews with management and the independent accountant our interim and year-end operating results

considers the adequacy of our internal accounting controls and audit procedures

approves (or, as permitted, pre-approves) all audit and non-audit services to be performed by the independent accountant

The audit committee has the sole and direct responsibility for appointing, evaluating and retaining our independent auditors and for overseeing their work. All audit services and all non-audit services, other than de minimis non-audit services, to be provided to us by our independent auditors must be approved in advance by our audit committee. A more detailed description of the audit committee's responsibilities can be found in our audit committee charter. The charter is published in the corporate governance section of our website at www.vandapharma.com. We believe that the composition of our audit committee meets the requirements for independence under the current Nasdaq Global Market and SEC rules and regulations.

Nominating/corporate governance committee. The members of our nominating/corporate governance committee are Drs. Halak and Karabelas and Mr. Watkins. Dr. Halak chairs the nominating/corporate governance committee. Our nominating/corporate governance committee identifies, evaluates and recommends nominees to our board of directors and committees of our board of directors, conducts searches for appropriate directors, and evaluates the performance of our board of directors and of individual directors. The nominating/corporate governance committee is also responsible for reviewing developments in corporate governance practices, evaluating the adequacy of our corporate governance practices and reporting and making recommendations to the board of directors concerning corporate governance matters. A more detailed description of the nominating/corporate governance committee's responsibilities can be found in our nominating/corporate governance charter. The charter is published in the corporate governance section of our website, www.vandapharma.com.

Compensation committee interlocks and insider participation

None of the members of the compensation committee was at any time during the 2006 fiscal year an officer or employee of the Company. No executive officer of the Company serves as a member of the board of directors or compensation committee of any other entity that has one or more executive officers serving as a member of our board of directors or compensation committee.

Director compensation

On December 19, 2005, our board of directors adopted a compensation program for outside directors. Pursuant to this program, each member of our board of directors who is not our employee receives a \$25,000 annual fee as well as \$2,500 for each board meeting attended in

person (\$1,250 for meetings attended by telephone conference). The chairman of the board of directors receives an additional annual fee of \$10,000, and the chairman of each committee of the board of directors receives an additional annual fee of \$2,000. Each director receives \$1,000 for each meeting of any committee of the board of directors attended in person or by telephone conference.

Under the director compensation program adopted on December 19, 2005, each member of our board of directors who is not our employee and who is elected after December 19, 2005 initially receives a nonstatutory option to purchase 35,000 shares of our common stock upon election, and each member of our board of directors who is not our employee will also receive, upon the conclusion of each annual meeting of our stockholders, an option to purchase 15,000 shares of our common stock. The stock option granted upon election vests and becomes exercisable in equal monthly installments over a period of four years from the date of the grant, except that in the event of a change of control the option will accelerate and become immediately exercisable. Each annual stock option vests and becomes exercisable in equal monthly installments over a period of one year from the date of grant, except that in the event of a change of control the option will accelerate and become immediately exercisable. All of these options have an exercise price equal to the fair market value of our common stock on the date of the grant. In cases where a director is serving as such on behalf of an entity, we may issue a warrant directly to such entity as consideration for the services provided in lieu of granting an option to the director himself.

The following table shows the compensation earned by each of our non-officer directors for the year ended December 31, 2006:

Name and principal position	Fees earned or		Option awards\$(4)	Total(\$)
	paid in cash(\$)			
Argeris N. Karabelas, Ph.D. (Chairman)(1)	\$ 56,750			\$ 56,750
Richard W. Dugan	\$ 52,500	\$	37,622(5)	\$ 90,122
Brian K. Halak, Ph.D.(1)	\$ 58,250			\$ 58,250
Wayne T. Hockmeyer, Ph.D.(1)(2)	\$ 37,750			\$ 37,750
David A. Ramsay(1)	\$ 51,500			\$ 51,500
James B. Tananbaum, M.D.(1)	\$ 43,500			\$ 43,500
H. Thomas Watkins(3)	\$ 27,417	\$	34,166(6)	\$ 61,583

(1) Fees earned by Dr. Karabelas, Dr. Halak, Dr. Hockmeyer, Mr. Ramsay and Dr. Tananbaum were paid to the management companies of the venture capital funds affiliated with these directors.

(2) Dr. Hockmeyer resigned from our board of directors effective September 12, 2006.

(3) Mr. Watkins was appointed to our board of directors effective September 12, 2006.

(4) This column reflects the compensation cost for the year ended December 31, 2006 of each director's options, calculated in accordance with SFAS 123(R) and using a Black-Scholes valuation model. See note 4 of Notes to condensed consolidated financial statements for a discussion of assumptions made by the Company in determining the grant date fair value and compensation costs of our equity awards.

(5)

As of December 31, 2006, Mr. Dugan held options to purchase an aggregate of 10,571 shares of our common stock, 2,642 shares of which were vested as of December 31, 2006.

- (6) As of December 31, 2006, Mr. Watkins held options to purchase an aggregate of 35,000 shares of our common stock, 2,916 shares of which were vested as of December 31, 2006.

Executive compensation

Compensation discussion and analysis

This section discusses the principles underlying our executive compensation decisions and the most important factors relevant to an analysis of these decisions. It provides qualitative

information regarding the manner and context in which compensation is awarded to and earned by our executive officers and places in perspective the data presented in the tables and other quantitative information that follows this section.

Our compensation of executives is designed to attract, as needed, individuals with the skills necessary for us to achieve our business plan, to reward those individuals fairly over time, and to retain those individuals who continue to perform at or above our expectations. Our executives' compensation has three primary components: salary, a yearly cash incentive bonus, and stock option awards. In addition, we provide our executives with benefits that are generally available to our salaried employees. We fix the base salary of each of our executives at a level we believe enables us to hire and retain individuals in a competitive environment and rewards satisfactory individual performance and a satisfactory level of contribution to our overall business goals. We also take into account the base salaries paid by similarly situated companies in the field of biotechnology and the base salaries of other private and public companies with which we believe we compete for talent. To this end, we subscribe to certain executive compensation surveys and other databases and review them periodically and when making a crucial executive hiring decision and annually when we review executive compensation. We designed the cash incentive bonuses for each of our executives to focus them on achieving key clinical, operational and/or financial objectives within a yearly time horizon, as described in more detail below. We use stock options to reward long-term performance; these options are intended to produce significant value for each executive if the Company's performance is outstanding and if the executive has an extended tenure.

We view the three components of our executive compensation as related but distinct. Although our compensation committee does review total compensation, we do not believe that significant compensation derived from one component of compensation should negate or reduce compensation from other components. We determine the appropriate level for each compensation component based in part, but not exclusively, on our view of internal equity and consistency, individual performance and other information we deem relevant, such as the survey data referred to above. We believe that, as is common in the biotechnology sector, stock option awards are the primary motivator in attracting and retaining executives, and that salary and cash incentive bonuses are secondary considerations. Except as described below, our compensation committee has not adopted any formal or informal policies or guidelines for allocating compensation between long-term and currently paid out compensation, between cash and non-cash compensation, or among different forms of compensation. This is due to the small size of our executive team and the need to tailor each executive's award to attract and retain that executive.

Our compensation committee's current intent is to perform annually a strategic review of our executive officers' cash compensation and share and option holdings to determine whether they provide adequate incentives and motivation to our executive officers and whether they adequately compensate our executive officers relative to comparable officers in other companies. Our compensation committee's most recent review occurred in November 2006, and utilized a report from Towers Perrin, a well-known consulting firm specializing in executive compensation. This review is described in more detail below. Compensation committee meetings typically have included, for all or a portion of each meeting, not only the committee members but also our President and Chief Executive Officer, our Chief Business Officer and our Chief Financial Officer. For compensation decisions, including decisions regarding the grant of equity compensation relating to executive officers (other than our President and Chief Executive Officer), the compensation committee typically considers the recommendations of our President and Chief Executive Officer.

We account for the equity compensation expense for our employees under the rules of SFAS 123R, which requires us to estimate and record an expense for each award of equity compensation over the service period of the award. Accounting rules also require us to record cash compensation as an expense at the time the obligation is accrued. Until we achieve sustained profitability, the availability to us of a tax deduction for compensation expense is not material to our financial position. We structure cash incentive bonus compensation so that it is taxable to our employees at the time it becomes available to them. It is not anticipated that any executive officer's annual cash compensation will exceed \$1 million, and the Company has accordingly not made any plans to qualify for any compensation deductions under Section 162(m) of the Internal Revenue Code.

Benchmarking of base compensation and equity holdings

At its November 2006 meeting, our compensation committee determined that our respective executive officers' salaries, cash incentive bonuses and equity holdings were at or near the median of executives with similar roles at comparable pre-public and recently public companies and that no material changes should be made to the compensation levels of our executive officers until our annual executive performance reviews are conducted early in the first quarter of 2007, other than the grant of additional options made in December 2006 to Drs. Baroldi, Copmann and Phadke reflected in the Grants of plan-based awards table below. This median was derived based on a report we obtained from Towers Perrin. The report compared our executive compensation with that of 22 comparable companies, including Myogen, Inc., New River Pharmaceuticals Inc., Keryx Biopharmaceuticals, Inc., Idenix Pharmaceuticals, Inc., AtheroGenics, Inc., CV Therapeutics, Inc., Xenon Port, Inc., Renovis, Inc., Santarus, Inc., Dendreon Corporation, Osiris Therapeutics, Inc., Coley Pharmaceutical Group, Inc., Somaxon Pharmaceuticals, Inc., Inspire Pharmaceuticals, Inc., Tercica, Inc., CoTherix, Inc., Barrier Therapeutics, Inc., Insmmed Incorporated, Dynavax Technologies Corporation, ISTA Pharmaceuticals, Inc., Acorda Therapeutics, Inc. and DOV Pharmaceutical, Inc., analyzing various factors such as geography, employee headcount, research and development expenses, capitalization, product candidate pipeline, and therapeutic focus. Our compensation committee realizes that benchmarking the Company's compensation against the compensation earned at comparable companies may not always be appropriate, but believes that engaging in a comparative analysis of the Company's compensation practices is useful at this point in the life cycle of the Company. In instances where an executive officer is uniquely key to our success, the compensation committee may provide compensation above the median referred to above. The committee's choice not to recommend to the board of directors immediate material changes to the compensation levels following its review of the Towers Perrin report reflects our consideration of stockholders' interests in paying what is necessary, but not significantly more than necessary, to achieve our corporate goals while conserving cash and equity as much as is practicable. We believe that, given the industry in which we operate and the corporate culture we have created, our compensation levels are generally sufficient to retain our existing executive officers and to hire new executive officers when and as required.

Equity compensation

All option grants made prior to our initial public offering on April 12, 2006 were made at what our board of directors determined to be the fair market value of our common stock on the respective grant dates. Beginning in the fourth quarter of 2005 our board of directors analyzed these grants for the years ended December 31, 2004 and December 31, 2005 retrospectively. As a result of this retrospective analysis, we determined that the fair value of our common stock on a fully-diluted basis steadily increased from \$3.21 per share at March 31, 2004 to \$17.18 per share

at December 31, 2005, even though our options were granted between the range of \$0.33 to \$4.73 per share on those dates. For more information on this retrospective analysis, please see the section of this prospectus entitled

Management's discussion and analysis of financial condition and results of operations - Stock-based compensation. Since our initial public offering on April 12, 2006 we have made option grants based on the closing market value of our stock as reported on The Nasdaq Global Market on the date of grant. The value of the shares subject to our 2006 option grants to executive officers is reflected in the Summary compensation table and Grants of plan-based awards tables below.

We do not have any program, plan or obligation that requires us to grant equity compensation to any executive on specified dates. The authority to make equity grants to executive officers rests with our compensation committee (subject to ratification by the full board of directors), although, as noted above, the compensation committee does consider the recommendations of its President and Chief Executive Officer in setting the compensation of our other executives. All of our option grants made prior to our initial public offering, including all grants to executives, were made under our Second Amended and Restated Management Equity Plan. All of our option grants since our initial public offering have been made under our 2006 Equity Incentive Plan.

Cash incentive bonuses

Yearly cash incentive bonuses for our executives are established as part of their respective individual employment agreements. Each of these employment agreements provides that the executive will receive a cash incentive bonus determined in the discretion of our board of directors, with a target bonus amount specified for that executive based on individualized objective and subjective criteria. These criteria are established by the compensation committee and approved by the full board of directors on an annual basis, and include specific objectives relating to the achievement of clinical, regulatory, business and/or financial milestones. The target cash incentive bonus amount for each of our executives is as follows:

Mihael H. Polymeropoulos, M.D., President and Chief Executive Officer: 40% of base salary

Paolo Baroldi, M.D., Ph.D., Senior Vice President and Chief Medical Officer: 25% of base salary

William D. Chip Clark, Senior Vice President and Chief Business Officer: 25% of base salary

Steven A. Shallcross, Senior Vice president and Chief Financial Officer: 25% of base salary

Thomas Copmann, Ph.D., Vice President of Regulatory Affairs: 28% of base salary

Deepak Phadke, Vice President of Manufacturing: 15% of base salary

The compensation committee has not yet reviewed the extent to which our executive officers have met the individualized performance criteria established by the committee for the year ended December 31, 2006. Accordingly, the compensation committee has not determined the cash incentive bonus amounts that should be earned by our executive officers for the year ended December 31, 2006. These amounts will be determined and paid early in the first quarter of 2007. Given that the Company has not yet generated revenues, the compensation committee has not considered whether the Company would attempt to recover cash incentive bonuses to the extent that they were paid based on our financial performance and our quarterly revenue or net income is restated in a downward direction.

Severance and change in control benefits

Each of our executives has a provision in his employment agreement providing for certain severance benefits in the event of termination without cause, as well as a provision providing for the acceleration of his then unvested options in the event of termination without cause

following a change in control of the Company. These severance and acceleration provisions are described in the Employment Agreements section below, and certain estimates of these change of control benefits are provided in Estimated payments and benefits upon termination below.

Other benefits

Our executives are eligible to participate in all of our employee benefit plans, such as medical, dental, vision, group life and disability insurance and our 401(k) plan, in each case on the same basis as our other employees. There were no special benefits or perquisites provided to any executive officer in 2006.

Summary compensation table

The following table sets forth all of the compensation awarded to, earned by, or paid to the Company's principal executive officer, principal financial officer and the four other highest paid executive officers (our named executive officers) for the year ended December 31, 2006:

Name and principal position	Year	Salary (\$)	Bonus (\$)(1)	All other		Total (\$)(1)
				Option awards (\$)	Compensation (\$)	
Mihael H. Polymeropoulos, M.D. President and Chief Executive Officer	2006	\$ 375,533		\$ 2,976,966(3)	\$ 6,582(5)	\$ 3,359,081
Paolo Baroldi, M.D., Ph.D. Senior Vice President and Chief Medical Officer(2)	2006	\$ 122,917	\$ 30,000	\$ 103,197(3)	\$ 63,619(6)	\$ 319,732
William D. Chip Clark Senior Vice President, Chief Business Officer and Secretary	2006	\$ 235,971		\$ 1,493,222(3)	\$ 3,039(5)	\$ 1,732,232
Steven A. Shallcross Senior Vice President, Chief Financial Officer and Treasurer	2006	\$ 250,000		\$ 585,619(3)	\$ 6,600(5)	\$ 842,219
Thomas Copmann, Ph.D. Vice President of Regulatory Affairs	2006	\$ 207,333		\$ 135,860(4)	\$ 6,600(5)	\$ 349,793
Deepak Phadke, Ph.D. Vice President of Manufacturing	2006	\$ 176,233	\$ 10,000	\$ 115,835(3)	\$ 4,800(5)	\$ 306,868

(1) Bonus and total amounts do not include 2006 cash incentive bonuses accrued in 2006 pursuant to our named executive officers' employment agreements, as described in Compensation discussion and analysis Cash incentive bonuses above. These amounts will be determined and paid early in the first quarter of 2007. The target amounts of these cash incentive bonuses are set forth as target estimated future payouts under Non-equity incentive plan awards in the Grants of plan based awards table below.

(2) Dr. Baroldi joined the Company in July 2006.

- (3) Amount reflects the compensation cost for the year ended December 31, 2006 of the named executive officer's options, calculated in accordance with SFAS 123(R) and using a Black-Scholes valuation model. See note 4 of Notes to condensed consolidated financial statements for a discussion of assumptions made by the Company in determining the grant date fair value and compensation costs of our equity awards.
- (4) Amount reflects the aggregate compensation cost for the year ended December 31, 2006 of Dr. Copmann's options and also 5,665 shares of restricted stock which were issued upon the early exercise of an option owned by Dr. Copmann and which vested to him during the year ended December 31, 2006, in each case calculated in accordance with SFAS 123(R) and using a Black-Scholes valuation model. See note 4 of Notes to condensed consolidated financial statements for a discussion of assumptions made by the Company in determining the grant date fair value and compensation costs of our equity awards.
- (5) Includes matching contributions made by the Company to executives' respective 401(k) plan contributions.
- (6) Includes \$938 in matching contributions made by the Company to Dr. Baroldi's 401(k) plan contributions, \$49,934 in relocation expenses paid by the Company, and \$12,747 in tax costs paid by the Company relating to such relocation expenses.

Employment agreements

We have entered into offer letters or employment agreements with each of Mihael H. Polymeropoulos, M.D., our Chief Executive Officer, Paolo Baroldi, M.D., Ph.D., our Chief Medical Officer,

William D. Chip Clark, our Chief Business Officer, Steven A. Shallcross, our Chief Financial Officer, Thomas Copmann, our Vice President of Regulatory Affairs, and Deepak Phadke, our Vice President of Manufacturing.

Mihael Polymeropoulos, M.D. We entered into an employment agreement in February 2005 with Dr. Polymeropoulos, our President and Chief Executive Officer, which provides for an annual base salary of not less than \$362,250 and the possibility of an annual target cash incentive bonus amount equal to 40% of his annual base salary upon achievement of certain performance goals. If Dr. Polymeropoulos' employment is terminated without cause, he becomes permanently disabled, or he terminates his employment for good reason, he will receive the following severance benefits following his employment termination: (a) a cash payment of his monthly base salary for 12 months; (b) payment of his monthly COBRA health insurance premiums; and (c) a bonus in an amount determined as follows: (i) if he is terminated prior to the first anniversary of this agreement, a pro-rata portion of the anticipated first-year target cash incentive bonus will be given to him; (ii) if he is terminated on or following the first anniversary and prior to the third, the amount will equal the greater of the most recent target cash incentive bonus or the average target cash incentive bonuses awarded for the prior years; or (iii) if he is terminated on or following the third anniversary, the amount will be equal to the greater of the most recent target cash incentive bonus or the average target cash incentive bonus awarded for the prior three years. In addition, if, following a change in control, Dr. Polymeropoulos is terminated without cause, or he terminates his employment for good reason, he will become vested in 100% of his then unvested shares and options.

Paolo Baroldi, M.D., Ph.D. We entered into an employment agreement in July 2006 with Dr. Baroldi, our Senior Vice President and Chief Medical Officer, which provides for an annual base salary of not less than \$250,000 and the possibility of an annual target cash incentive bonus equal to 25% of his annual base salary, prorated for fiscal year 2006 based on the number of days worked in that year. Additionally, Dr. Baroldi received a one-time bonus of \$30,000 and the Company paid \$62,681 for relocation expenses and tax costs relating to such relocation expenses. If Dr. Baroldi's employment is terminated without cause, he becomes permanently disabled, or he terminates his employment for good reason, he will receive the following severance benefits following his employment termination: (a) a cash payment of his monthly base salary for 12 months; (b) payment of his monthly COBRA health insurance premiums; and (c) a bonus in an amount determined as follows: (i) if he is terminated prior to the first anniversary of this agreement, a pro-rata portion of the anticipated first-year target cash incentive bonus will be given to him; (ii) if he is terminated on or following the first anniversary and prior to the third, the amount will equal the greater of the most recent target cash incentive bonus or the average target cash incentive bonuses awarded for the prior years; or (iii) if he is terminated on or following the third anniversary, the amount will be equal to the greater of the most recent target cash incentive bonus or the average target cash incentive bonus awarded for the prior three years. In addition, if, following a change in control, Dr. Baroldi is terminated without cause, or he terminates his employment for good reason, he will become vested in 24 months' worth of his then unvested shares and options.

William D. Chip Clark. We entered into an employment agreement in February 2005 with Mr. Clark, our Senior Vice President, Chief Business Officer and Secretary, which provides for an annual base salary of not less than \$227,625 and the possibility of an annual target cash incentive bonus equal to 25% of his annual base salary upon achievement of certain performance criteria. If Mr. Clark's employment is terminated without cause, he becomes permanently disabled, or he terminates his employment for good reason, he will receive the following severance benefits following his employment termination: (a) a cash payment of his monthly

base salary for 12 months; (b) payment of his monthly COBRA health insurance premiums; and (c) a bonus in an amount determined as follows: (i) if he is terminated prior to the first anniversary of this agreement, a pro-rata portion of the anticipated first-year target cash incentive bonus will be given to him; (ii) if he is terminated on or following the first anniversary and prior to the third, the amount will equal the greater of the most recent target cash incentive bonus or the average target cash incentive bonuses awarded for the prior years; or (iii) if he is terminated on or following the third anniversary, the amount will be equal to the greater of the most recent target cash incentive bonus or the average target bonus awarded for the prior three years. In addition, if, following a change in control, Mr. Clark is terminated without cause, or he terminates his employment for good reason, he will become vested in 24 months worth of his then unvested shares and options.

Steven A. Shallcross. We entered into an employment agreement in October 2005 with Mr. Shallcross, our Senior Vice President, Chief Financial Officer and Treasurer, which provides for an annual base salary of not less than \$250,000 and the possibility of an annual target cash incentive bonus equal to 25% of his annual base salary upon achievement of certain performance criteria. If Mr. Shallcross employment is terminated without cause, he becomes permanently disabled, or he terminates his employment for good reason, he will receive the following severance benefits following his employment termination: (a) a cash payment of his monthly base salary for 12 months; (b) payment of his monthly COBRA health insurance premiums; and (c) a bonus in an amount determined as follows: (i) if he is terminated prior to the first anniversary of this agreement, a pro-rata portion of the anticipated first-year target cash incentive bonus will be given to him; (ii) if he is terminated on or following the first anniversary and prior to the third, the amount will equal the greater of the most recent target cash incentive bonus or the average target cash incentive bonuses awarded for the prior years; or (iii) if he is terminated on or following the third anniversary, the amount will be equal to the greater of the most recent target cash incentive bonus or the average target cash incentive bonus awarded for the prior three years. In addition, if, following a change in control, Mr. Shallcross is terminated without cause, or he terminates his employment for good reason, he will become vested in 24 months worth of his then unvested shares and options.

Thomas Copmann, Ph.D. We entered into an employment agreement in May 2005 with Dr. Copmann, our Vice President of Regulatory Affairs, which provides for an annual base salary of not less than \$200,000 and the possibility of an annual target cash incentive bonus equal to 28% of his annual base salary upon achievement of certain performance criteria. If Dr. Copmann's employment is terminated without cause, he becomes permanently disabled, or he terminates his employment for good reason, he will receive the following severance benefits following his employment termination: (a) a cash payment of his monthly base salary for 6 months; (b) payment of his monthly COBRA health insurance premiums; and (c) a bonus in an amount equal to a pro-rata portion of the annual target cash incentive bonus for the year of his termination. In addition, if, following a change in control, Dr. Copmann is terminated without cause, or he terminates his employment for good reason, he will become vested in 12 months worth of his then unvested shares and options.

Deepak Phadke, Ph.D. We entered into an offer letter in July 2005 with Dr. Phadke, our Vice President of Manufacturing, which provides for a sign-on bonus of \$20,000, \$10,000 of which was awarded in his first pay period and the remainder of which was awarded on the one year anniversary of his start date. We also entered into an employment agreement in August 2005 with Dr. Phadke, which provides for an annual base salary of not less than \$170,000 and the possibility of an annual target bonus equal to 15% of his annual base salary upon achievement of certain performance criteria. If Dr. Phadke's employment is terminated without cause, he

becomes permanently disabled, or he terminates his employment for good reason, he will receive the following severance benefits following his employment termination: (a) a cash payment of his monthly base salary for 6 months; (b) payment of his monthly COBRA health insurance premiums; and (c) a bonus in an amount equal to a pro-rata portion of the annual target cash incentive bonus for the year of his termination. In addition, if, following a change in control, Dr. Phadke is terminated without cause, or he terminates his employment for good reason, he will become vested in 12 months' worth of his then unvested shares and options.

Grants of plan-based awards

The following table sets forth each equity award granted to the Company's named executive officers during the year ended December 31, 2006.

Name	Grant date	Estimated future	All other	Exercise or base price of option awards (\$/Sh)	Grant date fair value of stock option awards(\$)(2)
		payouts under non-equity incentive plan awards Target (\$)(1)	option awards: Number of securities underlying options		
Mihael H. Polymeropoulos, M.D.		\$150,696			
Paolo Baroldi, M.D., Ph.D.		30,735			
	07/06/06		60,427	\$ 8.30	\$ 348,368
	12/13/06		35,000	24.71	595,175
William D. Chip Clark		59,183			
Steven A. Shallcross		62,500			
Thomas Copmann, Ph.D.		58,240			
Deepak Phadke, Ph.D.		26,520			

(1) This column sets forth the target amount of each executive's cash incentive bonus for 2006, as set forth in such executive's employment agreement and described in Compensation discussion & analysis and Employment agreements above.

(2) Represents the fair value of each stock option as of the date it was granted, in accordance with SFAS 123(R) and using a Black-Scholes valuation model.

Description of certain awards granted in 2006

On July 6, 2006, we granted an option to Dr. Paolo Baroldi to purchase a total of 60,427 shares of our common stock. The option vests with respect to 15,106 shares on July 6, 2007, provided Dr. Baroldi has remained employed with us through that date. The option then vests with respect to an additional 1,258 shares for each month after July 2007 that Dr. Baroldi remains employed with us.

On December 13, 2006, we granted an option to Dr. Baroldi to purchase a total of 35,000 shares of our common stock. The option vests with respect to 8,750 shares on December 13, 2007, provided Dr. Baroldi has remained employed

with us through that date. The option then vests with respect to an additional 729 shares for each month after December 2007 that Dr. Baroldi remains employed with us.

Outstanding equity awards at fiscal year-end

The following table sets forth information regarding each unexercised option held by each of our named executive officers as of December 31, 2006.

Name	Option awards		Option exercise price(\$)	Option expiration date
	Number of securities underlying unexercised options exercisable	Number of securities underlying unexercised options (#)unexercisable		
Mihael H. Polymeropoulos, M.D.		15,530(2)	\$ 0.33	05/05/13
	25,070	69,555(3)	\$ 0.33	02/10/15
	129,255	284,364(4)	\$ 0.33	09/28/15
	47,593	142,780(5)	\$ 4.73	12/29/15
Paolo Baroldi, M.D., Ph.D.		60,327(6)	\$ 8.30	07/06/16
		35,000(7)	\$ 24.71	12/13/16
William D. Chip Clark	17,562	40,106(8)	\$ 0.33	09/01/04
	22,156	26,185(9)	\$ 0.33	02/10/15
	64,231	141,310(10)	\$ 0.33	09/28/15
	9,976	29,931(11)	\$ 4.73	12/29/15
Steven A. Shallcross	12,502	60,585(12)	\$ 0.83	11/14/15
	16,995	50,985(13)	\$ 4.73	12/29/15
Thomas Copmann, Ph.D.(1)	3,172	9,517(14)	\$ 4.73	12/29/15
		5,000(15)	\$ 25.50	12/18/16
Deepak Phadke, Ph.D.	315	10,071(16)	\$ 0.33	08/15/15
	3,275	9,825(17)	\$ 4.73	12/29/15
		20,000(18)	\$ 25.50	12/18/16

- (1) Does not include a total of 22,660 shares issued to Dr. Copmann upon the exercise of an option held by him. Of these 22,660 shares, 9,913 shares were vested to Dr. Copmann on December 31, 2006, and the remaining 12,747 shares were not yet vested to Dr. Copmann on December 31, 2006. 472 of these remaining shares vest each month after December, 2006, provided that Dr. Copmann remains employed with us.
- (2) The option vests with respect to 3,105 additional shares each month after December, 2006, provided that Dr. Polymeropoulos remains employed with us.
- (3) The option vests with respect to 2,675 additional shares each month after December, 2006, provided that Dr. Polymeropoulos remains employed with us.
- (4)

The option vests with respect to 8,617 additional shares each month after December, 2006, provided that Dr. Polymeropoulos remains employed with us.

- (5) The option vests with respect to 3,966 additional shares each month after December, 2006, provided that Dr. Polymeropoulos remains employed with us.
- (6) The option vests with respect to 15,106 shares on July 6, 2007 and with respect to 1,256 additional shares for each month after July 2007, provided that Dr. Baroldi remains employed with us.
- (7) The option vests with respect to 8,750 shares on December 13, 2007 and with respect to 729 additional shares for each month after December 2007, provided that Dr. Baroldi remains employed with us.
- (8) The option vests with respect to 1,909 additional shares each month after December, 2006, provided that Mr. Clark remains employed with us.
- (9) The option vests with respect to 1,007 additional shares each month after December, 2006, provided that Mr. Clark remains employed with us.
- (10) The option vests with respect to 4,282 additional shares each month after December, 2006, provided that Mr. Clark remains employed with us.
- (11) The option vests with respect to 831 additional shares each month after December, 2006, provided that Mr. Clark remains employed with us.
- (12) The option vests with respect to 1,730 additional shares each month after December, 2006, provided that Mr. Shallcross remains employed with us.
- (13) The option vests with respect to 1,416 additional shares each month after December, 2006, provided that Mr. Shallcross remains employed with us.

- (14) The option vests with respect to 264 additional shares each month after December, 2006, provided that Dr. Copmann remains employed with us.
- (15) The option vests with respect to 1,250 shares on December 18, 2007 and with respect to 104 additional shares for each month after December 2007, provided that Dr. Copmann remains employed with us.
- (16) The option vests with respect to 314 additional shares each month after December, 2006, provided that Dr. Phadke remains employed with us.
- (17) The option vests with respect to 272 additional shares each month after December, 2006, provided that Dr. Phadke remains employed with us.
- (18) The option vests with respect to 5,000 shares on December 18, 2007 and with respect to 416 additional shares for each month after December 2007, provided that Dr. Phadke remains employed with us.

Option exercises and stock vested

The following table shows the number of shares acquired upon exercise of options by each named executive officer during the year ended December 31, 2006 and the number of shares of restricted stock held by each named executive officer that vested during the year ended December 31, 2006.

Name	Option awards	
	Number of shares acquired on exercise(#)	Value realized on exercise(\$)
Mihael H. Polymeropoulos, M.D.	167,327	4,007,783
Paolo Baroldi, M.D., Ph.D.		
William D. Chip Clark	34,000	598,602
Steven A. Shallcross	10,000	256,200
Thomas Copmann, Ph.D(1).		
Deepak Phadke, Ph.D.	4,720	116,772

(1) Does not include 5,665 shares of restricted stock which were issued to Dr. Copmann upon the early exercise of an option owned by him and which vested during the year ended December 31, 2006.

Option repricings

The Company has not engaged in any option repricings or other modifications to any of its outstanding equity awards during fiscal year 2006.

Severance and change in control arrangements

See Employment agreements above for a description of the severance and change in control arrangements for Drs. Polymeropoulos, Baroldi, Copmann and Phadke and Messrs. Clark and Shallcross. Drs. Polymeropoulos, Baroldi, Copmann and Phadke and Messrs. Clark and Shallcross will only be eligible to receive severance payments if each officer signs a general release of claims.

The compensation committee of our board of directors, as plan administrator of our Second Amended and Restated Management Equity Plan and our 2006 Equity Incentive Plan, has the authority to provide for accelerated vesting of the shares of common stock subject to outstanding options held by our named executive officers and any other person in connection with certain changes in control of Vanda.

In each employment agreement, a change in control is defined as (i) the consummation of a merger or consolidation of the Company with or into another entity, if persons who were not stockholders of the Company immediately prior to such merger or consolidation own immediately after such merger or consolidation 50% or more of the voting power of the outstanding securities of each of (A) the continuing or surviving entity and (B) any direct or indirect parent

corporation of such continuing or surviving entity; or (ii) the sale, transfer or other disposition of all or substantially all of the Company's assets. A transaction shall not constitute a change in control if its sole purpose is to change the state of the Company's incorporation or to create a holding company that will be owned in substantially the same proportions by the persons who held the Company's securities immediately before such transaction.

Estimated payments and benefits upon termination

The amount of compensation and benefits payable to each named executive officer in various termination situations has been estimated in the tables below.

Mihael H. Polymeropoulos, M.D.

The following table describes the potential payments and benefits upon employment termination for Dr. Polymeropoulos, the Company's President and Chief Executive Officer, as if his employment terminated as of December 29, 2006, the last business day of our last fiscal year.

Executive benefits and payments upon termination	Voluntary resignation not for good reason	Voluntary resignation for good reason	Termination by company not for cause	Termination by company for cause	Involuntary termination in connection with or following change in control
Compensation:					
Base salary		\$ 376,740(1)	\$ 376,740(1)		\$ 376,740(1)
Highest target cash incentive bonus		\$ 181,000(2)	\$ 181,000(2)		\$ 181,000(2)
Stock options					
Unvested and accelerated					\$ 11,829,202(3)
Benefits and perquisites:					
Health care		\$ 23,398(4)	\$ 23,398(4)		\$ 23,398(4)
Accrued vacation pay		\$ 5,161(5)	\$ 5,161(5)		\$ 5,161(5)
Total		\$ 586,299	\$ 586,299		\$ 12,415,501

- (1) Last monthly base salary prior to the termination for a period of 12 months following the date of the termination.
- (2) Greater of the most recent target cash incentive bonus or the average of target cash incentive bonuses awarded for the prior years.

- (3) All options held by Dr. Polymeropoulos will become fully vested in the event of an involuntary termination following a change of control.
- (4) Payment of the COBRA health insurance premiums up to 18 months or until Dr. Polymeropoulos begins employment with another company that offers comparable benefits.
- (5) Based on 5 vacation days available to Dr. Polymeropoulos at December 31, 2006.

Paolo Baroldi, M.D., Ph.D.

The following table describes the potential payments and benefits upon employment termination for Dr. Baroldi, the Company's Senior Vice President and Chief Medical Officer, as if his employment terminated as of December 29, 2006, the last business day of our last fiscal year.

Executive benefits and payments upon termination	Voluntary resignation not for good reason	Voluntary resignation for good reason	Termination by company not for cause	Termination by company for cause	Involuntary termination in connection with or following change in control
Compensation:					
Base salary		\$ 250,000(1)	\$ 250,000(1)		\$ 250,000(1)
Highest target cash incentive bonus		\$ 62,500(2)	\$ 62,500(2)		\$ 62,500(2)
Stock options					
Unvested and accelerated					\$ 986,346(3)
Benefits and perquisites:					
Health care		\$ 23,398(4)	\$ 23,398(4)		\$ 23,398(4)
Accrued vacation pay		\$ 2,397(5)	\$ 2,397(5)		\$ 2,397(5)
Total		\$ 338,295	\$ 338,295		\$ 1,324,642

- (1) Last monthly base salary prior to the termination for a period of 12 months following the date of the termination.
- (2) Current target cash incentive bonus.
- (3) Acceleration of 24 months' worth of Dr. Baroldi's then unvested options will occur in the event of an involuntary termination following a change of control.
- (4) Payment of the COBRA health insurance premiums up to 18 months or until Dr. Baroldi begins employment with another company that offers comparable benefits.
- (5) Based on 3.5 vacation days available to Dr. Baroldi at December 31, 2006.

William D. Chip Clark

The following table describes the potential payments and benefits upon employment termination for Mr. Clark, the Company's Senior Vice President, Chief Business Officer and Secretary, as if his employment terminated as of December 29, 2006, the last business day of our last fiscal year.

Executive benefits and payments upon termination	Voluntary resignation not for good reason	Voluntary resignation for good reason	Termination by company not for cause	Termination by company for cause	Involuntary termination in connection with or following change in control
Compensation:					
Base salary		\$ 236,730(1)	\$ 236,730(1)		\$ 236,730(1)
Highest target cash incentive bonus		\$ 62,600(2)	\$ 62,600(2)		\$ 62,600(2)
Stock options					
Unvested and accelerated					\$ 4,460,057(3)
Benefits and perquisites:					
Health care		\$ 23,398(4)	\$ 23,398(4)		\$ 23,398(4)
Accrued vacation pay		\$ 1,946(5)	\$ 1,946(5)		\$ 1,946(5)
Total		\$ 324,674	\$ 324,674		\$ 4,784,731

- (1) Last monthly base salary prior to the termination for a period of 12 months following the date of the termination.
- (2) Greater of the most recent target cash incentive bonus or the average of target cash incentive bonuses awarded for the prior years.
- (3) Acceleration of 24 months' worth of Mr. Clark's then unvested options will occur in the event of an involuntary termination following a change of control.
- (4) Payment of the COBRA health insurance premiums up to 18 months or until Mr. Clark begins employment with another company that offers comparable benefits.
- (5) Based on 3 vacation days available to Mr. Clark at December 31, 2006.

Steven A. Shallcross

The following table describes the potential payments and benefits upon employment termination for Mr. Shallcross, the Company's Senior Vice President, Chief Financial Officer and Treasurer, as if his employment terminated as of December 29, 2006, the last business day of our last fiscal year.

Executive benefits and payments upon termination	Voluntary resignation not for good reason	Voluntary resignation for good reason	Termination by company not for cause	Termination by company for cause	Involuntary termination in connection with or following change in control
Compensation:					
Base salary		\$ 250,000(1)	\$ 250,000(1)		\$ 250,000(1)
Highest target cash incentive bonus		\$ 62,500(2)	\$ 62,500(2)		\$ 62,500(2)
Stock options					
Unvested and accelerated					\$ 2,458,756(3)
Benefits and perquisites:					
Health care		\$ 23,398(4)	\$ 23,398(4)		\$ 23,398(4)
Accrued vacation pay		\$ 3,425(5)	\$ 3,425(5)		\$ 3,425(5)
Total		\$ 339,323	\$ 339,323		\$ 2,789,079

- (1) Last monthly base salary prior to the termination for a period of 12 months following the date of the termination.
- (2) Greater of the most recent target cash incentive bonus or the average of target cash incentive bonuses awarded for the prior years.
- (3) Acceleration of 24 months' worth of Mr. Shallcross' then unvested options will occur in the event of an involuntary termination following a change of control.
- (4) Payment of the COBRA health insurance premiums up to 18 months or until Mr. Shallcross begins employment with another company that offers comparable benefits.
- (5) Based on 5 vacation days available to Mr. Shallcross at December 31, 2006.

Thomas Copmann, Ph.D.

The following table describes the potential payments and benefits upon employment termination for Dr. Copmann, the Company's Vice President of Regulatory Affairs, as if his employment terminated as of December 29, 2006, the last business day of our last fiscal year.

Executive benefits and payments upon termination	Voluntary resignation not for good reason	Voluntary resignation for good reason	Termination by company not for cause	Termination by company for cause	Involuntary termination in connection with or following change in control
Compensation:					
Base salary		\$ 104,000(1)	\$ 104,000(1)		\$ 104,000(1)
Target cash incentive bonus		\$ 58,240(2)	\$ 58,240(2)		\$ 58,240(2)
Stock options					
Unvested and accelerated					\$ 200,964(3)
Benefits and perquisites:					
Health care		\$ 23,398(4)	\$ 23,398(4)		\$ 23,398(4)
Accrued vacation pay		\$ 2,849(5)	\$ 2,849(5)		\$ 2,849(5)
Total		\$ 188,487	\$ 188,487		\$ 389,451

- (1) Last monthly base salary prior to the termination for a period of 6 months following the date of the termination.
- (2) 2006 target bonus.
- (3) Acceleration of 12 months' worth of Dr. Copmann's then unvested options will occur in the event of an involuntary termination following a change of control.
- (4) Payment of the COBRA health insurance premiums up to 18 months or until Dr. Copmann begins employment with another company that offers comparable benefits.
- (5) Based on 5 vacation days available to Dr. Copmann at December 31, 2006.

Deepak Phadke, Ph.D.

The following table describes the potential payments and benefits upon employment termination for Dr. Phadke, the Company's Vice President of Manufacturing, as if his employment terminated as of December 29, 2006, the last business day of our last fiscal year.

Executive benefits and payments upon termination	Voluntary resignation not for good reason	Voluntary resignation for good reason	Termination by company not for cause	Termination by company for cause	Involuntary termination in connection with or following change in control
Compensation:					
Base salary		\$ 88,400(1)	\$ 88,400(1)		\$ 88,400(1)
Target cash incentive bonus		\$ 26,520(2)	\$ 26,520(2)		\$ 26,520(2)
Stock options					
Unvested and accelerated					\$ 157,082(3)
Benefits and perquisites:					
Health care		\$ 23,398(4)	\$ 23,398(4)		\$ 23,398(4)
Accrued vacation pay		\$ 2,422(5)	\$ 2,422(5)		\$ 2,422(5)
Total		\$ 140,740	\$ 140,740		\$ 297,822

- (1) Last monthly base salary prior to the termination for a period of 6 months following the date of the termination.
- (2) 2006 target bonus.
- (3) Acceleration of 12 months' worth of Dr. Phadke's then unvested options will occur in the event of an involuntary termination following a change of control.
- (4) Payment of the COBRA health insurance premiums up to 18 months or until Dr. Phadke begins employment with another company that offers comparable benefits.
- (5) Based on 5 vacation days available to Dr. Phadke at December 31, 2006.

The value of the option vesting acceleration was calculated for each of the above tables based on the assumption that the change in control and the executive's employment termination occurred on December 29, 2006. The closing price of the Company's stock as of December 29, 2006, was \$24.65, which was used as the value of the Company's stock in the change in control. The value of the vesting acceleration was calculated by multiplying the number of unvested option shares subject to vesting acceleration as of December 29, 2006 by the difference between the closing price of the Company's stock as of December 29, 2006 and the exercise price for such unvested option shares.

Equity benefit plans

Second Amended and Restated Management Equity Plan

Share reserve. Our Second Amended and Restated Management Equity Plan was adopted by us in December 2004. As of December 31, 2006, options for a total of 318,158 shares were exercised under the plan, and options for a total of 1,347,205 shares remained outstanding. No further option grants were made under this plan after the effective date of our initial public offering. The options that were outstanding under the plan after the effective date of our initial public offering continue to be governed by their terms. After the effective date of our initial public offering, any shares that remained available for grants under the plan and any shares subject to options or share awards under the plan that are canceled, forfeited or repurchased will not be available for future grants or awards. The plan is administered by our compensation committee.

Eligibility. Employees, non-employee members of our board of directors and consultants are eligible to participate in our Second Amended and Restated Management Equity Plan.

Types of awards. Our Second Amended and Restated Management Equity Plan provides for the purchase of shares of our common stock, and incentive and nonstatutory stock options to purchase shares of our common stock. The exercise price for incentive stock options and nonstatutory stock options granted under the plan may not be less than 100% and 30%, respectively, of the fair market value of our common stock on the option grant date. Optionees may pay the purchase price or the exercise price by using cash, shares of common stock that the optionee already owns, a full-recourse promissory note, by rendering services to us, by an immediate sale of the option shares through a broker designated by us, or with a loan from a broker designated by us and secured by the option shares. In most cases, our options vest over a four-year period following the date of grant and generally expire 10 years after they are granted, unless the optionee separates from service with us.

Change in control. If we merge or consolidate with another company, an option granted under the Second Amended and Restated Management Equity Plan will be subject to the terms of the merger or consolidation agreement, which may provide that the option continues, is assumed or substituted, becomes vested and exercisable in full, or is canceled and the optionees receive a payment.

Amendments or termination. Our board of directors may amend or terminate the Second Amended and Restated Management Equity Plan at any time. If our board amends the plan, it does not need to seek stockholder approval of the amendment unless the number of shares reserved under the plan increases or the class of person eligible for the grant of incentive stock options materially changes. The plan will automatically terminate 10 years after its adoption by our board of directors.

2006 Equity Incentive Plan

Our 2006 Equity Incentive Plan was adopted in March 2006 and took effect as of the closing of the initial public offering with the following material terms:

Share reserve. We have reserved 1,500,000 shares of our common stock for issuance under the 2006 Equity Incentive Plan. As of December 31, 2006, awards for a total of 359,527 shares were outstanding under the plan. On January 1 of each year, starting with the year 2007, the number of shares in the reserve will automatically increase by 4% of the total number of shares of common stock that are outstanding at that time or, if less, by 1,500,000 shares (or such lesser number as may be approved by the board of directors). If options or shares awarded under the 2006 Equity Incentive Plan are forfeited, then those options or shares will again become available for awards under this plan.

Administration. The compensation committee of our board of directors administers the 2006 Equity Incentive Plan. The committee has complete discretion to make all decisions relating to the interpretation and operation of the plan, including the discretion to determine who will receive an award, what type of award it will be, how many shares will be covered by the award, what the vesting requirements will be, if any, and what the other features and conditions of each award will be. The compensation committee has the ability to reprice outstanding options and modify outstanding awards in other ways.

Eligibility. The following groups of individuals are eligible to participate in the 2006 Equity Incentive Plan:

- employees
- members of our board of directors who are not employees
- consultants

Types of awards. The 2006 Equity Incentive Plan provides for the following types of awards:

- options to purchase shares of our common stock
- stock appreciation rights
- restricted shares of our common stock
- stock units (sometimes called phantom shares)

Options and stock appreciation rights. Both incentive stock options and nonstatutory stock options are available for grant under the 2006 Equity Incentive Plan. An optionee who exercises an incentive stock option may qualify for favorable tax treatment under section 422 of the Internal Revenue Code of 1986. On the other hand, nonstatutory stock options do not qualify for such favorable tax treatment. The exercise price of options and stock appreciation rights granted under the 2006 Equity Incentive Plan may not be less than 100% of the fair market value of our common stock on the grant date. Optionees may pay the exercise price by using:

- cash
- shares of common stock that the optionee already owns
- an immediate sale of the option shares through a broker designated by us
- a full-recourse promissory note

Options and stock appreciation rights vest at the time or times determined by the compensation committee. In most cases, our options vest over the four-year period following the date of grant. Options and stock appreciation rights generally expire 10 years after they are granted, except that they generally expire earlier if the optionee's service terminates earlier. The 2006 Equity Incentive Plan provides that no participant may receive options covering more than 500,000 shares and stock appreciation rights covering more than 500,000 shares in the same year, except that a newly hired employee may receive options covering up to 1,000,000 shares and stock appreciation rights covering up to 1,000,000 shares in the first year of employment.

The 2006 Equity Incentive Plan also provides for automatic annual option grants to members of our board of directors who are not our employees. See Director compensation.

Restricted shares and stock units. Restricted shares may be awarded under the 2006 Equity Incentive Plan in return for:

- cash

a full-recourse promissory note; or

services

Restricted shares and stock units vest at the time or times determined by the compensation committee.

Change in control. If a change in control of Vanda occurs, an award under the 2006 Equity Incentive Plan will vest on an accelerated basis to the extent determined by the compensation committee. The compensation committee may determine that outstanding grants will vest in full or in part at the time of the change in control. It may also determine that the grants will

vest on an accelerated basis only if the participant is actually or constructively discharged within a specified period of time after the change in control. Finally, the committee has the discretion to determine that the grants will remain outstanding without acceleration of vesting, except that if the surviving corporation fails to assume an outstanding award or replace it with a comparable award or cash payment, then the award will always become fully vested as a result of the change in control. A change in control includes the following events for purposes of the 2006 Equity Incentive Plan:

a merger of Vanda after which our own stockholders own 50% or less of the surviving corporation

a sale of all or substantially all of our assets

a proxy contest that results in the replacement of 50% or more of our directors over a 24-month period

an acquisition of 50% or more of our outstanding stock by any person or group, other than a person related to Vanda (such as a holding company owned by our stockholders)

Amendments or termination. Our board of directors may amend or terminate the 2006 Equity Incentive Plan at any time. If our board were to amend the plan, it would not need to ask for stockholder approval of the amendment unless applicable law requires it. The 2006 Equity Incentive Plan will automatically terminate on April 12, 2016.

401(k) plan

We have established a 401(k) plan to allow our employees to save on a tax-favorable basis for their retirements. We match up to 50% of the first 6% of contributions made by employees pursuant to the plan.

Limitation of liability and indemnification of officers and directors

Our amended and restated certificate of incorporation and amended and restated bylaws provide that we will indemnify our directors and officers to the fullest extent permitted by Delaware law, as it now exists or may in the future be amended, against all expenses and liabilities reasonably incurred in connection with their service for or on behalf of us. In addition, our amended and restated certificate of incorporation provides that our directors will not be personally liable for monetary damages to us for breaches of their fiduciary duty as directors, unless they violated their duty of loyalty to us or our stockholders, acted in bad faith, knowingly or intentionally violated the law, authorized illegal dividends or redemptions or derived an improper personal benefit from their actions as directors. We maintain liability insurance which insures our directors and officers against certain losses and which insures us against our obligations to indemnify our directors and officers.

In addition, we have entered into indemnification agreements with each of our directors and officers. These agreements, among other things, require us to indemnify each director and officer to the fullest extent permitted by Delaware law, including indemnification of expenses such as attorneys' fees, judgments, fines and settlement amounts incurred by the director or officer in any action or proceeding, including any action or proceeding by or in right of us, arising out of the person's services as a director or officer. At present, we are not aware of any pending or threatened litigation or proceeding involving any of our directors, officers, employees or agents in which indemnification would be required or permitted. We believe provisions in our amended and restated certificate of incorporation and indemnification agreements are necessary to attract and retain qualified persons as directors and officers.

Certain relationships and related party transactions

2004 Securityholder Agreement

We have entered into a 2004 Securityholder Agreement with certain holders of our common stock, including significant holders that are affiliates of certain of our directors. Under the Securityholders Agreement, these holders have the right to demand the registration of our common stock and to participate in other public offerings of our common stock (for more information regarding the registration rights granted pursuant to the 2004 Securityholder Agreement, see Description of capital stock Registration rights)

Indemnification agreements

We have entered into indemnification agreements with each of our directors and officers. These agreements, among other things, require us to indemnify each director and officer to the fullest extent permitted by Delaware law, including indemnification of expenses such as attorneys fees, judgments, fines and settlement amounts incurred by the director or officer in any action or proceeding, including any action or proceeding by or in right of us, arising out of the person s services as a director or officer.

Relationship with Care Capital, LLC

From time to time, we reimbursed Care Capital, LLC (Care Capital), an affiliate of our stockholders, Care Capital Investments II, LP and Care Capital Offshore Investments II, LP, for certain expenses incurred by Care Capital on our behalf. We reimbursed Care Capital for approximately \$54,000 and approximately \$299,000 for the year ended December 31, 2004 and for the period from March 13, 2003 (inception) to December 31, 2003, respectively.

We also used the services of a Care Capital employee and reimbursed Care Capital for such personnel services related to occupancy and salary expenses incurred on our behalf. Reimbursements related to such expenses were approximately \$49,000 and \$34,000 for the year ended December 31, 2004 and the period from March 13, 2003 (inception) to December 31, 2003, respectively.

Principal stockholders

The following table sets forth certain information known to us regarding beneficial ownership of our common stock as of December 31, 2006 and as adjusted to reflect the sale of the shares of common stock in this offering by:

each person known by us to be the beneficial owner of more than 5% of our common stock
our named executive officers
each of our directors
all executive officers and directors as a group

Unless otherwise indicated in the footnotes, to our knowledge, each stockholder possesses sole voting and investment power over the shares listed, except for shares owned jointly with that person's spouse.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Options and warrants to purchase shares of our common stock that are exercisable within 60 days of December 31, 2006, are deemed to be beneficially owned by the persons holding these options for the purpose of computing percentage ownership of that person, but are not treated as outstanding for the purpose of computing any other person's ownership percentage.

Percentage of shares beneficially owned before the offering is based on 22,128,534 shares of common stock outstanding as of December 31, 2006. Percentage of shares beneficially owned after the offering is based on 25,628,534 shares of common stock as of December 31, 2006, after giving effect to the sale of 3,500,000 shares in this offering.

Name and address of beneficial owner(1)	Number of shares beneficially owned	Percentage of shares beneficially owned	
		Before offering	After offering
5% Stockholders			
Domain Partners VI, L.P.(2) One Palmer Square, Suite 515 Princeton, NJ 08542	1,995,976	9.02%	7.79%
Care Capital Investments II, LP(3) 47 Hulfish St., Ste 310 Princeton, NJ 08542	1,893,730	8.56%	7.39%
Versant Capital Management LLC(4) 45 Rockefeller Plaza Suite 2074 New York, NY 10111	1,500,000	6.78%	5.85%
Steven A. Cohen(5) 72 Cummings Point Road Stanford, CT 06902	1,448,332	6.55%	5.65%
Davidson Kempner Partners(6) 65 East 55th Street, 19th Floor New York, NY 10022	1,401,000	6.33%	5.46%
Executive Officers and Directors			
Mihael H. Polymeropoulos, M.D.(7)	238,467	1.07%	*
Paolo Baroldi, M.D., Ph.D.(8)			
William D. Chip Clark(9)	131,896	*	*
Steven A. Shallcross(10)	35,791	*	*
Argeris N. Karabelas, Ph.D.(11)	1,893,730	8.56%	7.39%
Richard W. Dugan(12)	3,083	*	*
Brian K. Halak, Ph.D.			
H. Thomas Watkins(13)	3,645	*	*
David Ramsay(14)	1,893,730	8.56%	7.39%
James B. Tananbaum, M.D.(15)	736,077	3.33%	2.87%
Deepak Phadke, Ph.D.(16)	4,764	*	*
Thomas Copmann, Ph.D.(17)	26,360	*	*
All executive officers and directors as a group	3,073,993	13.62%	11.79%

* Represents beneficial ownership of less than one percent of our outstanding common stock.

(1) Unless otherwise indicated, the address for each beneficial owner is c/o Vanda Pharmaceuticals Inc., 9605 Medical Center Drive, Suite 300, Rockville, Maryland 20850.

(2) Includes 1,954,450 shares held of record by Domain Partners VI, L.P., 21,068 shares held of record by DP VI Associates, L.P. and 20,458 shares held of record by One Palmer Square Associates: VI, L.L.C. Voting and/or dispositive decisions with respect to the shares held by Domain Partners VI, L.P. and DP VI Associates, L.P. are made by the managing members of their general partner, One Palmer Square Associates VI, L.L.C.: James C. Blair, Ph.D., Brian H. Dovey, Robert J. More, Kathleen K. Schoemaker, Jesse I. Treu, Ph.D. and Nicole Vitullo,

each of whom disclaims beneficial ownership of such shares except to the extent of his or her pecuniary interest therein, the amount of which cannot currently be determined.

- (3) Includes 1,772,184 shares held of record by Care Capital Investments II, LP and 121,546 shares held of record by Care Capital Offshore Investments II, LP. Voting and/or dispositive decisions with respect to the shares held by Care Capital Investments II, LP and Care Capital Offshore Investments II, LP are made by the managing members of their general partner, Care Capital II, LLC: Jan Leschly, Argeris N. Karabelas, Ph.D. and David R. Ramsay, each of whom disclaims beneficial ownership of such shares except to the extent of his pecuniary interest therein, the amount of which cannot currently be determined.
- (4) Based on Schedule 13G filed by Versant Capital Management LLC and Herriot Tabuteau on November 17, 2006. Harriot Tabuteau is the managing member of Versant Capital Management LLC and so may be deemed to beneficially own such shares of Common Stock. Mr. Tabuteau disclaims such beneficial ownership.

- (5) Based on Schedule 13G filed jointly on December 21, 2006 by (i) S.A.C. Capital Advisors, LLC, (SAC Capital Advisors), beneficially owned by S.A.C. Capital Associates, LLC (SAC Capital Associates) and S.A.C. MultiQuant Fund, LLC (SAC MultiQuant), (ii) S.A.C. Capital Management, LLC, (SAC Capital Management) with respect to shares beneficially owned by SAC Capital Associates and SAC MultiQuant, (iii) SAC Capital Associates with respect to shares beneficially owned by it, (iv) Sigma Capital Management, LLC (Sigma Capital Management) with respect to shares beneficially owned by Sigma Capital Associates, LLC (Sigma Capital Associates), and (v) Steven A. Cohen with respect to shares beneficially owned by SAC Capital Advisors, SAC Capital Management, SAC Capital Associates, SAC MultiQuant, Sigma Management and Sigma Capital Associates. SAC Capital Advisors, SAC Capital Management, Sigma Management and Mr. Cohen do not directly own any shares. Pursuant to investment agreements, each of SAC Capital Advisors and SAC Capital Management share all investment and voting power with respect to the securities held by SAC Capital Associates and SAC MultiQuant. Pursuant to an investment management agreement, Sigma Management maintains investment and voting power with respect to the securities held by Sigma Capital Associates. Mr. Cohen controls each of SAC Capital Advisors, SAC Capital Management and Sigma Management. By reason of the provisions of Rule 13d-3 of the Securities Exchange Act of 1934, as amended, each of (i) SAC Capital Advisors, SAC Capital Management and Mr. Cohen may be deemed to own beneficially 1,348,332 shares; and (ii) Sigma Management and Mr. Cohen may be deemed to own beneficially an additional 100,000 shares. Each of SAC Capital Advisors, SAC Capital Management, Sigma Management and Mr. Cohen disclaim beneficial ownership of any shares.
- (6) Based on Schedule 13G filed jointly on December 11, 2006 by Davidson Kempner Partners, a New York limited partnership (DKP), Davidson Kempner Institutional Partners, L.P., a Delaware limited partnership (DKIP), M. H. Davidson & Co., a New York limited partnership (CO), Davidson Kempner International, Ltd., a British Virgin Islands corporation (DKIL), Serena Limited, a Cayman Islands corporation (Serena), Davidson Kempner Healthcare Fund LP, a Delaware limited partnership (DKHF), Davidson Kempner Healthcare International Ltd., a Cayman Islands corporation (DKHI), MHD Management Co., a New York limited partnership and the general partner of DKP (MHD), Davidson Kempner Advisers Inc., a New York corporation and the general partner of DKIP (DKAI), Davidson Kempner International Advisers, L.L.C., a Delaware limited liability company and the manager of DKIL and Serena (DKIA), DK Group LLC, a Delaware limited liability company and the general partner of DKHF (DKG), DK Management Partners LP, a Delaware limited partnership and the investment manager of DKHI (DKMP), DK Stillwater GP LLC, a Delaware limited liability company and the general partner of DKMP (DKS), and Messrs. Thomas L. Kempner, Jr., Marvin H. Davidson, Stephen M. Dowicz, Scott E. Davidson, Michael J. Leffell, Timothy I. Levart, Robert J. Brivio, Jr., Anthony A. Yoseloff, Eric P. Epstein and Avram Z. Friedman (collectively, the Principals), who are the general partners of CO and MHD, the sole managing members of DKIA and DKG and the sole stockholders of DKAI. Messrs. Thomas L. Kempner, Jr. and Timothy I. Levart are Executive Managing Member and Deputy Executive Managing Member, respectively, of DKS. Each of Messrs. Kempner and Levart, together with Messrs. Marvin H. Davidson, Stephen M. Dowicz, Scott E. Davidson, Michael J. Leffell, Robert J. Brivio, Jr., Anthony A. Yoseloff, Eric P. Epstein and Avram Z. Friedman are limited partners of DKMP. The Principals may be deemed to beneficially own an aggregate of 1,401,100 shares as a result of their voting and dispositive power over the 1,401,100 shares beneficially owned by DKP, DKIP, DKIL, Serena, CO, DKHF and DKHI. DKIA may be deemed to beneficially own the 226,978 shares beneficially owned by DKIL and the 5,604 shares beneficially owned by Serena as a result of its voting and dispositive power over those shares. DKAI may be deemed to beneficially own the 141,513 shares beneficially owned by DKIP as a result of its voting and dispositive power over those shares. MHD may be deemed to beneficially own the 86,868 shares beneficially owned by DKP as a result of its voting and dispositive power over those shares. DKG may be deemed to beneficially own the 479,175 shares beneficially owned by DKHF as a result of its voting and dispositive power over those shares. DKMP and DKS may be deemed to beneficially own the 451,154 shares beneficially owned by DKHI as a result of their voting and dispositive power over those shares.

- (7) Excludes 475,501 shares unexercisable within 60 days of December 31, 2006.
- (8) Excludes 95,427 shares unexercisable within 60 days of December 31, 2006
- (9) Excludes 219,561 shares unexercisable within 60 days of December 31, 2006.
- (10) Excludes 105,276 shares unexercisable within 60 days of December 31, 2006.
- (11) Includes 1,772,184 shares held of record by Care Capital Investments II, LP and 121,546 shares of record held by Care Capital Offshore Investments II, LP. Dr. Karabelas is a managing member of Care Capital II, LLC. Care Capital II, LLC is the general partner of Care Capital Investments II, LP and Care Capital Offshore Investments II, LP. Dr. Karabelas disclaims beneficial ownership of the shares held by Care Capital Investments II, LP and Care Capital Offshore Investments II, LP except to the extent of his pecuniary interest therein, the amount of which cannot currently be determined.
- (12) Excludes 7,488 shares unexercisable within 60 days of December 31, 2006.
- (13) Excludes 31,355 shares unexercisable within 60 days of December 31, 2006.
- (14) Includes 1,772,184 shares held of record by Care Capital Investments II, LP and 121,546 shares held of record held by Care Capital Offshore Investments II, LP. Mr. Ramsay is a Partner of Care Capital, LLC. Care Capital, LLC is the general partner of Care Capital Investments II, LP and Care Capital Offshore Investments II, LP. Mr. Ramsay disclaims beneficial ownership of the shares held by Care Capital Investments II, LP and Care Capital Offshore Investments II, LP except to the extent of his pecuniary interest therein, the amount of which cannot currently be determined.
- (15) Includes 725,036 shares held of record by Prospect Venture Partners II, L.P. and 11,041 shares held of record by Prospect Associates II, L.P. Dr. Tananbaum serves as a managing member of Prospect Management Co. II, L.L.C., the general partner of Prospect Venture Partners II, L.P. and Prospect Associates II, L.P. He disclaims beneficial ownership of the shares held of record by Prospect Venture Partners II, L.P. and Prospect Associates II, L.P. except to the extent of his pecuniary interest therein the amount of which cannot currently be determined. Also includes 2,303 shares held directly by Dr. Tananbaum.
- (16) Excludes 38,722 shares unexercisable within 60 days of December 31, 2006.
- (17) Excludes 13,989 shares unexercisable within 60 days of December 31, 2006. Includes 12,747 restricted shares which are subject to vesting restrictions as of December 31, 2006.

Description of capital stock

General

The following is a summary of the rights of our common stock and related provisions of our restated certificate of incorporation and bylaws as in effect upon the closing of this offering. For more detailed information, please see our Amended and Restated Certificate of Incorporation, Amended and Restated Bylaws, and our 2004 Securityholder Agreement, which are filed as exhibits to the Registration Statement on Form S-1 for our initial public offering and which are each incorporated by reference in this prospectus.

Our authorized capital stock consists of 150,000,000 shares of common stock and 20,000,000 shares of undesignated preferred stock, each with a par value of \$0.001 per share.

As of December 31, 2006, we had outstanding 22,128,534 shares of common stock. In addition, as of December 31, 2006, a total of 1,706,732 shares of our common stock were subject to outstanding options. At December 31, 2006, a total of 91,533 shares of our outstanding common stock were held by our employees and consultants (not including shares underlying outstanding options). 28,610 of these shares are subject to a lapsing right of repurchase in our favor, under which we may repurchase these shares upon the termination of the holder's employment or consulting relationship.

Common stock

Voting rights

Unless otherwise provided for in our amended and restated certificate of incorporation or required by applicable law, on all matters submitted to our stockholders for vote, our common stockholders are entitled to one vote per share, voting together as a single class.

Dividends

Our amended and restated certificate of incorporation provides that the holders of common stock shall be entitled to share equally in any dividends that our board of directors may determine to issue from time to time. We do not currently expect to pay dividends.

Liquidation

Our amended and restated certificate of incorporation provides that upon our liquidation, dissolution or winding-up, the holders of common stock are entitled to share equally in all assets remaining after the payment of any liabilities and the liquidation preferences on any outstanding preferred stock.

Anti-takeover effects of our amended and restated certificate of incorporation, bylaws and Delaware law

Some provisions of Delaware law and our amended and restated certificate of incorporation and bylaws could make the following transactions more difficult:

- our acquisition by means of a tender offer

our acquisition by means of a proxy contest or otherwise

removal of our incumbent officers and directors

These provisions, summarized below, are expected to discourage and prevent coercive takeover practices and inadequate takeover bids. These provisions are designed to encourage persons seeking to acquire control of us to first negotiate with our board of directors, and also are

intended to provide management with flexibility to enhance the likelihood of continuity and stability in our composition if our board of directors determines that a takeover is not in our best interests or the best interests of our stockholders. These provisions, however, could have the effect of discouraging attempts to acquire us, which could deprive our stockholders of opportunities to sell their shares of common stock at prices higher than prevailing market prices. We believe that the benefits of these provisions, including increased protection of our potential ability to negotiate with the proponent of an unfriendly or unsolicited proposal to acquire or restructure us, outweigh the disadvantages of discouraging takeover proposals because negotiation of takeover proposals could result in an improvement of their terms.

Election and removal of directors. Our board of directors is divided into three classes serving staggered three-year terms. This system of electing directors may tend to discourage a third party from making a tender offer or otherwise attempting to obtain control of us because generally at least two stockholders' meetings will be required for stockholders to effect a change in control of the board of directors. Our amended and restated certificate of incorporation and our bylaws contain provisions that establish specific procedures for appointing and removing members of the board of directors. Under our amended and restated certificate of incorporation, vacancies and newly created directorships on the board of directors may be filled only by a majority of the directors then serving on the board, and under our bylaws, directors may be removed by the stockholders only for cause.

Stockholder meetings. Under our amended and restated bylaws, only the board of directors, the Chairman of the board or our Chief Executive Officer may call special meetings of stockholders.

Requirements for advance notification of stockholder nominations and proposals. Our amended and restated bylaws contain advance notice procedures with respect to stockholder proposals and the nomination of candidates for election as directors, other than nominations made by or at the direction of the board of directors or a committee of the board of directors.

Delaware anti-takeover law. We are subject to Section 203 of the Delaware General Corporation Law, an anti-takeover law. In general, Section 203 prohibits a publicly held Delaware corporation from engaging in a business combination with an interested stockholder for a period of three years following the date the person became an interested stockholder, unless the business combination or the transaction in which the person became an interested stockholder is approved in a prescribed manner. Generally, a business combination includes a merger, asset or stock sale, or another transaction resulting in a financial benefit to the interested stockholder. Generally, an interested stockholder is a person who, together with affiliates and associates, owns, or within three years prior to the date of determination of interested stockholder status did own, 15% or more of the corporation's voting stock. The existence of this provision may have an anti-takeover effect with respect to transactions that are not approved in advance by our board of directors, including discouraging attempts that might result in a premium over the market price for the shares of common stock held by stockholders.

No stockholder action by written consent. Our amended and restated certificate of incorporation prohibits stockholders from taking action without a meeting.

No cumulative voting. Our amended and restated certificate of incorporation and bylaws do not provide for cumulative voting in the election of directors. Cumulative voting allows a minority stockholder to vote a portion or all of its shares for one or more candidates for seats on the board of directors. Without cumulative voting, a minority stockholder will not be able to gain as many seats on our board of directors based on the number of shares of our stock the stockholder holds as the stockholder would be able to gain if cumulative voting were permitted.

The absence of cumulative voting makes it more difficult for a minority stockholder to gain a seat on our board of directors to influence our board's decision regarding a takeover.

Undesignated preferred stock. The authorization of undesignated preferred stock in our amended and restated certificate of incorporation makes it possible for our board of directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us.

These and other provisions may have the effect of deferring hostile takeovers or delaying changes in control or management.

Limitation of liability of directors

To the fullest extent permitted by the Delaware General Corporation Law as it now exists or hereafter may be amended, our directors will not be personally liable to us or our stockholders for monetary damages for breach of fiduciary duty as a director.

If the Delaware General Corporation Law is later amended to authorize the further elimination or limitation of the liability of directors, then the liability of our directors, in addition to the limitation on personal liability provided in our certificate of incorporation, will be limited to the fullest extent permitted by the amended Delaware General Corporation Law. Any repeal or modification of the provisions in our certificate of incorporation by our stockholders relating to the limitation of the liability of our directors will be prospective only and will not adversely affect any limitation on the personal liability of our directors existing at the time of the repeal or modification.

Registration rights

As of December 31, 2006, the holders of approximately 6,477,177 shares of our common stock are entitled to rights with respect to the registration of their shares under the Securities Act. These registration rights are contained in our 2004 Securityholder Agreement and are described below. These registration rights will expire on April 18, 2011.

Demand registration rights

Stockholders holding at least 25% of the total shares of common stock held by our venture capital investors as of our initial public offering may demand the registration of such shares under our 2004 Securityholder Agreement. We are only obligated to effect two registrations in response to these demand registration rights, and we are not obligated to effect any demand registration for shares having an aggregate market value of less than \$5,000,000 as of the date notice is given to us to effect such a registration. We may also postpone the filing of a registration statement for up to 90 days once in any 12-month period if our board of directors determines in good faith that the filing would be significantly disadvantageous to us and our affiliates, taken as a whole. We must pay all expenses incurred in connection with demand registration rights.

Incidental registration rights

Stockholders with incidental registration rights under our 2004 Securityholder Agreement have the right to include their shares in any registration of shares to be issued by the Company, subject to specified exceptions. The underwriters of any underwritten offering have the right to limit the number of shares registered by these stockholders due to marketing reasons. We must pay all expenses incurred in connection with these incidental registration rights. These incidental registration rights have been waived with respect to this offering.

S-3 registration rights

If we are eligible to file a registration statement on Form S-3, the stockholders with S-3 registration rights under the 2004 Securityholder Agreement can request that we register their shares, provided that the total price of the shares of common stock offered to the public is at least \$1,000,000 (before deduction of underwriting discounts and commissions). The holders of S-3 registration rights may only require us to file one Form S-3 registration statement in any 12-month period. We may postpone the filing of a Form S-3 registration statement for up to 90 days once in any 12-month period if our board of directors determines in good faith that the filing would be seriously detrimental to us.

Transfer agent and registrar

The transfer agent and registrar for our common stock and the rights is American Stock Transfer and Trust Company.

Material United States federal tax consequences

The following is a general discussion of the material U.S. federal income and estate tax consequences of the ownership and disposition of common stock by a beneficial owner that is a non-U.S. holder, other than a non-U.S. holder that owns, or has owned, actually or constructively, more than 5% of the company's common stock. A non-U.S. holder is a person or entity that, for U.S. federal income tax purposes, is a:

non-resident alien individual, other than certain former citizens and residents of the United States subject to tax as expatriates

foreign corporation

foreign estate or trust

A non-U.S. holder does not include an individual who is present in the United States for 183 days or more in the taxable year of disposition and is not otherwise a resident of the United States for U.S. federal income tax purposes. Such an individual is urged to consult his or her own tax advisor regarding the U.S. federal income tax consequences of the sale, exchange or other disposition of common stock.

This discussion is based on the Internal Revenue Code of 1986, as amended (the Code), and administrative pronouncements, judicial decisions and final, temporary and proposed Treasury Regulations, changes to any which subsequent to the date of this prospectus may affect the tax consequences described herein. This discussion does not address all aspects of U.S. federal income and estate taxation that may be relevant to non-U.S. holders in light of their particular circumstances such as non-U.S. holders subject to special tax treatment under U.S. federal tax laws (including partnerships or other pass-through entities, controlled foreign corporations, passive foreign investment companies, banks and insurance companies, dealers in securities, holders of securities held as part of a straddle, hedge, conversion transaction or other risk-reduction transaction, non-U.S. holders that do not hold our common stock as a capital asset and persons who hold or receive common stock as compensation). In addition, this discussion does not address any tax consequences arising under the laws of any state, local or foreign jurisdiction.

We have not requested a ruling from the Internal Revenue Service (IRS) in connection with the tax consequences described herein. Accordingly, the discussion below neither binds the IRS nor precludes it from adopting a contrary position.

IN VIEW OF THE FOREGOING AND BECAUSE THE FOLLOWING DISCUSSION IS INTENDED AS A GENERAL SUMMARY ONLY, YOU ARE URGED TO CONSULT YOUR OWN TAX ADVISORS AS TO THE SPECIFIC TAX CONSEQUENCES OF THE OWNERSHIP OR DISPOSITION OF OUR STOCK, INCLUDING THE APPLICABLE FEDERAL, STATE, LOCAL AND FOREIGN TAX CONSEQUENCES, IN LIGHT OF YOUR OWN PARTICULAR TAX SITUATION.

Dividends

As discussed under Dividend policy above, the company does not currently expect to pay dividends. In the event that the company does pay dividends, dividends paid to a non-U.S. holder of common stock generally will be subject to withholding tax at 30% rate or a reduced rate specified by an applicable income tax treaty. In order to obtain a reduced rate of withholding, a non-U.S. holder will be required to provide an IRS Form W-8BEN certifying its entitlement to benefits under a treaty.

The withholding tax does not apply to dividends paid to a non-U.S. holder who provides a Form W-8ECI, certifying that the dividends are effectively connected with the non-U.S. holder s

conduct of a trade or business within the United States. Instead, the effectively connected dividends will be subject to regular U.S. income tax as if the non-U.S. holder were a U.S. resident, subject to an applicable income tax treaty providing otherwise. A non-U.S. corporation receiving effectively connected dividends may also be subject to an additional branch profits tax imposed at a rate of 30% (or a lower treaty rate).

Gain on disposition of common stock

A non-U.S. holder generally will not be subject to U.S. federal income tax on gain realized on a sale or other disposition of common stock unless:

the gain is effectively connected with a trade or business of the non-U.S. holder in the United States, subject to an applicable treaty providing otherwise

the company is or has been a U.S. real property holding corporation, as defined below, at any time within the five-year period preceding the disposition or the non-U.S. holder's holding period, whichever period is shorter, and its common stock has ceased to be traded on an established securities market prior to the beginning of the calendar year in which the sale or disposition occurs

In general, we would be a U.S. real property holding corporation if interests in U.S. real estate comprised the majority of our assets. The company believes that it is not, and does not anticipate becoming, a U.S. real property holding corporation.

Information reporting requirements and backup withholding

Information returns will be filed with the IRS in connection with payments of dividends and the proceeds from a sale or other disposition of common stock. A non-U.S. holder may have to comply with certification procedures to establish that it is not a United States person in order to avoid information reporting and backup withholding tax requirements. The certification procedures required to claim a reduced rate of withholding under a treaty will satisfy the certification requirements necessary to avoid the backup withholding tax as well. The amount of any backup withholding from a payment to a non-U.S. holder will be allowed as a credit against such holder's United States federal income tax liability and may entitle such holder to a refund, provided that the required information is furnished to the IRS.

Federal estate tax

Individual non-U.S. holders and entities the property of which is potentially includible in such an individual's gross estate for U.S. federal estate tax purposes (for example, a trust funded by such an individual and with respect to which the individual has retained certain interests or powers), should note that, absent an applicable treaty benefit, the common stock will be treated as U.S. situs property subject to U.S. federal estate tax.

Underwriters

Under the terms and subject to the conditions contained in an underwriting agreement dated the date of this prospectus, the underwriters named below, for whom J.P. Morgan Securities Inc. and Morgan Stanley & Co., Incorporated are acting as representatives, have severally agreed to purchase, and we have agreed to sell to them, severally, the number of shares indicated below:

Underwriters	Number of shares
J.P. Morgan Securities Inc. Morgan Stanley & Co., Incorporated Banc of America Securities LLC Natexis Bleichroeder Inc.	3,500,000
Total	3,500,000

The underwriters are offering the shares of common stock subject to their acceptance of the shares from us and subject to prior sale. The underwriting agreement provides that the obligations of the several underwriters to pay for and accept delivery of the shares of common stock offered by this prospectus are subject to the approval of specified legal matters by their counsel and to other conditions. The underwriters are obligated to take and pay for all of the shares of common stock offered by this prospectus if any such shares are taken. However, the underwriters are not required to take or pay for the shares covered by the underwriters' over-allotment option described below.

The underwriters initially propose to offer the shares of common stock directly to the public at the public offering price listed on the cover page of this prospectus and to certain dealers at a price that represents a concession not in excess of \$ per share under the public offering price. Any underwriter may allow, and such dealers may re-allow, a concession not in excess of \$ per share to other underwriters or to certain dealers. After the public offering of the shares of common stock, the offering price and other selling terms may from time to time be varied by the representatives.

We have granted to the underwriters an option, exercisable for 30 days from the date of this prospectus, to purchase up to an aggregate of 525,000 additional shares of common stock at the public offering price listed on the cover page of this prospectus, less underwriting discounts and commissions. The underwriters may exercise this option solely for the purpose of covering over-allotments, if any, made in connection with the offering of the shares of common stock offered by this prospectus. To the extent the option is exercised, each underwriter will become obligated, subject to certain conditions, to purchase about the same percentage of the additional shares of common stock as the number listed next to the underwriter's name in the preceding table bears to the total number of shares of common stock listed next to the names of all underwriters in the preceding table. If the underwriters' option is exercised in full, the total price to the public would be \$, the total underwriters' discounts and commissions would be \$ and the total proceeds to us would be \$.

The underwriters have informed us that they do not intend sales to discretionary accounts to exceed five percent of the total number of shares of common stock offered by them.

We, each of our directors and officers and certain venture capital funds affiliated with certain of our directors that held an aggregate of 5,543,183 shares of our common stock as of

December 31, 2006 have agreed that, without the prior written consent of J.P. Morgan Securities Inc. and Morgan Stanley & Co., Incorporated on behalf of the underwriters, we and they will not, during the period ending 30 days after the date of this prospectus:

offer, pledge, announce the intention to sell, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase of or otherwise transfer or dispose of, directly or indirectly, any shares of common stock or any securities convertible into or exercisable or exchangeable for common stock

enter into any swap or other agreement that transfers to another, in whole or in part, any of the economic consequences of ownership of the common stock

whether any transaction described above is to be settled by delivery of common stock or such other securities, in cash or otherwise. These restrictions do not apply to:

in the case of a corporation, the transfer of shares of our common stock or any shares convertible into common stock to any wholly-owned subsidiary of such corporation, provided that in such case, the transferee will execute an agreement stating that the transferee is subject to the restrictions described above

transactions relating to shares of common stock or other securities acquired in open market transactions after the completion of the offering of the shares, provided that no filing or other public announcement by any party under the Exchange Act shall be required or made in connection with subsequent sales of common stock or other securities acquired in such open market transactions (other than a filing on a Form 5 made after the expiration of the 30-day period referred to above)

transfers of any shares of common stock or other securities convertible into common stock made as a gift, to a trust, to limited partners, limited liability company members or stockholders of our executive officers, directors, or holders of substantially all of our stock, or to immediate family members, provided that the transferee agrees to be bound by the restrictions described above and if the donor or transferor is a reporting person subject to Section 16(a) of the Exchange Act, any gifts or transfers made in accordance with this paragraph will not require such person to and such person will not voluntarily, file a report of such transaction on Form 4 under the Exchange Act

sales or other transfers of up to 100,000 shares of common stock in the aggregate by non-executive employees of the Company

sales or other transfer by certain executive officers of the Company pursuant to trading plans established, pursuant to Rule 1065-1 under the Securities Exchange Act of 1934, prior to the date of this prospectus

The following table shows the underwriting discounts and commissions that we are to pay to the underwriters in connection with this offering. These amounts are shown assuming both no exercise and full exercise of the underwriters' option to purchase additional shares of our common stock.

Paid by Vanda	No exercise	Full exercise
Per Share	\$	\$

Total \$ \$

We estimate that the total expenses of this offering payable by us, not including the underwriting discounts and commissions, will be approximately \$1,250,000.

In order to facilitate the offering of the common stock, the underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the common stock. Specifically, the underwriters may sell more shares than they are obligated to purchase under the underwriting agreement, creating a short position. A short sale is covered if the short position is no greater than the number of shares available for purchase by the underwriters under the over-allotment option. The underwriters can close out a covered short sale by exercising the over-allotment option or purchasing shares in the open market. In determining the source of shares to close out a covered short sale, the underwriters will consider, among other things, the open market price of shares compared to the price available under the over-allotment option. The underwriters may also sell shares in excess of the over-allotment option, creating a naked short position. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the common stock in the open market after pricing that could adversely affect investors who purchase in this offering. In addition, to stabilize the price of the common stock, the underwriters may bid for, and purchase, shares of common stock in the open market. Finally, the underwriting syndicate may reclaim selling concessions allowed to an underwriter or a dealer for distributing the common stock in this offering, if the syndicate repurchases previously distributed common stock in transactions to cover syndicate short positions or to stabilize the price of the common stock. Any of these activities may stabilize or maintain the market price of the common stock above independent market levels. The underwriters are not required to engage in these activities, and may end any of these activities at any time.

We trade our common stock on The Nasdaq Global Market under the trading symbol VNDA.

We and the underwriters have agreed to indemnify each other against certain liabilities, including liabilities under the Securities Act of 1933, as amended.

Certain of the underwriters or their affiliates have provided from time to time, and may provide in the future, investment and commercial banking and financial advisory services to Vanda and its affiliates in the ordinary course of business, for which they have received and may continue to receive customary fees and commissions.

A prospectus in electronic format will be made available on the websites maintained by one or more of the lead managers of this offering and may also be made available on websites maintained by other underwriters. The underwriters may agree to allocate a number of shares to underwriters for sale to their online brokerage account holders. Internet distributions will be allocated by the lead managers to underwriters that may make Internet distributions on the same basis as other allocations.

Each underwriter acknowledges and agrees that it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of Section 21 of the Financial Services and Markets Act 2000, also known as the FSMA) received by it in connection with the issue or sale of any common stock in circumstances in which Section 21(1) of the FSMA does not apply to us. Each underwriter further acknowledges and agrees that it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the shares in, from or otherwise involving the United Kingdom.

Regarding each Member State of the European Economic Area which has implemented European Union Directive 2003/71/EC, also known as the EU Prospectus Directive, each underwriter has acknowledged and agreed that, from and including the date on which the EU Prospectus Directive is implemented in such Member State, such underwriter has not made and will not

make an offer of our securities to the public in that Member State prior to the publication of a prospectus in relation to such securities which has been approved by the competent authority in that Member State or, where appropriate, approved in another applicable Member State and notified to the competent authority in that Member State, all in accordance with the EU Prospectus Directive, except that it may, with effect from and including the relevant implementation date of the EU Prospectus Directive, make an offer of shares to the public in that Member State at any time

to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities

to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than 43,000,000 and (3) an annual net turnover of more than 50,000,000, as shown in its last annual or consolidated accounts

to fewer than 100 natural or legal persons (other than qualified investors as defined in the EU Prospectus Directive) subject to obtaining the prior consent of the book-running manager(s) for any such offer

in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the EU Prospectus Directive

For the purposes of this provision, the expression an offer of shares to the public in relation to any shares in any Member State that has implemented the EU Prospectus Directive means the communication in any form and by any means of sufficient information on the terms of the offer and the shares to be offered so as to enable an investor to decide to purchase or subscribe the shares, as the same may be varied in that Member State by any measure implementing the EU Prospectus Directive in that Member State.

No prospectus (including any amendment, supplement or replacement thereto) has been prepared in connection with this offering that has been approved by the Autorité des marchés financiers in France or by the competent authority of another applicable Member State that has provided notice to the Autorité des marchés financiers. No securities to be registered pursuant to this offering have been offered or sold or will be offered or sold, directly or indirectly, to the public in France except to permitted investors, such permitted investors consisting of persons licensed to provide the investment service of portfolio management for the account of third parties, qualified investors (investisseurs qualifiés) acting for their own account and/or investors belonging to a limited circle of investors (cercle restreint d'investisseurs) acting for their own account, with qualified investors and limited circle of investors having the meaning ascribed to them in Articles L. 411-2, D. 411-1, D. 411-2, D. 734-1, D. 744-1, D. 754-1 and D. 764-1 of the French Code Monétaire et Financier and applicable regulations thereunder. None of this prospectus or any other materials related to the offering or information contained therein relating to the securities to be registered pursuant to this offering has been released, issued or distributed to the public in France except to the permitted investors described above, and the direct or indirect resale to the public in France of any Securities acquired by any such permitted investors may be made only as provided by Articles L. 411-1, L. 411-2, L. 412-1 and L. 621-8 to L. 621-8-3 of the French Code Monétaire et Financier and applicable regulations thereunder.

This offering has not been cleared by the Italian Securities Exchange Commission (Company's Commissione Nazionale per le Società e la Borsa, also known as CONSOB) pursuant to Italian securities legislation and, accordingly, each underwriter has acknowledged and agreed that the Company's common stock may not and will not be offered, sold or delivered, nor may or will copies of the prospectus or any other documents relating to such common stock be distributed in Italy, except (i) to professional investors (operatori qualificati), as defined in Article 31, second

paragraph, of CONSOB Regulation No. 11522 of July 1, 1998, as amended, or (ii) in other circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of Legislative Decree No. 58 of February 24, 1998 (also known as the Financial Services Act) and Article 33, first paragraph, of CONSOB Regulation No. 11971 of May 14, 1999, as amended.

Any offer, sale or delivery of the common stock or distribution of copies of the prospectus or any other document relating to the common stock in Italy may and will be effected in accordance with all Italian securities, tax, exchange control and other applicable laws and regulations, and, in particular, will be made by an investment firm, bank or financial intermediary permitted to conduct such activities in Italy in accordance with the Financial Services Act, Legislative Decree No. 385 of September 1, 1993, as amended, the above- mentioned CONSOB Regulation No. 11522, and any other applicable laws and regulations. Such offer, sale or delivery will further be made in compliance with Article 129 of the above-mentioned Legislative Decree No. 385 and the implementing guidelines of the Bank of Italy, and will be made in compliance with any other applicable notification requirement or limitation which may be imposed by CONSOB or the Bank of Italy.

Any investor purchasing the common stock in the offering is solely responsible for ensuring that any offer or resale of the common stock it purchased in the offering occurs in compliance with applicable laws and regulations.

The prospectus and the information contained therein are intended only for the use of its recipient and, unless in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of the Financial Services Act and Article 33, first paragraph, of CONSOB Regulation No. 11971 of May 14, 1999, as amended, is not to be distributed, for any reason, to any third party resident or located in Italy. No person resident or located in Italy other than the original recipients of this document may rely on it or its content.

Italy has only partially implemented the EU Prospectus Directive. The provisions above regarding the EU Prospectus Directive shall apply with respect to Italy only to the extent that the relevant provisions of the EU Prospectus Directive have already been implemented in Italy.

Insofar as the requirements above are based on laws which are superseded at any time pursuant to the implementation of the EU Prospectus Directive, such requirements shall be replaced by the applicable requirements under the EU Prospectus Directive.

Legal matters

Gunderson Dettmer Stough Villeneuve Franklin & Hachigian, LLP will pass upon the validity of the common stock offered by this prospectus. Hoffman, Warnick & D Alessandro LLC, will pass upon certain intellectual property matters. Davis Polk & Wardwell will pass upon certain legal matters for the underwriters.

Experts

The consolidated financial statements for the period from March 13, 2003 (date of inception) to December 31, 2003, and for the years ended December 31, 2004 and 2005 included in this prospectus have been so included in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

Where you can find more information

We have filed with the Securities and Exchange Commission (SEC), Washington, D.C. 20549, a registration statement on Form S-1 under the Securities Act of 1933, with respect to our common stock offered hereby. This prospectus, which forms part of the registration statement, does not contain all of the information set forth in the registration statement and the exhibits and schedules to the registration statement. Some items are omitted in accordance with the rules and regulations of the SEC. For further information about us and our common stock, we refer you to the registration statement and the exhibits and schedules to the registration statement filed as part of the registration statement, as well as the reports and other information that we have filed with the SEC. Statements contained in this prospectus as to the contents of any contract or other document filed as an exhibit are qualified in all respects by reference to the actual text of the exhibit. You may read and copy the registration statement, including the exhibits and schedules to the registration statement, as well as the reports and other information we have filed with the SEC, at the SEC's Public Reference Room at 100 F Street N.E., Washington, D.C. 20549. You can obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site at www.sec.gov, from which you can electronically access the registration statement, including the exhibits and schedules to the registration statement.

Index to consolidated financial statements

Vanda Pharmaceuticals Inc.
(A development stage company)

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Vanda Pharmaceuticals Inc. (A development stage company):

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in stockholders' equity and cash flows present fairly, in all material respects, the financial position of Vanda Pharmaceuticals Inc. and its subsidiary (a development stage company) at December 31, 2004 and 2005, and the results of operations and cash flows for the period from March 13, 2003 (date of inception) to December 31, 2003 and the years ended December 31, 2004 and 2005 and for the period from March 13, 2003 (date of inception) to December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP
McLean, Virginia
February 15, 2006, except for Note 8
as to which the date is April 12, 2006

Vanda Pharmaceuticals Inc.
(A development stage company)
Consolidated Balance Sheets

	December 31,	2005
	2004	
Assets		
Current assets		
Cash and cash equivalents	\$ 16,259,770	\$ 21,012,815
Short-term investments		10,141,189
Prepaid expenses and other current assets	190,604	2,217,960
Total current assets	16,450,374	33,371,964
Property and equipment, net	1,251,867	1,110,576
Deposits	50,000	840,000
Restricted cash		430,230
Total assets	\$ 17,752,241	\$ 35,752,770
Liabilities and stockholders equity		
Current liabilities		
Accounts payable	\$ 718,606	\$ 2,254,897
Accrued liabilities	689,428	2,528,091
Deferred rent and credit on lease concession, current	3,549	8,131
Current portion of long-term debt	173,929	142,461
Current portion of capital lease	37,241	
Deferred grant revenue		129,950
Total current liabilities	1,622,753	5,063,530
Deferred rent and credit on lease concession, less current portion	30,371	24,433
Long-term debt, less current portion	142,487	
Capital lease, less current portion	13,043	
Total liabilities	1,808,654	5,087,963
Commitments		
Stockholders equity		

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Series A Preferred Stock, \$0.001 par value; 10,000,000 shares authorized, issued and outstanding at December 31, 2004 and 2005, respectively; liquidation preference of \$10,000,000	9,963,541	9,963,541
Series B Preferred Stock, \$0.001 par value; 42,276,437 shares authorized; 15,040,654 and 42,276,437 shares issued and outstanding at December 31, 2004 and 2005, respectively; liquidation preference of \$52,000,018	18,345,023	51,831,646
Common stock, \$0.001 par value; 50,000,000 and 70,000,000 shares authorized and 3,020 and 98,945 shares issued and outstanding at December 31, 2004 and 2005, respectively	3	99
Additional paid-in capital	340,637	23,982,981
Deferred stock-based compensation	(257,934)	(18,766,443)
Accumulated other comprehensive loss	(2,576)	(17,609)
Deficit accumulated during the development stage	(12,445,107)	(36,329,408)
Total stockholders' equity	\$ 15,943,587	\$ 30,664,807
Total liabilities and stockholders' equity	\$ 17,752,241	\$ 35,752,770

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

Vanda Pharmaceuticals Inc.
(A development stage company)
Consolidated Statements of Operations

	Period from March 13, 2003 (inception) to December 31, 2003	Year ended December 31, 2004 2005		Period from March 13, 2003 (inception) to December 31, 2005
Revenues from services	\$ 47,565	\$ 33,980	\$	\$ 81,545
Operating expenses:				
Research and development	2,010,532	7,442,983	16,890,615	26,344,130
General and administrative	1,052,659	2,119,394	7,396,038	10,568,091
 Total operating expenses	 3,063,191	 9,562,377	 24,286,653	 36,912,221
 Loss from operations	 (3,015,626)	 (9,528,397)	 (24,286,653)	 (36,830,676)
Other income (expense):				
Interest income	52,595	100,785	435,537	588,917
Interest expense	(8,090)	(41,934)	(25,629)	(75,653)
Other income	300	209	93	602
 Total other income	 44,805	 59,060	 410,001	 513,866
 Loss before tax provision	 (2,970,821)	 (9,469,337)	 (23,876,652)	 (36,316,810)
Tax provision		4,949	7,649	12,598
 Net loss	 (2,970,821)	 (9,474,286)	 (23,884,301)	 (36,329,408)
Beneficial conversion feature deemed dividend to preferred stockholders			(33,486,623)	(33,486,623)
 Net loss attributable to common stockholders	 \$ (2,970,821)	 \$ (9,474,286)	 \$ (57,370,924)	 \$ (69,816,031)
 Basic and diluted net loss per share attributable to common stockholders	 \$ (983.72)	 \$ (3,137.18)	 \$ (3,374.33)	

Shares used in calculation of basic and diluted net loss per share attributable to common stockholders	3,020	3,020	17,002
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The accompanying notes are an integral part of these consolidated financial statements.

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Vanda Pharmaceuticals Inc.
(A development stage company)
Statements of Changes in Stockholders Equity

Series A preferred stock		Series B preferred stock		Common stock Par value		Additional paid-in capital	Deferred stock-based compensation	Accumulated other comprehensive loss	Deficit accumulated during the development stage	Comp
Shares	Par value	Shares	Par value	Shares	value					
	\$		\$		\$	\$	\$	\$	\$	\$
0,000,000	9,963,541			3,020	3	3,997				
						12,628			(2,970,821)	(2,970,821)
								(2,315)		(2,315)
0,000,000	9,963,541			3,020	3	16,625		(2,315)	(2,970,821)	(2,970,821)
		15,040,654	18,345,023							
						27,945				
						281,130	(281,130)			
							23,196			

14,937

(9,474,286) (9,

(261)

(9,

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Vanda Pharmaceuticals Inc.
(A development stage company)
Statements of Changes in Stockholders' Equity (continued)

Series A Preferred stock	Series B preferred stock		Common stock		Additional paid-in	Deferred stock-based	Accumulated other comprehensive	Deficit accumulated during the	
Par value	Shares	Par value	Shares	Par value	capital	compensation	loss	development stage	
000	9,963,541	15,040,654	18,345,023	3,020	3	340,637	(257,934)	(2,576)	(12,445,107)
		27,235,783	33,486,623						
			95,925	96	31,658				
					18,788,385	(18,788,385)			
					1,702,625	(1,702,625)			
					3,119,676				
						1,982,501			
					33,486,623				
					(33,486,623)				

(23,884,301)

(17,711)

2,678

000 \$ 9,963,541 42,276,437 \$ 51,831,646 98,945 \$ 99 \$ 23,982,981 \$ (18,766,443) \$ (17,609) \$ (36,329,408)

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Vanda Pharmaceuticals Inc.
(A development stage company)
Consolidated Statements of Cash Flows

	Period from March 13, 2003 (inception) to December 31, 2003	2004	Year ended December 31, 2005	Period from March 13, 2003 (inception) to December 31, 2005
Cash flows from operating activities				
Net loss	\$ (2,970,821)	\$ (9,474,286)	\$ (23,884,301)	\$ (36,329,408)
Adjustments to reconcile net loss to net cash used in operating activities				
Depreciation and amortization	79,891	376,709	423,828	880,428
Stock-based compensation		66,078	5,102,177	5,168,255
Accretion of discount on investments			(42,335)	(42,335)
Changes in assets and liabilities:				
Accounts receivable	(28,489)	28,489		
Prepaid expenses and other current assets	(97,044)	(93,024)	(2,027,544)	(2,217,960)
Deposits		(50,000)	(790,000)	(840,000)
Accounts payable	458,608	415,506	1,514,868	2,254,897
Accrued expenses	432,474	99,335	1,860,539	2,528,091
Deferred grant revenue			129,950	129,950
Deferred rent and credit on lease concession	17,661	16,259	(1,356)	32,564
Net cash used in operating activities	(2,107,720)	(8,614,934)	(17,714,174)	(28,435,518)
Cash flows from investing activities				
Purchases of property and equipment	(1,161,921)	(414,531)	(291,978)	(1,868,430)
Purchases of short-term investments			(11,846,176)	(11,846,176)
Maturities of short-term investments			1,750,000	1,750,000
Investments in restricted cash			(430,230)	(430,230)
Net cash used in investing activities	(1,161,921)	(414,531)	(10,818,384)	(12,394,836)
Cash flows from financing activities				
Proceeds from borrowings on note payable	515,147			515,147

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Principal payments on obligations under capital lease		(42,887)	(51,569)	(94,456)
Principal payments on note payable	(45,010)	(156,446)	(172,617)	(374,073)
Proceeds from the issuance of preferred stock, net of issuance costs	9,963,541	18,345,023	33,486,623	61,795,187
Proceeds from exercise of stock options			31,754	31,754
Proceeds from issuance of common stock	4,000			4,000
Net cash provided by financing activities	10,437,678	18,145,690	33,294,191	61,877,559
Effect of foreign currency translation	(2,315)	(22,177)	(8,588)	(34,390)
Net increase in cash and cash equivalents	7,165,722	9,094,048	4,753,045	21,012,815
Cash and cash equivalents				
Beginning of period		7,165,722	16,259,770	
End of period	\$ 7,165,722	\$ 16,259,770	\$ 21,012,815	\$ 21,012,815
Supplemental disclosure				
Cash payments for interest	\$ 4,221	\$ 41,354	\$ 25,043	\$ 70,618
Supplemental disclosure of noncash financing activities				
Equipment acquired through obligation under capital lease	\$	\$ 95,305	\$	\$ 95,305

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

Vanda Pharmaceuticals Inc.
(A development stage company)
Notes to consolidated financial statements
Vanda Pharmaceuticals Inc.
(A development stage company)
Notes to consolidated financial statements (continued)

1. Business organization and presentation

Business organization

Vanda Pharmaceuticals Inc. (Vanda or the Company) was founded in November 2002 and commenced its operations on March 13, 2003. Vanda is a biopharmaceutical company focused on the development and commercialization of small molecule therapeutics, with exclusive worldwide commercial rights to three product candidates in clinical development for various central nervous system disorders. The Company's lead product candidate, iloperidone, is a compound for the treatment of schizophrenia and bipolar disorder and is in a Phase III trial for schizophrenia. The Company's second product candidate, VEC-162, is a compound for the treatment of sleep and mood disorders and has recently completed a Phase III trial for transient insomnia. VEC-162 is also ready for Phase II trials for the treatment of depression. The Company's third product candidate, VSF-173, is a compound for the treatment of excessive sleepiness and is ready for a Phase II trial. Each of these product candidates benefits from new chemical entity (NCE) patent protection and may offer substantial advantages over approved therapies.

The Company expects to complete its Phase III trial for iloperidone in the first half of 2007. If this trial is successful, the Company will file a New Drug Application (NDA) for approval with the Food and Drug Administration (FDA) later that year. The Company recently completed an efficacy and safety Phase III trial of VEC-162 for insomnia and announced top-line results in a Phase III trial in November 2006. The Company also expects to begin a Phase II trial of VSF-173 for excessive sleepiness in the second half of 2006.

Vanda Pharmaceuticals Pte. Ltd. (Vanda Singapore) is a limited liability company domiciled and incorporated in Singapore on February 24, 2003 as a wholly-owned subsidiary of Vanda Pharmaceuticals Inc. Vanda Singapore's principal activity is drug research using genetic and genomic sciences.

Capital resources

Although the Company was incorporated in November 2002, the Company did not commence operations until March 13, 2003, the date on which the Company first issued capital stock and began incurring expenses. Prior to March 13, 2003, the Company did not have any assets or liabilities, directly incur any expenses, or indirectly incur any expenses by a related party. Since its inception, the Company has devoted substantially all of its efforts to business planning, research and development, recruiting management and technical staff, acquiring operating assets and raising capital. Accordingly, the Company is considered to be in the development stage as defined in Statement of Financial Accounting Standards (SFAS) No. 7, *Accounting and Reporting by Development Stage Enterprises*.

The Company's activities will necessitate significant uses of working capital throughout 2006 and beyond. Additionally, the Company's capital requirements will depend on many factors, including the success of the Company's research and development efforts, payments received under contractual agreements with other parties, if any, and the status of competitive products. The Company plans to continue financing operations with the cash received from the private placement of Series B Preferred Stock (see Note 8) and the Company plans to seek additional sources of

funding in 2006. The Company's failure to raise additional capital, as and when

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needed, could have a negative impact on the financial condition and the ability of the Company to execute its business strategy. In the absence of our ability to raise additional private equity capital, we are also prepared and have the ability to curtail our existing clinical trial commitments and extend them in such a manner so that we have operating funds through the end of 2007.

Basis of presentation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All inter-company balances and transactions have been eliminated. The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Unaudited pro forma balance sheet

The unaudited pro forma balance sheet gives effect to the conversion of the Series A and B Preferred Stock in the event of an initial public offering (IPO), as if it occurred on December 31, 2005. The shares of the Company's Series A and B Preferred Stock shall be converted into common stock on a 3.309755-to-one basis automatically upon consummation of an IPO, after giving effect to the reverse split of the Company's common stock described in Note 8 below.

2. Summary of significant accounting policies

Cash and cash equivalents

For purposes of the consolidated balance sheet and consolidated statement of cash flows, cash equivalents represent all highly-liquid investments with an original maturity date of three months or less. At December 31, 2005, the Company maintained all of its cash and cash equivalents in two financial institutions. Deposits held with these institutions may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand, and the Company believes there is minimal risk of losses on such cash balances.

Short-term investments

The Company maintained highly-liquid investments throughout the period ending December 31, 2005, which were classified as available-for-sale because they can be utilized for current operations. The Company's investment policy requires the selection of high-quality issuers, with bond ratings of AAA to A1+/P1. These available-for-sale securities are accounted for at their fair market value and unrealized gains and losses on these securities, if any, are included in accumulated other comprehensive loss in stockholders' equity. Interest and dividend income is recorded when earned and included in interest income. Premiums and discounts on short-term investments are amortized and accreted to maturity and included in interest income. The Company uses the specific identification method in computing realized gains and losses on the sale of investments, which would be included in the consolidated statements of operations when generated. For the period from March 13, 2003 (inception) to December 31, 2003 and for the years ended December 31, 2004 and 2005, the Company did not have any realized gains or losses.

The following is a summary of the Company's available-for-sale short-term investments as of December 31, 2005:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair market value
U.S. government agencies	\$ 6,054,023	\$ 847	\$	\$ 6,054,870
U.S. corporate debt	4,084,488	1,831		4,086,319
	\$ 10,138,511	\$ 2,678	\$	\$ 10,141,189

Concentrations of credit risk

Financial instruments which potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and short-term investments. The Company places its cash and cash equivalents and short-term investments with highly-rated financial institutions.

Fair value of financial instruments

The carrying amounts of the Company's financial instruments, which include cash and cash equivalents, short-term investments, and accounts payable, approximate their fair values due to their short maturities. The fair value of the long-term debt approximates its carrying value based on the variable nature of interest rates and current market rates available to the Company.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation of property and equipment is provided on a straight-line basis over the estimated useful lives of the assets, generally three to seven years. Amortization of leasehold improvements is provided on a straight-line basis over the shorter of their estimated useful life or the lease term. The costs of additions and betterments are capitalized, and repairs and maintenance costs are charged to operations in the period incurred.

Upon retirement or disposition of property and equipment, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in general and administrative expenses for that period.

Impairment of long-lived assets

The Company assesses the recoverability of its long-lived assets by determining whether the carrying value of such assets can be recovered through undiscounted future operating cash flows. If impairment is indicated, the Company measures the amount of such impairment by comparing the fair value to the carrying value. There have been no indicators of impairment through December 31, 2005.

Restricted cash

During 2005, in conjunction with the lease of the office and laboratory space building, the Company provided the landlord with a letter of credit, which was collateralized with a restricted cash deposit in the amount of \$430,230 (see Note 6). The deposit is recorded as non-current restricted cash at December 31, 2005.

Deferred grant revenue

Vanda Singapore entered into an agreement with the Economic Development Board of Singapore (EDB) to provide a grant for a Development Project. During 2005, the Company submitted its first asset-related claim with the EDB and received a cash payment of \$127,866. Given that the Company has not met the conditions attached to the grant, the payment has been recorded as deferred grant revenue on the balance sheet at December 31, 2005. Management expects that a resolution is likely to be reached with the EDB in the near future.

Translation of foreign currency

The functional currency of the Company's wholly-owned foreign subsidiary located in Singapore is the local currency. Assets and liabilities of the Company's foreign subsidiary are translated to United States dollars based on exchange rates at the end of the reporting period. Income and expense items are translated at weighted average exchange rates prevailing during the reporting period. Translation adjustments are accumulated in a separate component of stockholder's equity. Translation gains or losses are included in the determination of operating results.

Other comprehensive income (loss)

SFAS No. 130, *Reporting Comprehensive Income*, requires a full set of general-purpose financial statements to include the reporting of comprehensive income. Other comprehensive loss is composed of two components, net loss and other comprehensive income. At December 31, 2004 and 2005, other comprehensive loss of \$2,576 and \$17,609, respectively, consists of cumulative translation adjustments due to foreign currency and unrealized gains on short-term investments.

Revenue recognition

Revenue is recognized upon delivery of products to customers. Revenue earned under research and development contracts are recognized in accordance with the proportional performance method outlined in Staff Accounting Bulletin No. 104 whereby the extent of progress toward completion is measured on the cost-to-cost basis; however, revenue recognized at any point will not exceed the cash received. When the current estimates of total contract revenue and contract cost indicate a loss, a provision for the entire loss on the contract is made in the period which it becomes probable. All costs related to these agreements are expensed as incurred. Revenue is derived principally from consulting agreements the Company entered into during its start-up phase to defray research costs. Vanda completed its obligations under these agreements during the year ended December 31, 2004, and no longer seeks such arrangements.

The Company will use the substantive milestone payment method for its revenues recognition policy. Under this method, revenue is recognized when all milestones to be received under contractual arrangements are determined to be substantive, at-risk and the culmination of an

earnings process. Substantive milestones are payments that are conditioned upon an event requiring substantive effort, when the amount of the milestone is reasonable relative to the time, effort and risk involved in achieving the milestones and when the milestones are reasonable relative to each other and the amount of any up-front payment. If these criteria are not met, the timing of the recognition of revenue from the milestone payment may be deferred.

Research and development expenses

Research and development costs are expensed as incurred and include the cost of salaries, building costs, utilities, allocation of indirect costs, and expenses to third parties who conduct research and development, pursuant to development and consulting agreements, on behalf of the Company. Costs related to the acquisitions of intellectual property are expensed as incurred since the underlying technology associated with these acquisitions were made in connection with the Company's research and development efforts and have no alternative future use.

General and administrative expenses

General and administrative costs are expensed as incurred and consist primarily of salaries and other related costs for personnel serving executive, finance, accounting, information technology and human resource functions. Other costs include facility costs not otherwise included in research and development expense and professional fees for legal and accounting services.

Interest income and expense

Interest income consists of interest earned on the Company's cash and cash equivalents and short-term investments. Interest expense consists of interest incurred on equipment debt.

Accounting for stock-based compensation

As provided by SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), the Company has elected to continue to account for its stock-based compensation programs according to the provisions of Accounting Principles Board Opinion No. 25, (APB 25) *Accounting for Stock Issued to Employees*. Accordingly, compensation expense has been recognized to the extent of employee or director services rendered based on the intrinsic value of compensatory options or shares granted under the plans. Under APB 25, compensation expense is recognized over the vesting period of the option to the extent that the fair value of the stock exceeds the exercise price of the stock at the date of grant.

Variable stock-based compensation awards are amortized and expensed in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option Plan or Award Plans*, an accelerated vesting model. Under this model, all stock based employee compensation charges are amortized over the vesting periods of the individual stock awards.

Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS 123, the Company's net loss and basic and diluted net loss

attributable to common stockholders per share would have been changed to the following pro forma amounts:

	Period from March 13, 2003 (inception) to December 31, 2003	Year ended December 31, 2004	2005
Net loss attributable to common stockholders	\$ (2,970,821)	\$ (9,474,286)	\$ (57,370,924)
Add: Stock based employee compensation expense included in net loss		38,133	5,102,177
Less: Stock-based employee compensation expense determined under SFAS 123	(33,160)	(57,954)	(5,167,246)
Pro forma net loss attributable to common stockholders	\$ (3,003,981)	\$ (9,494,107)	\$ (57,435,993)
Net loss per share:			
Basic and diluted, net loss attributable to common stockholders as reported	\$ (983.72)	\$ (3,137.18)	\$ (3,374.33)

The weighted average fair value of an option granted during the period from March 13, 2003 (inception) to December 31, 2003 and years ended December 31, 2004 and 2005 was \$1.06, \$3.97 and \$14.89 respectively. The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions for each year:

	Period from March 13, 2003 (inception) to December 31, 2003	Year ended December 31, 2004	2005
Expected dividend yield	0%	0%	0%
Expected volatility	0%	67%	67%-68%
Expected term (years)	10	5	5
Weighted average risk-free interest rate	3.65%	3.42%	4.00%

Given the lack of an active public market for our common stock, the Company's board of directors determined the fair value of the Company's common stock for stock option awards and the Company did not employ a third party valuation firm to determine fair value. In establishing the Company's estimates of fair value, the Company considered the guidance set forth in the AICPA Practice Guide, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, and made retrospective determinations of fair value. Information on stock

option grants, net of forfeitures, during the previous two years ended December 31, 2005 is summarized as follows:

Date of Issuance	Type of equity issuance	Number of options granted	Exercise price(1)	Fair market value estimate per common share	Intrinsic value per share
06/15/04	Employee Options	3,443	\$ 0.33	\$ 3.21	\$ 2.88
09/01/04	Employee Options	91,668	0.33	4.07	3.74
12/06/04	Employee Options	777	0.33	5.69	5.36
02/10/05	Employee Options	209,893	0.33	10.52	10.19
04/05/05	Employee Options	27,974	0.33	15.99	15.66
08/15/05	Employee Options	15,559	0.33	16.85	16.52
09/28/05	Employee Options	620,973	0.33	16.85	16.52
10/03/05	Employee Options	906	0.33	17.18	16.85
11/14/05	Employee Options	83,087	0.83	17.18	16.35
12/29/05	Employee Options	358,847	4.73	17.18	12.45

(1) The Company's board of directors approved a modification to all outstanding stock option awards that were granted prior to February 10, 2005, repricing the options from their original exercise price of \$1.32 to \$0.33. According to FIN 44, the result of such a modification is to account for the modified stock option awards as variable from the date of the modification to the date the awards are exercised, forfeited, or cancelled. The Company remeasured the modified awards that were outstanding at the end of each quarter during the year ended December 31, 2005.

Stock warrants

The Company accounts for warrants granted to consultants and advisors under SFAS 123 and Emerging Issues Task Force Issue 96-18, *Accounting for Equity Investments that are Issued to Other Than Employees for Acquiring or in Conjunction with Selling Goods or Services*, (EITF 96-18). As such, warrants granted to non-employees are periodically re-measured and expense is incurred during their vesting terms.

Income taxes

The Company accounts for income taxes under the liability method in accordance with provisions of SFAS No. 109, *Accounting for Income Taxes*, (SFAS 109) which requires companies to account for deferred income taxes using the asset and liability method. Under the asset and liability method, current income tax expense or benefit is the amount of income taxes expected to be payable or refundable for the current year. A deferred income tax asset or liability is recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credits and loss carryforwards. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Tax rate changes are reflected in income during the period such

changes are enacted. Changes in ownership may limit the amount of net operating loss carryforwards that can be utilized in the future to offset taxable income.

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Net loss per share

Net loss attributable to common stockholders per share is calculated in accordance with SFAS No. 128, *Earnings per Share*, and Staff Accounting Bulletin (SAB) No. 98. Basic earnings per share (EPS) is calculated by dividing the net income or loss attributable to common stockholders by the weighted average number of common shares outstanding, reduced by the weighted average unvested common shares subject to repurchase.

Diluted EPS is computed by dividing the net income or loss attributable to common stockholders by the weighted average number of other potential common stock outstanding for the period. Other potential common stock include Series A and B Preferred Stock, stock options and warrants but only to the extent that their inclusion is dilutive. The Company incurred a net loss in all periods presented, causing inclusion of any potentially dilutive securities to have an anti-dilutive affect, resulting in dilutive loss per share attributable to common stockholders and basic loss per share attributable to common stockholders being equivalent. The Company did not have any common shares issued for nominal consideration as defined under the terms of SAB No. 98, which would be included in EPS calculations.

	Period from March 13, 2003 (inception) to December 31, 2003	Year ended December 31, 2004 2005	
Historical:			
Numerator:			
Net loss	\$ (2,970,821)	\$ (9,474,286)	\$ (23,884,301)
Beneficial conversion feature deemed dividend to preferred stockholders			(33,486,623)
Net loss attributable to common stockholders	\$ (2,970,821)	\$ (9,474,286)	\$ (57,370,924)
Denominator:			
Weighted average common shares outstanding	3,020	3,020	30,346
Weighted average unvested common shares subject to repurchase			(13,344)
Denominator for basic and diluted net loss per share	3,020	3,020	17,002
Basic and diluted net loss per share attributable to common stockholders	\$ (983.72)	\$ (3,137.18)	\$ (3,374.33)
Historical outstanding anti-dilutive securities not included in diluted net loss per share calculation:			
Series A and B Preferred Stock(1)	3,021,368	7,565,703	15,794,632
Options to purchase common stock	236,204	314,961	1,532,540
Warrants to purchase common stock	13,626	50,335	50,335
	3,271,198	7,930,999	17,377,507

(1) Common stock equivalents assuming conversion.

The unaudited pro forma shares used to compute basic and diluted net loss per share is the weighted average shares of common stock outstanding, reduced by the weighted average unvested common shares subject to repurchase, and

includes the assumed conversion of the Series A and B Preferred Stock into shares of common stock as of January 1, 2005 or the actual date of issuance if later.

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**Year ended
December 31,
2005**

Pro forma (unaudited):

Numerator:

Pro forma net loss attributable to common stockholders	\$ (57,370,924)
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Denominator:

Weighted average common shares outstanding	17,002
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Pro forma adjustments to reflect assumed weighted average effect on conversion of preferred stock	8,948,015
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Pro forma shares used to compute basic and diluted net loss per share	8,965,017
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Basic and diluted pro forma net loss per share applicable to common stockholders	\$ (6.40)
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Certain risks and uncertainties

The Company's product candidates under development require approval from the Food and Drug Administration (FDA) or other international regulatory agencies prior to commercial sales. There can be no assurance the products will receive the necessary clearance. If the Company is denied clearance or clearance is delayed, it may have a material adverse impact on the Company.

The Company's products are concentrated in rapidly-changing, highly-competitive markets, which are characterized by rapid technological advances, changes in customer requirements and evolving regulatory requirements and industry standards. Any failure by the Company to anticipate or to respond adequately to technological developments in its industry, changes in customer requirements or changes in regulatory requirements or industry standards, or any significant delays in the development or introduction of products or services, could have a material adverse effect on the Company's business, operating results and future cash flows.

The Company depends on single source suppliers for critical raw materials for manufacturing, as well as other components required for the administration of its product candidates. The loss of these suppliers could delay the clinical trials or prevent or delay commercialization of the product candidates.

Segment information

Management has determined that the Company operates in one business segment which is the development and commercialization of pharmaceutical products.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates that affect the reported amounts of assets and liabilities at the date of the financial statements, disclosure of contingent assets and liabilities, and the reported amounts of revenue

and expenses during the reporting period. Actual results could differ from those estimates.

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Recent accounting pronouncements

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment*, a revision of SFAS No. 123, *Accounting for Stock-based Compensation*. SFAS 123R requires companies to recognize expense associated with share-based compensation arrangements, including employee stock options, using a fair value-based option pricing model, and eliminates the alternative to use APB 25's intrinsic method of accounting for share-based payments. In accordance with the new pronouncement, the Company plans to begin recognizing the expense associated with its share-based payments, as determined using a fair-value-based method, in its statements of operations beginning on January 1, 2006. Adoption of the expense provisions of SFAS 123R are expected to have a material impact on the Company's results of operations and net loss per share. The standard generally allows two alternative transition methods in the year of adoption—modified prospective application and retroactive application with restatement of prior financial statements to include the same amounts that were previously included in the pro forma disclosures. On January 1, 2006 the Company adopted SFAS 123R using the modified prospective method of implementation and adopted the accelerated vesting method. According to the modified prospective method the previously issued financial statements will not be adjusted and the deferred compensation balances recorded within the shareholders' equity will be eliminated as of January 1, 2006 against the additional paid-in capital account. On January 1, 2006, there was approximately \$19.7 million in unamortized compensation expense under the fair value method that will be recognized in the future over the remaining service periods through 2009.

In order to provide implementation guidance related to SFAS 123R, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 107, *Share-Based Payment* in March 2005. SAB 107 provides guidance on numerous issues such as valuation methods (including assumptions such as expected volatility and expected term), the classification of compensation expense, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123R, and disclosures in MD&A subsequent to adoption of SFAS 123R.

SFAS No. 154, *Accounting Changes and Error Corrections—a Replacement of APB Opinion No. 20 and FASB Statement No. 3* was issued by the FASB in May 2005. This Statement replaces APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in accounting principle and requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This Statement also requires that a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. SFAS No. 154 is not expected to have a material effect on the Company's consolidated financial statements.

In November 2005, the FASB Staff issued FASB Staff Position (FSP) FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. FSP FAS 115-1

addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP amends FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, and APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. The guidance in this FSP shall be applied to reporting periods beginning after December 15, 2005. Earlier application is permitted. FSP FAS 115-1 is not expected to have a material effect on the Company's consolidated financial statements.

3. Property and equipment

Property and equipment at cost:

	December 31,	
	2004	2005
Computer equipment	\$ 698,405	\$ 739,001
Laboratory equipment	681,455	730,232
Furniture and fixtures	29,309	101,556
Leasehold improvements	304,972	302,228
Construction in progress		120,851
	1,714,141	1,993,868
Less accumulated depreciation and amortization	(462,274)	(883,292)
	\$ 1,251,867	\$ 1,110,576

Depreciation and amortization expense for the period from March 13, 2003 (inception) to December 31, 2003 and years ended December 31, 2004 and 2005 was \$79,891, \$376,709 and \$423,828, respectively.

4. Accrued expenses

Accrued expenses consist of the following:

December 31,	
2004	2005

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Bonus accrual	\$ 284,143	\$ 530,311
Accrued professional fees	192,977	71,000
Accrued research and development expenses	172,730	1,862,288
Employee benefits	33,680	46,063
Other accrued expenses	5,898	18,429
Total accrued expenses	\$ 689,428	\$ 2,528,091

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5. Line of credit facility

In 2003, the Company entered into a \$515,147 line of credit facility to finance the purchase of specified equipment based on lender-approved schedules. The interest rate was fixed at 9.3% per annum. The Company has granted a security interest in the assets purchased under the credit line. During 2003, the full line of credit amount was drawn down. During 2004 and 2005, the Company had no draw downs under the line of credit. During 2004 and 2005, the Company repaid \$156,446 and \$172,617 on the line of credit, respectively. The total indebtedness relating to this line of credit was \$316,416 and \$142,461 as of December 31, 2004 and 2005, respectively.

Interest expense for the line of credit facility for the period from March 13, 2003 (inception) to December 31, 2003 and the years ended December 31, 2004 and 2005 was \$3,971, \$41,668, and \$21,887, respectively.

The following is a schedule of remaining principal payments under borrowings as of December 31, 2005:

2006	\$ 146,944
Less: Portion representing interest	4,483
Current portion	\$ 142,461

6. Commitments

Lease agreements

In 2003, the Company entered into a five-year non-cancelable operating lease agreement for office and laboratory space. The lease expires in June 2008. The lease contains an option to renew for an additional five years on the same terms and conditions. The lease contains a 3% annual escalation.

In August 2005, the Company entered into a ten-year, six-month non-cancelable operating lease agreement for office and laboratory space at a new office complex, which is renewable for an additional five-year period at the end of the original term. The lease expires in June 2016. The Company will take possession of the lease space during 2006. The lease includes a rent abatement and scheduled base rent increases over the term of the lease. The total amount of the base rent payments and rent abatement will be charged to expense on a straight-line method over the term of the lease. In conjunction with a letter of credit, the Company collateralized the operating lease with a restricted cash deposit in the amount of \$430,230 in September 2005, which is recorded as non-current restricted cash at December 31, 2005.

In 2004, the Company entered into a capital lease obligation at an interest rate of 7.5%. The lease obligation was payable in monthly installments of \$3,312 through April 2006. The Company capitalized the equipment in accordance with Statement of Financial Accounting Standard No. 13, *Accounting for Leases* (SFAS 13). SFAS 13 requires the capitalization of leases meeting certain criteria, with the related asset being recorded in property and equipment and an offsetting amount recorded as a liability. During 2005, the Company repaid the capital lease obligation in full.

The following is a schedule of future minimum lease payments for non-cancelable operating leases as of December 31, 2005:

2006	\$ 503,064
2007	642,347
2008	536,404
2009	427,260
2010	440,182
Thereafter	2,669,569
	\$ 5,218,826

Total rent expense for the period from March 13, 2003 (inception) through December 31, 2003 and the years ended December 31, 2004 and 2005 was \$143,174, \$315,241 and 299,234, respectively.

License and clinical agreements

License agreements

In June 2004, the Company acquired exclusive rights to develop and commercialize iloperidone through a sublicense agreement with Novartis AG (Novartis). In consideration for this license, the Company paid Novartis an initial license fee of \$500,000, which was immediately expensed to research and development expenses on the Consolidated Statements of Operations for the year ended December 31, 2004. The Company is obligated to make future milestone payments to Novartis of less than \$100 million in the aggregate (the majority of which are tied to sales milestones), as well as royalty payments to Novartis which, as a percentage of net sales, is in the mid-twenties. The Company's rights with respect to these patents and to commercialize iloperidone may terminate in whole or in part if the Company breaches its royalty obligations, covenants in the sublicense regarding our financial condition or certain restrictions in the sublicense regarding other development activities.

In February 2004, the Company entered into a license agreement with Bristol-Myers Squibb (BMS) under which the Company received an exclusive worldwide license under certain patents and patent applications to develop and commercialize VEC-162. In partial consideration for the license, the Company paid BMS an initial license fee of \$500,000, which was immediately expensed in research and development expenses on the Consolidated Statements of Operations for the year ended December 31, 2004. The Company is obligated to make future milestone payments to BMS of less than \$40 million in the aggregate (the majority of which are tied to sales milestones) as well as royalty payments based on the net sales of VEC-162 at a rate which, as a percentage of net sales, is in the low teens. The Company is also obligated under this agreement to pay BMS a royalty on certain payments (excluding royalties) that the Company receives from a third party in connection with any sublicensing arrangement, at a rate in the mid-twenties. Either party may terminate the agreement under certain circumstances.

In June 2004, the Company entered into a license agreement with Novartis under which the Company received an exclusive worldwide license to develop and commercialize VSF-173. In consideration for the license, the Company paid Novartis an initial license fee of \$500,000,

which was immediately expensed in research and development expenses on the Consolidated Statements of Operations for the year ended December 31, 2004. The Company is also obligated to make future milestone payments to Novartis of less than \$50 million in the aggregate (the majority of which are tied to sales milestones) and royalty payments which, as a percentage of net sales, is in the low to mid teens. Either party may terminate the agreement under certain circumstances, including a material breach of the agreement by the other.

Clinical agreements

During 2004 and 2005, the Company entered into agreements with clinical organizations to provide services relating to iloperidone and VEC-162 under fee service arrangements. The Company incurred a total of \$915,631 and \$6,305,044 in charges under these arrangements during the years ended December 31, 2004 and 2005, respectively. \$3,003,843 of these charges during the year ended December 31, 2005 were incurred under agreements that have expired; the other \$3,301,201 in charges were incurred for clinical services rendered in connection with the Company's current Phase III trial for Iloperidone and VEC-162.

The Company's current agreements for clinical services may be terminated on no more than 60 days' notice without incurring additional charges (other than charges for work completed but not paid for through the effective date of termination and other costs incurred by the Company's contractors in closing out work in progress as of the effective date of termination). Assuming that the Company's upcoming Phase III trials for iloperidone and VEC-162 are completed in accordance with our expectations, the Company will incur estimated additional charges of approximately \$20.9 million and \$9.9 million from such contractual obligations during the years ended December 31, 2006 and 2007, respectively.

7. Related party transactions

From time to time, the Company reimbursed Care Capital, LLC ("Care"), an affiliate of the majority shareholder of the Company, for certain expenses paid by Care on behalf of the Company. The Company reimbursed Care for approximately \$299,000 and \$54,000 for the period from March 13, 2003 (inception) through December 31, 2003 and the year ended December 31, 2004, respectively.

The Company also used the services of a Care employee and reimbursed Care for such personnel services related to occupancy and salary expenses incurred on behalf of the Company. Reimbursements related to such expenses were approximately \$34,000 and approximately \$49,000 for the period from March 13, 2003 (inception) through December 31, 2003 and the year ended December 31, 2004, respectively.

There were no related party transactions during 2005.

8. Preferred and common stock

Reverse stock split

In March 2006, the board of directors approved a one-for-3.309755 reverse stock split of the Company's common stock to be effected upon the effectiveness of the Company's initial public offering. All historical common stock and per share common stock information has been changed to reflect this reverse stock split. Preferred stock information has not been changed.

except to reflect the 3.309755-to-one conversion ratio in effect after giving effect to this reverse stock split.

Series A Preferred Stock and Class A Common Stock

In March 2003, the Company closed a private placement of its securities and raised approximately \$10.0 million. The Company sold 100 shares of newly issued Class A Common Stock at a per share price of \$40.00 and 10,000,000 shares of newly-issued Series A Preferred Stock at a per share price of \$1.00 a share.

The 100 shares of Class A Common Stock converted into 10,000 shares of common stock in September 2004 (3,020 shares of common stock after giving effect to the reverse stock split discussed in this Note 8). No Series A Common Stock is currently authorized or outstanding. All share information in the financial statements has been retroactively adjusted to reflect the effect of the conversion as if it had occurred at the beginning of the earliest period presented.

Series B Preferred Stock

In September 2004, the Company closed a private placement of 15,040,654 shares of Series B Preferred Stock for approximately \$18.5 million.

In September 2005, the Company closed an additional private placement of 15,040,654 shares of Series B Preferred Stock for approximately \$18.5 million.

In December 2005, the Company closed an additional private placement of 12,195,129 shares of Series B Preferred Stock for approximately \$15.0 million.

Voting rights

The holders of preferred stock shall vote together with the holders of the outstanding shares of common stock, and not as a separate class or series, on an as-converted-to-common-stock basis. So long as at least 10,528,457 shares of Series B Preferred Stock remain outstanding, the holders of the outstanding shares of Series B Preferred Stock, voting together as a class and to the exclusion of all other classes of capital stock of the Company, shall be entitled to elect three (3) members of the board of directors (the Series B Preferred Directors). So long as at least 3,500,000 shares of Series A Preferred Stock remain outstanding, the holders of the outstanding shares of Series A Preferred Stock, voting together as a class and to the exclusion of all other classes of capital stock of the Company, shall be entitled to elect three (3) members of the board of directors (the Series A Preferred Directors and, together with the Series B Preferred Directors, the Preferred Directors). Any remaining directors shall be appointed upon the mutual agreement of a majority of the Series A Preferred Directors and the Series B Preferred Directors (the General Directors), provided that one of the General Directors shall be the chief executive officer of the Company.

Dividends

The holder of each then outstanding share of Series A Preferred Stock and the holder of each then outstanding share of Series B Preferred Stock shall be entitled to receive dividends payable out of funds legally available therefor when, as and if declared by the board of directors of the Company. Such dividends shall be payable on parity with the holders of the common stock and

any such dividend shall be distributed ratably among the holders of the common stock and the holders of the preferred stock as if all such shares of preferred stock were to convert into common stock. The right to such dividends shall not be cumulative, and no right shall accrue to holders of preferred stock. Dividends, if paid, or if declared and set apart for payment, must be paid, or declared and set apart for payment, on all outstanding shares of the preferred stock contemporaneously.

Liquidation preference

In the event of any voluntary or involuntary dissolution, liquidation or winding up of the affairs of the Company (a Liquidation Event), after payment or provision for payment of the debts and other liabilities of the Company, the holders of each share of Series A Preferred Stock and each share of Series B Preferred Stock shall be entitled to receive, on a pari passu basis out of the assets of the Company, an amount equal to the liquidation preference. The liquidation preference per share of Series A Preferred Stock as of any particular date (the Series A Liquidation Preference) shall be the greater of the Original Series A Purchase Price or the amount per share of Series A Preferred Stock that the holder of the number of shares of common stock issuable upon conversion thereof would receive upon any such Liquidation Event. The liquidation preference per share of Series B Preferred Stock as of any particular date (the Series B Liquidation Preference and, together with the Series A Liquidation Preference, the Liquidation Preference) shall be the greater of the Original Series B Purchase Price or the amount per share of Series B Preferred Stock that the holder of the number of shares of common stock issuable upon conversion thereof would receive upon any such Liquidation Event.

If upon any Liquidation Event the assets of the Company distributable among the holders of the Series A Preferred Stock and the Series B Preferred Stock shall be insufficient to permit the payment to them of the full preferential amounts to which they are entitled, then the entire assets of the Company to be distributed shall be distributed ratably among the holders of the Series A Preferred Stock and the Series B Preferred Stock, in proportion to the sum of their respective per share liquidation preferences, until payment in full of such amount per share.

Conversion

Each share of the preferred stock shall be convertible, at the option of the holder, at any time after the date of the issuance of such share, into that number of the fully paid and nonassessable shares of common stock determined in accordance with the following provisions:

- (a) Each share of Series A Preferred Stock shall be convertible into the number of shares of common stock which results from dividing the Series A Conversion Price (as defined herein) per share in effect at the time into the Original Series A Purchase Price; and
- (b) Each share of Series B Preferred Stock shall be convertible into the number of shares of common stock which results from dividing the Series B Conversion Price (as defined herein) per share in effect at the time into the Original Series B Purchase Price.

The conversion price per share for the Series A Preferred Stock is currently approximately \$3.31, such that shares of Series A Preferred Stock convert to shares of common stock at a 3.309755-to-one ratio after giving effect to the reverse stock split described in Note 8 to these financial

statements. The conversion price per share for the Series B Preferred Stock is currently approximately \$4.07, such that shares of Series B Preferred Stock convert to shares of common stock at a 3.309755-to-one ratio after giving effect to the reverse stock split described in Note 8 to these financial statements. The conversion price per share of both the Series A Preferred Stock and the Series B Preferred Stock shall be subject to equitable adjustment in the event of a stock split, stock combination, reclassification, reorganization, recapitalization or similar event, and shall also be subject to adjustment in the event that the Company issues shares of common stock (or securities convertible into or exercisable for common stock) at a price per share below the applicable conversion price then in effect (excluding shares issued or issuable to employees, officers, directors or consultants pursuant to agreements duly approved by the Company's board of directors, pursuant to exercises of warrants, options or other convertible securities outstanding as of September 2004, or pursuant to certain lease financings).

Automatic conversion

Each share of preferred stock then outstanding shall be automatically converted into the number of fully paid and nonassessable shares of common stock determined in accordance with the conversion features listed above upon the earlier of:

- (a) The close of business of the day immediately preceding the closing of the sale of its common stock in connection with a Qualified Public Offering (as defined in the Company's Second Amended and Restated Certificate of Incorporation); or
- (b) The consent of the holders of at least a majority of the outstanding shares of preferred stock voting or consenting together as a single class and to the exclusion of all other classes of capital stock of the Company.

Special mandatory conversion

In connection with the additional sale of Series B Preferred Stock in September 2005, if any holder of shares of Series B Preferred Stock fails to purchase all shares of Series B Preferred Stock required to be purchased by such holder at any additional closing (as defined), all of such holder's Series B Preferred Stock shall automatically and without further action on the part of such holder be converted into such number of shares of common stock into which such shares of Series B Preferred Stock are then convertible. Upon conversion, the shares of Series B Preferred Stock converted shall be canceled and not subject to reissuance.

9. Beneficial conversion feature Series B Preferred Stock

In September 2005, the Company completed the sale of an additional 15,040,654 shares of Series B Preferred Stock for proceeds of approximately \$18.5 million. After evaluating the fair value of the Company's common stock obtainable upon conversion by the stockholders, the Company determined that the issuance of the Series B Preferred Stock sold in September 2005 resulted in a beneficial conversion feature calculated in accordance with EITF Issue No. 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*, (EITF 98-5) as interpreted by EITF Issue No. 00-27, *Application of Issue No. 98-5 to Certain Convertible Instruments*, (EITF 00-27) of approximately \$18.5 million which was fully accreted in September 2005 and is recorded as a deemed dividend to preferred stockholders for the year ended December 31, 2005.

In December 2005, the Company closed an additional private placement of 12,195,129 shares of Series B Preferred Stock for proceeds of approximately \$15.0 million. The Company evaluated the fair value of the Company's common stock obtainable upon conversion by the stockholders using EITF 98-5 and EITF 00-27 and determined that the issuance of the Series B Preferred Stock sold in December 2005 resulted in a beneficial conversion feature of approximately \$15.0 million that was fully accreted in December 2005 and recorded as a deemed dividend to preferred stockholders for the year ended December 31, 2005.

10. Equity benefit plans

In March 2003, the Company adopted the Vanda Pharmaceuticals Inc. Management Equity Plan (Stock Option Plan), a non-qualified stock option plan. The Company has reserved 1,781,509 shares of common stock to accommodate the exercise of options granted under the Stock Option Plan. As of December 31, 2005, there were remaining 153,044 shares reserved for issuance under the Stock Option Plan. The Company has issued options to purchase common stock to various employees which expire 10 years from the date of grant. The options become 100% vested on the fourth anniversary of the date of grant.

Management equity plan

The Company has historically granted stock options at exercise prices that equaled the fair value of its common stock at the date of grant as estimated by its board of directors. Since there has not been a public market for the Company's common stock, the board of directors determined the fair value of its common stock by considering a number of objective and subjective factors, including the pricing of convertible preferred stock, the preferences and rights of the Company's preferred stock over the common stock, important operational events, the risk and non-liquid nature of the common stock, and underlying market conditions. The Company has not historically obtained contemporaneous valuations by an unrelated valuation specialist because, at the time of the issuances of stock options, the Company believed its estimates of the fair value of its common stock to be reasonable based on the foregoing factors.

In connection with this proposed initial public offering, the Company retrospectively assessed the fair value of its common stock. In reassessing the fair value, the Company considered the factors used in its historical determinations of fair value, the likelihood of a liquidity event such as an initial public offering, and feedback received from investment banks relating to an initial public offering upon beginning such discussions in November 2005. In reassessing the fair value of the common stock, the Company determined that an increase in the estimated fair value of the underlying common stock for options granted after December 2003 was appropriate. As allowed by SFAS No. 123, *Accounting for Stock Based Compensation*, the Company accounts for its stock options granted to employees and directors under APB 25, *Accounting for Stock Issued to Employees*. Accordingly, deferred stock compensation is recognized to the extent that the price of the underlying common stock, as determined in the retrospective fair value analysis, exceeds the exercise price of the stock options at the date of grant. Deferred stock compensation is amortized over the vesting period of the related options which is generally four years.

For the year ended December 31, 2004, the Company granted 97,398 stock options to employees with a weighted average intrinsic value of \$2.81 per share, resulting in deferred stock

compensation of \$281,130. For the year ended December 31, 2005, the Company granted 1,318,753 stock options to employees with a weighted average intrinsic value of \$14.36 per share, resulting in deferred stock compensation of \$18,788,385. Compensation expense relating to stock options with the common stock fair value greater than the exercise price granted to employees was \$23,196 and \$1,276,021 for the years ended December 31, 2004 and 2005, respectively. Of the \$23,196 of compensation expense recognized during the year ended December 31, 2004, \$2,086 was included in research and development and \$21,110 was included in general and administrative. Of the \$1,276,021 of compensation expense recognized during the year ended December 31, 2005, \$152,971 was included in research and development and \$1,123,050 was included in general and administrative expense.

In August 2004, the Company approved a modification to an employee's stock option awards at time of employment termination. The modification was to accelerate a portion of the unvested stock options so the shares could be immediately exercisable. According to FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation* (FIN 44), the result of such a modification is to remeasure the stock options that were modified. The remeasurement of the stock options resulted in an immediate charge of \$14,937, which was included in general and administrative expense for the year ended December 31, 2004.

In February 2005, the board of directors approved a modification to all outstanding granted stock option awards, repricing the options from its original exercise price of \$1.32 to \$0.33. According to FIN 44, the result of such a modification is to account for the modified stock option awards as variable from the date of the modification to the date the awards are exercised, forfeited, or cancelled. For each of the quarters ended during the year ended December 31, 2005, the Company remeasured approximately 335,000 outstanding stock options, resulting in a deferred stock compensation of \$1,702,625 at December 31, 2005. Compensation expense relating to the remeasurement of modified stock options was \$3,826,157 for the year ended December 31, 2005, which includes \$3,119,676 of immediate stock compensation charges for vested shares at the time of remeasurement. Of the \$3,826,157 of compensation expense recognized during the year ended December 31, 2005, \$635,906 was included in research and development and \$3,190,251 was included in general and administrative expense.

A summary of stock option activity is as follows with the repricing the options from its original exercise price of \$1.32 to \$0.33 reflected for all option activity:

	Number of shares	Weighted average exercise price at grant date
March 13, 2003 (inception)		\$
Granted	236,204	\$ 0.33
Outstanding at December 31, 2003	236,204	0.33
Granted	97,398	0.33
Cancelled or expired	(18,641)	0.33
Outstanding at December 31, 2004	314,961	0.33
Granted	1,318,753	1.52
Cancelled or expired	(5,249)	0.33
Exercised	(95,925)	0.33
Outstanding at December 31, 2005	1,532,540	1.39
Exercisable at December 31, 2005	132,413	0.33

The following table summarizes information about stock options outstanding and exercisable at December 31, 2005:

Exercise price	Options outstanding			Options exercisable	
	Number of underlying shares	Weighted- average exercise price per share	Weighted- average remaining contractual life (years)	Number of underlying shares	Weighted- average exercise price per share
\$0.33	1,090,606	\$ 0.33	9.2	132,413	\$ 0.33
\$0.83	83,087	0.83	9.9		
\$4.73	358,847	4.73	10.0		
	1,532,540			132,413	

Restricted stock

Certain of the Company's employees have entered into the Company's standard form of stock restriction agreement as a condition to their exercise of options to acquire common stock pursuant to the Plan. Shares exercised prior to vesting are subject to forfeiture in accordance with the vesting schedule of the granted stock options. During 2005, certain of the Company's employees exercised unvested stock options, awarded under the Company's Stock Incentive Plan, to acquire a total of 57,882 shares of restricted common stock. At December 31, 2005, 55,375 shares of restricted common stock remain unvested pursuant to awards.

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11. Stock warrants

In 2003, in connection with entering into the line of credit facility to finance the purchase of equipment, the Company granted to the lender a freely exercisable warrant to purchase 13,626 shares of the Company's common stock (the Lender Warrant Shares) at an exercise price of \$1.32 per share. The Lender Warrant Shares were valued using the Black-Scholes option pricing model at \$0.93 per share and the aggregate value was \$12,628, which was recorded as general and administrative for the period from March 13, 2003 through December 31, 2003.

In February 2004, the Company issued warrants to a consultant to purchase 36,709 shares of the Company's common stock (the Consultant Warrant Shares) at an exercise price of \$1.32 per share. The Consultant Warrant Shares were valued using the Black-Scholes option pricing model at \$0.76 per Consultant Warrant Share and the aggregate value was \$27,945, which was recorded as general and administrative for the year ended December 31, 2004.

The Company used the following assumptions to calculate the individual warrant shares through the Black-Scholes option pricing model:

	Lender	Consultant
Expected dividend yield	0%	0%
Expected volatility	67%	67%
Expected term (years)	8	5
Risk-free interest rate	3.65%	3.08%

12. Income taxes

The tax provision is as follows:

	Period from March 13, 2003 (inception) to December 31, 2003	December 31, 2004	2005
Current federal tax expense	\$	\$	\$
Current state tax expense			
Current foreign expense		4,949	7,649
Deferred tax expense			
 Total tax expense	 \$	 \$ 4,949	 \$ 7,649

Deferred tax assets consist of the following:

	December 31,	
	2004	2005
Deferred tax asset (liability)		
Net operating loss carryforwards	\$ 3,863,758	\$ 8,340,222
Start-up costs	869,656	3,717,820
Stock-based compensation		1,683,454
Research and development credit	365,134	769,019
Depreciation and amortization	(52,549)	(57,340)
Amortization of warrants	26,878	12,156
Accrued and deferred expenses	74,870	19,359
Net deferred tax assets	5,147,747	14,484,690
Deferred tax asset valuation allowance	(5,147,747)	(14,484,690)
	\$	\$

Based on the Company's limited operating history and management's expectation of future profitability, management believes that the Company's deferred tax assets do not meet the more likely than not criteria under SFAS No. 109. Accordingly, a valuation allowance for the entire deferred tax asset amount has been recorded.

The effective tax rate differs from the U.S. federal statutory tax rate of 34% due to the following:

	December 31,	
	2004	2005
Federal tax at statutory rate	34.0%	34.0%
State taxes	4.6%	4.5%
Change in valuation allowance	(42.5%)	(39.1%)
Research and development credit	4.0%	1.7%
Meals, entertainment and other non-deductable items	(0.1%)	(1.1%)
Effective tax rate	0.0%	0.0%

At December 31, 2004 and 2005, the Company had U.S. federal and state net operating loss carryforwards of approximately \$10.0 million and \$21.6 million, respectively available to reduce future taxable income, which will begin to expire in 2023. At December 31, 2004 and 2005, the Company had approximately \$0.4 million and \$0.8 million of research and development credit, respectively which will begin to expire in 2023.

Under the Tax Reform Act of 1986, the amounts of and benefits from the operating loss carryforwards may be impaired in certain circumstances. Events which cause limitations in the amount of net operating losses that the Company may utilize in any one year include, but are not limited to, a cumulative ownership change of more than 50%, as defined, over a three year period.

13. Employee benefit plan

The Company has a defined contribution plan (the Plan) under the Internal Revenue Code Section 401(k). This plan covers substantially all employees who meet minimum age and service requirements and allows participants to defer a portion of their annual compensation on a pre-tax basis. Currently, the Company matches 50 percent up to the first six percent of employee contributions. All matching contributions have been paid by the Company. The employer match vests over a 4 year period. The total employer match for the period from March 13, 2003 (inception) through December 31, 2003 and for the years ended December 31, 2004 and 2005 was \$12,731, \$42,206 and \$55,503, respectively.

14. Subsequent event

When the Company took possession of the new lease space in January 2006, the Company vacated the current office and laboratory space. According to SFAS 146 *Accounting for Costs Associated with Exit or Disposal Activities*, a liability for costs that will continue to be incurred under a contract for its remaining term without economic benefit to the Company shall be recognized and measured when the Company ceases using the right conveyed by the lease agreement, reduced by estimated sublease rentals that could be reasonably obtained. The Company incurred a charge of approximately \$260,000 at the time the Company moved from the current location to the new office complex in January 2006.

Vanda Pharmaceuticals Inc.
(A development stage company)
Condensed Consolidated Balance Sheets (Unaudited)

	September 30, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	\$ 31,899,979	\$ 21,012,815
Short-term investments	11,096,506	10,141,189
Prepaid expenses and other current assets	1,827,513	2,217,960
Total current assets	44,823,998	33,371,964
Property and equipment, net	1,848,270	1,110,576
Deposits	180,000	840,000
Restricted cash	430,230	430,230
Total assets	\$ 47,282,498	\$ 35,752,770
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	\$ 2,112,395	\$ 2,254,897
Accrued expenses	7,839,431	2,528,091
Current portion of long-term debt	374	142,461
Deferred grant revenue	136,251	129,950
Deferred rent		8,131
Total current liabilities	10,088,451	5,063,530
Deferred rent and other long-term liabilities	242,415	24,433
Total liabilities	10,330,866	5,087,963
Commitments and contingencies (Note 10)		
Stockholders equity	21,907	99

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Common stock, \$0.001 par value, 150,000,000 and 70,000,000 shares authorized as of September 30, 2006 and December 31, 2005, respectively; and 21,907,188 and 98,945 shares issued and outstanding as of September 30, 2006 and December 31, 2005, respectively

Series A and Series B convertible preferred stock		61,795,187
Additional paid-in capital	124,893,956	23,982,981
Deferred stock-based compensation		(18,766,443)
Accumulated other comprehensive loss	(15,130)	(17,609)
Deficit accumulated during the development stage	(87,949,101)	(36,329,408)
Total stockholders' equity	36,951,632	30,664,807
Total liabilities and stockholders' equity	\$ 47,282,498	\$ 35,752,770

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

Vanda Pharmaceuticals Inc.
(A development stage company)
Condensed Consolidated Statements of Operations (Unaudited)

	Three months ended		Nine months ended		Period from
	September 30,	September 30,	September 30,	September 30,	March 13,
	2006	2005	2006	2005	2003
					(inception) to
					September 30,
					2006
Revenues from services	\$	\$	\$	\$	\$ 81,545
Operating expenses:					
Research and development	9,542,385	4,092,240	44,130,788	11,641,565	70,474,919
General and administrative	3,264,849	1,664,902	9,170,439	5,587,147	19,738,530
Total operating expenses	12,807,234	5,757,142	53,301,227	17,228,712	90,213,449
Loss from operations	(12,807,234)	(5,757,142)	(53,301,227)	(17,228,712)	(90,131,904)
Other income (expense):					
Interest income	683,469	57,259	1,686,363	208,763	2,275,280
Interest expense	(396)	(5,005)	(4,829)	(20,568)	(80,481)
Other income				93	602
Total other income	683,073	52,254	1,681,534	188,288	2,195,401
Loss before tax provision	(12,124,161)	(5,704,888)	(51,619,693)	(17,040,424)	(87,936,503)
Income tax provision					12,598
Net loss	(12,124,161)	(5,704,888)	(51,619,693)	(17,040,424)	(87,949,101)
Beneficial conversion feature deemed dividend to preferred		(18,500,005)		(18,500,005)	(33,486,623)

stockholders

Net loss attributable to common stockholders	\$ (12,124,161)	\$ (24,204,893)	\$ (51,619,693)	\$ (35,540,429)	\$ (121,435,724)
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Basic and diluted net loss per share attributable to common stockholders	\$ (0.55)	\$ (1,308.87)	\$ (3.72)	\$ (3,094.51)
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Shares used in calculation of basic and diluted net loss per share attributable to common stockholders	21,871,542	18,493	13,862,613	11,485
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The accompanying notes are an integral part of these condensed consolidated financial statements.

Vanda Pharmaceuticals Inc.
(A development stage company)
Condensed Consolidated Statement of Changes in Stockholders' Equity (Unaudited)

Series A and B convertible preferred stock		Common stock		Additional paid-in capital	Deferred stock-based compensation	Accumulated other comprehensive loss	Deficit accumulated during the development stage	Comprehensive income
Shares	Par value	Shares	Par value					
52,276,437	\$ 61,795,187	98,945	\$ 99	\$ 23,982,981	\$ (18,766,443)	\$ (17,609)	\$ (36,329,408)	
				(18,766,443)	18,766,443			
		887	1	293				
		5,964,188	5,964	53,323,987				
52,276,437)	(61,795,187)	15,794,632	15,795	61,779,392				
		48,536	48	48,544				
				4,488,909				
				36,293				
							(51,619,693)	\$ (51,619,693)
						3,645		
						(1,166)		
								\$ (51,619,693)
		21,907,188	\$ 21,907	\$ 124,893,956	\$	\$ (15,130)	\$ (87,949,101)	

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

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Vanda Pharmaceuticals Inc.
(A development stage company)
Condensed Consolidated Statements of Cash Flows (Unaudited)

	Nine months ended		Period from
	September 30,	September 30,	March 13, 2003
	2006	2005	(inception) to
			September 30,
			2006
Cash flows from operating activities			
Net loss	\$ (51,619,693)	\$ (17,040,424)	\$ (87,949,101)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	415,197	316,435	1,295,480
Employee and non-employee stock-based compensation	4,525,202	4,090,301	9,706,086
Loss on disposal of assets	29,528		29,528
Accretion of discount on investments	(301,293)	(15,800)	(343,629)
Changes in assets and liabilities:			
Prepaid expenses and other current assets	391,559	(335,615)	(1,826,980)
Deposits	660,000		(180,000)
Accounts payable	(143,303)	(134,948)	2,027,896
Accrued expenses	5,329,690	1,179,697	7,726,200
Deferred grant revenue		127,866	130,603
Other liabilities	209,851	(370)	242,415
 Net cash used in operating activities	 (40,503,262)	 (11,812,858)	 (69,141,502)
Cash flows from investing activities			
Purchases of property and equipment	(1,187,295)	(96,341)	(2,872,784)
Purchases of short-term investments	(101,313,078)	(1,734,200)	(113,159,254)
Sales of short-term investments	82,137,888	1,750,000	82,137,888
Maturities of short-term investments	18,520,000		20,270,000
Investment in restricted cash		(430,230)	(430,230)
 Net cash used in investing activities	 (1,842,485)	 (510,771)	 (14,054,380)
Cash flows from financing activities			
Proceeds from borrowings on credit facility			515,147
Principal payments on obligations under capital lease	(1,071)	(51,246)	(94,097)
Principal payments on credit facility	(141,074)	(127,858)	(515,147)

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Proceeds from issuance of preferred stock, net of issuance costs		18,500,005	61,795,187
Proceeds from exercise of stock options and warrants	48,886	14,076	80,640
Proceeds from issuance of common stock, net of issuance costs	53,329,951		53,333,950
Net cash provided by financing activities	53,236,692	18,334,977	115,115,680
Effect of foreign currency translation	(3,781)	(6,198)	(19,819)
Net increase in cash and cash equivalents	10,887,164	6,005,150	31,899,979
Cash and cash equivalents			
Beginning of period	21,012,815	16,259,770	
End of period	\$ 31,899,979	\$ 22,264,920	\$ 31,899,979

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

Vanda Pharmaceuticals Inc.
(A development stage company)
Notes to condensed consolidated financial statements (unaudited)

1. Basis of presentation

The accompanying unaudited condensed consolidated financial statements of Vanda Pharmaceuticals Inc. have been prepared in accordance with generally accepted accounting principles and the rules and regulations of the Securities and Exchange Commission, or SEC, for interim financial information. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2005 included in the Company's Registration Statement on Form S-1, as amended (Registration No. 333-130759), which was declared effective by the SEC on April 12, 2006. The financial information as of September 30, 2006 and for the periods of the three and nine months ended September 30, 2006 and September 30, 2005 and for the period from March 13, 2003 (inception) to September 30, 2006, is unaudited, but in the opinion of management all adjustments, consisting only of normal recurring accruals, considered necessary for a fair statement of the results of these interim periods have been included. The results of the Company's operations for any interim period are not necessarily indicative of the results that may be expected for any other interim period or for a full fiscal year.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned Singapore subsidiary. All inter-company balances and transactions have been eliminated.

2. Initial public offering and reverse stock split

On April 18, 2006, the Company consummated its initial public offering, consisting of 5,750,000 shares of common stock. On April 21, 2006 the underwriters exercised an over-allotment option to purchase additional 214,188 shares of the Company's common stock. Including the over-allotment shares, the offering totaled 5,964,188 shares at a public offering price of \$10.00, resulting in net proceeds to the Company of approximately \$53.3 million (after deducting payment of underwriters' discounts and commissions and offering expenses).

In connection with the initial public offering, the Company effected a 1-for-3.309755 reverse stock split of the issued and outstanding common stock. Information relating to common stock and common stock-equivalents set forth in this report (including the share numbers in the preceding paragraph) has been restated to reflect this split for all periods presented. Upon consummation of the initial public offering, all shares of the Company's Series A Preferred Stock and Series B Preferred Stock were converted into an aggregate of 15,794,632 shares of common stock.

3. Capital resources and liquidity

Since its inception, the Company has devoted substantially all of its efforts to business planning, research and development, recruiting management and technical staff, acquiring operating assets and raising capital. Accordingly, the Company is considered to be in the development stage as defined in Statement of Financial Accounting Standards (SFAS) No. 7, Accounting and Reporting by Development Stage Enterprises.

The Company's activities will necessitate significant uses of working capital throughout 2006 and beyond. The Company plans to continue financing its operations with the cash received

Vanda Pharmaceuticals Inc.
(A development stage company)
Notes to condensed consolidated financial statements
(unaudited) (continued)

from financing activities, including its initial public offering. The Company believes that its current capital resources will be sufficient to meet the Company's operating through mid-2007, and after that time the Company will require additional capital.

In budgeting for its activities, the Company has relied on a number of assumptions, including assumptions that:

the Company will not initiate a Phase II VSF-173 trial for excessive sleepiness with its current capital resources

its clinical trials will be conducted in accordance with the Company's expectations

the Company will not expend significant funds on the four week injectable formulation of, or bipolar indication for, iloperidone or on a Phase II or Phase III trial of VEC-162 for depression

the Company will be able to continue the manufacturing of its product candidates at commercially reasonable prices

the Company will be able to retain its key personnel and

the Company will not incur any significant contingent liabilities

The Company may need to raise additional funds more quickly if one or more of its assumptions proves to be incorrect, if the Company chooses to expand its product development efforts more rapidly than presently anticipated or if it seeks to acquire additional product candidates. The Company does not plan to initiate a Phase II VSF-173 trial for excessive sleepiness with its current capital resources and has also delayed other non-priority manufacturing activities as a result of completing the enrollment for its iloperidone and VEC-162 Phase III trials significantly ahead of schedule. The Company expects these actions to allow the Company to focus its currently available resources on the Company's two lead product candidates. However, the Company does not expect these actions to result in any significant delays in the Company's overall clinical development results, including with respect to VSF-173.

The Company may decide to raise additional funds even before they are needed if the conditions for raising capital are favorable. However, the Company may not be able to raise additional funds on acceptable terms, or at all. If the Company is unable to secure sufficient capital to fund the commercialization of its product candidates or its other research and development activities, it may not be able to continue operations, or it may have to enter into strategic collaborations that could require the Company to share commercial rights to its products to a greater extent or at earlier stages in the drug development process than is currently intended. These collaborations, if consummated prior to proof-of-efficacy or safety of a given product candidate, could impair the Company's ability to realize value from that product candidate. In the absence of the ability to raise additional equity capital, the Company is also prepared and believes it has the ability to curtail its existing clinical trial commitments and extend them in such a manner so that the Company has operating funds through the third quarter of 2007.

Vanda Pharmaceuticals Inc.
(A development stage company)
Notes to condensed consolidated financial statements
(unaudited) (continued)

4. Summary of significant accounting policies

Use of estimates

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates based upon current assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual conditions may differ materially from management's current assumptions. This may result in the estimates being incorrect and may require the Company to record additional charges or benefits from operations.

Cash and cash equivalents

For purposes of the condensed consolidated balance sheet and condensed consolidated statement of cash flows, cash equivalents represent all highly-liquid investments with an original maturity date of three months or less. At September 30, 2006, the Company maintained all of its cash and cash equivalents in four financial institutions. Deposits held with these institutions may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand, and the Company believes there is minimal risk of losses on such cash balances.

Short-term investments

The Company classifies all of its short-term investments as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses reported as a component of stockholders' equity in accumulated other comprehensive loss. Interest income, amortization of premium and accretion of discount on short-term investments, and realized gains and losses on securities are included in interest income in the statements of operations.

Restricted cash

During 2005, in conjunction with the lease of the office and laboratory space building, the Company provided the landlord with a letter of credit, which was collateralized with a restricted cash deposit in the amount of \$430,230.

Stock-based compensation

In December 2004, the Financial Accounting Standards Board (FASB) revised Statement of Accounting Standards No. 123 (SFAS 123(R)), *Share-Based Payment*. On April 14, 2005, the SEC adopted a new rule amending the effective dates for SFAS 123(R).

Effective January 1, 2006 and for all periods subsequent to that date, SFAS 123(R) supersedes the previous accounting under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

In accordance with the new rule, the Company adopted the provisions of SFAS 123(R) on January 1, 2006. Accordingly, compensation costs for all stock-based awards to employees are measured based on the grant date fair value of those awards and recognized over the period

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Vanda Pharmaceuticals Inc.
(A development stage company)
Notes to condensed consolidated financial statements
(unaudited) (continued)

during which the employee is required to perform service in exchange for the award (generally over the vesting period of the award). The Company has not granted any awards with market or performance conditions.

The Company adopted SFAS 123(R) using the modified prospective transition method. The valuation provisions of SFAS 123(R) apply to new awards and to awards that are outstanding at the effective date and subsequently modified or cancelled. Estimated compensation expense for awards outstanding at the effective date will be recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes under FASB Statement No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). In accordance with the modified prospective transition method, the Company's condensed consolidated financial statements for prior periods were not restated to reflect, and do not include, the impact of SFAS 123(R).

Stock-based compensation expense, which is a non-cash charge, results from estimating the fair value of employee stock options granted. On April 12, 2006, the Company completed its initial public offering and began trading on The Nasdaq Global Market. Prior to April 12, 2006, given the absence of an active market for our common stock, the exercise price of the stock options on the date of grant was determined by the board of directors using several factors, including progress and milestones achieved in the Company's business development and performance, the price per share of its convertible preferred stock offerings, the perspectives provided by the underwriters regarding estimates of a potential price per share in an initial public offering of the Company's common stock and general industry and economic trends. In establishing the estimated fair value of the common stock, the Company considered the guidance set forth in the AICPA Practice Guide, *Valuation of Privately-Held-Company Equity Securities Issues as Compensation* and made retrospective determination of fair value. The exercise price for employee option grants issued subsequent to April 12, 2006 is based on the closing market value of the Company's common stock at the date of grant.

Stock-based compensation expense recognized during the three and nine months ended September 30, 2006 is based on the value of the portion of stock-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the Company's condensed consolidated statements of operations includes:

compensation expense for stock-based payment awards granted prior to, but not yet vested as of, December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 and

compensation expense for stock-based payment awards granted subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with SFAS 123(R).

For stock awards granted in 2006, expenses are amortized under the accelerated attribution method. For stock awards granted prior to fiscal 2006, expenses are amortized under the accelerated attribution method for options that were modified after the original grant date and under the straight-line attribution method for all other options. As stock-based compensation expense recognized in the condensed consolidated statement of operations for the three and nine months ended September 30, 2006 is based on awards ultimately expected to vest, it has

Vanda Pharmaceuticals Inc.
(A development stage company)
Notes to condensed consolidated financial statements
(unaudited) (continued)

been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Pre-vesting forfeitures on the options granted during the first nine months of 2006 have been estimated to be approximately 2% based on the Company's historical experience. In the pro forma information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred. The cumulative effect adjustment of adopting the change in estimating forfeitures was not considered material to the Company's financial statements for periods prior to January 1, 2006 upon implementation of SFAS 123(R) as of January 1, 2006.

Total stock-based compensation expense, related to all of the Company's stock-based awards to employees, recognized during the first three and nine months of 2006 and 2005 under SFAS 123(R) and APB 25, respectively, was comprised of the following:

	Three months ended		Nine months ended		Period from
	September 30,	September 30,	September 30,	September 30,	March 13, 2003
	2006	2005	2006	2005	(inception) to
					September 30,
					2006
Research and development	\$ 184,789	\$ 16,700	\$ 475,563	\$ 658,529	\$ 1,266,526
General and administrative	1,321,008	766,316	4,013,347	3,431,772	8,362,694
Stock-based compensation expense	\$ 1,505,797	\$ 783,016	\$ 4,488,910	\$ 4,090,301	\$ 9,629,220
Stock-based compensation expense per basic and diluted share of common stock	\$ 0.07	\$ 42.34	\$ 0.32	\$ 356.14	

For the three months ended September 30, 2006, the adoption of SFAS 123R had the following effect on reported amounts that would have been reported using the intrinsic value method under APB No. 25:

Three months ended September 30, 2006		
Using		
APB No. 25	SFAS 123R	As reported
accounting	adjustments	

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Net loss	\$ (11,929,729)	\$ (194,432)	\$ (12,124,161)
Basic and diluted earnings per share	\$ (0.54)	\$ (0.01)	\$ (0.55)

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Vanda Pharmaceuticals Inc.
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Notes to condensed consolidated financial statements
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For the nine months ended September 30, 2006, the adoption of SFAS 123R had the following effect on reported amounts that would have been reported using the intrinsic value method under APB No. 25:

	Nine months ended September 30, 2006		
	Using	SFAS 123R	As reported
	APB No. 25	adjustments	
	accounting		
Net loss	\$ (51,054,650)	\$ (565,043)	\$ (51,619,693)
Basic and diluted earnings per share	\$ (3.68)	\$ (0.04)	\$ (3.72)

Since the Company had a net operating loss carryforward as of September 30, 2006, no excess tax benefits for the tax deductions related to stock-based awards were recognized in the condensed consolidated statements of operations. Additionally, no incremental tax benefits were recognized from stock options exercised in the three and nine months ended September 30, 2006 which would have resulted in a reclassification to reduce net cash used in operating activities with an offsetting increase in net cash provided by financing activities.

As of September 30, 2006, the Company had two equity incentive plans, the Second Amended and Restated Management Equity Plan (the 2004 Plan) and 2006 Equity Incentive Plan (the 2006 Plan) that were adopted in December 2004 and April 2006, respectively. An aggregate of 1,569,669 shares were subject to outstanding options granted under the 2004 Plan as of September 30, 2006, and no additional options will be granted under this plan. Reserved under the 2006 Plan are 1,500,000 shares of the Company's common stock of which 103,692 shares were subject to outstanding options as of September 30, 2006. On January 1 of each year starting with the year 2007, the number of shares reserved under the 2006 Plan will automatically increase by 4% of the total number of shares of common stock that are outstanding at that time, or, if less, by 1,500,000 shares (or such lesser number as may be approved by the Company's board of directors).

Options are subject to terms and conditions established by the compensation committee of the board of directors. None of the stock-based awards are classified as a liability as of September 30, 2006. Option awards have 10-year contractual terms and 25% of the option shares typically vest and become exercisable on the first anniversary of the grant date and the remaining 75% of the option shares typically vest and become exercisable monthly in equal installments thereafter over three years. Certain option awards provide for accelerated vesting if there is a change in control (as described in these plans).

The fair value of each option award is estimated on the date of grant using a Black-Scholes option pricing model (Black-Scholes model) that uses the assumptions noted in the following table. Expected volatility rates are based on historical volatility of the common stock of comparable entities and other factors. The expected term of options granted is based on the transition approach provided by SAB 107. The risk-free interest rates are based on the

U.S. Treasury yield for a period consistent with the expected term of the option in effect at the

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Vanda Pharmaceuticals Inc.
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time of the grant. Assumptions used in the Black-Scholes model for the nine months ended September 30, 2006 were as follows:

	Nine months ended September 30, 2006
Expected dividend yield	0%
Expected volatility	70-73%
Expected term (years)	5.0-6.25
Weighted average risk-free interest rate	4.84%
Expected forfeiture rate	2%

A summary of option activity during the nine months ended September 30, 2006 is presented below.

	Number of shares	Weighted average exercise price at grant date	Weighted average remaining term (years)	Aggregate intrinsic value
Outstanding at December 31, 2005	1,532,542	\$ 1.39		
Granted	141,706	7.99		
Exercised	(887)	0.33		
Outstanding at September 30, 2006	1,673,361	\$ 1.95	8.77	\$ 12,301,503
Exercisable at September 30, 2006	419,500	\$ 0.36	8.03	\$ 3,751,202

The weighted average grant date fair value of options granted during the nine months ended September 30, 2006 was \$7.56 per share. The total intrinsic value of options exercised during the nine months ended September 30, 2006 was \$14,955. The Company received a total of \$294 in cash from the exercises of options during the nine months ended September 30, 2006. As of September 30, 2006, approximately \$16.2 million of total unrecognized compensation costs related to non-vested awards is expected to be recognized over a weighted average period of 3.2 years.

In conjunction with the 1-for-3.309755 reverse stock split of its common stock the Company also effected the reverse stock split of outstanding option grants using the same ratio. This modification has not resulted in any additional compensation expense.

Pro forma information under SFAS 123 for periods prior to January 1, 2006

Through fiscal year 2005, the Company accounted for stock-based awards to employees using the intrinsic value method in accordance with APB 25 and related interpretations and provided the required pro forma disclosures of SFAS 123. Under APB 25 the compensation expense is

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calculated as the difference between the fair value of the common stock on the date such options were granted and their exercise price.

The following table summarizes the pro forma effect on the net loss and per share data if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation for the three and nine-month periods ended September 30, 2005.

	Three months ended September 30, 2005	Nine months ended September 30, 2005
Net loss attributable to common stockholders	\$ (24,204,893)	\$ (35,540,429)
Add: Stock-based employee compensation expense included in net loss	783,016	4,090,301
Less: Stock-based employee compensation expense determined under SFAS 123	(661,381)	(4,012,441)
 Pro forma net loss applicable to common stockholders	 \$ (24,083,258)	 \$ (35,462,569)
 Net loss per share:		
Basic and diluted, net loss attributed to common stockholders as reported	\$ (1,308.87)	\$ (3,094.73)
 Pro forma basic and diluted, net loss attributed to common stockholders	 \$ (1,302.29)	 \$ (3,087.73)

For employee stock options granted during the nine months ended September 30, 2005, the Company determined pro forma compensation expense under the provisions of SFAS 123 using the Black-Scholes model and the following assumptions:

**Nine months
ended
September 30,
2005**

Expected dividend yield	0%
Expected volatility	67-68%
Expected term (years)	5
Weighted average risk-free interest rate	3.44%

The weighted average fair value of options granted during the nine months ended September 30, 2005 was \$15.03 per share.

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Vanda Pharmaceuticals Inc.
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Notes to condensed consolidated financial statements
(unaudited) (continued)

Equity instruments issued to non-employees

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123, as amended by SFAS No. 148, *Accounting for Stock-based Compensation Transition and Disclosure - An Amendment of SFAS No. 123* 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*, which require such equity instruments to be recorded at their fair value on the measurement date. The measurement of stock-based compensation is subject to periodic adjustment as the underlying equity instruments vest. The Company amortizes compensation expense related to non-employee stock options in accordance with FIN No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*.

On January 19, 2006, the Company granted to one of its consultants an option to purchase 3,625 shares of common stock with an exercise price of \$4.73 per share. The option was vested with respect to 2,190 shares as of January 19, 2006. The balance of the option will vest ratably over 19 months. The option expires on January 19, 2016 and for the nine months ended September 30, 2006 the Company recognized \$36,293 in consulting expense relating to this option.

During the three months ended September 30, 2006 the Company entered into two consulting agreements that will require the Company to grant options to purchase up to 20,000 shares of common stock to these consultants subject to certain performance criteria. The terms of the stock option grants will be finalized upon their issuance.

Research and development expenses

Research and development expenses include the cost of salaries, building costs, utilities, allocation of indirect costs, and expenses to third parties who conduct research and development, pursuant to development and consulting agreements, on behalf of the Company. Costs related to the acquisitions of intellectual property are expensed as incurred since the underlying technology associated with these acquisitions were made in connection with the Company's research and development efforts and have no alternative future use. Research and development expenses are charged to operations as they are incurred.

Recognition of expenses in outsourced contracts

Pursuant to the Company's assessment of the services that have been performed on clinical trials and other contracts, the Company recognizes expenses as the services are provided. Such assessments include, but are not limited to: (1) an evaluation by the project manager of the work that has been completed during the period, (2) measurement of progress prepared internally and/or provided by the third-party service provider, (3) analyses of data that justify the progress, and (4) management's judgment.

General and administrative expenses

General and administrative costs are expensed as incurred and consist primarily of salaries and other related costs for personnel serving executive, finance, accounting, information technology

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and human resource functions. Other costs include facility costs not otherwise included in research and development expense and professional fees for legal and accounting services.

Income taxes

The Company accounts for income taxes under the liability method in accordance with provisions of SFAS No. 109, *Accounting for Income Taxes*, (SFAS 109) which requires companies to account for deferred income taxes using the asset and liability method. Under the asset and liability method, current income tax expense or benefit is the amount of income taxes expected to be payable or refundable for the current year. A deferred income tax asset or liability is recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credits and loss carryforwards. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Tax rate changes are reflected in income during the period such changes are enacted. Changes in ownership may limit the amount of net operating loss carryforwards that can be utilized in the future to offset taxable income.

Segment information

Management has determined that the Company operates in one business segment which is the development and commercialization of pharmaceutical products.

New accounting standards

In July 2006, the Financial Accounting Standard Board (FASB) issued FASB Interpretation No. 48 (FIN 48) *Accounting for Uncertainty in Income Taxes and interpretation of FASB Statement No. 109*, to clarify certain aspects of accounting for uncertain tax positions, including issues related to the recognition and measurement of these tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of FIN 48 on its results of operations and financial condition.

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements* (FAS 157), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). FAS 157 outlines a common definition of fair value to be used throughout GAAP and the new standard intends to make the measurement of fair value more consistent and comparable and improve disclosures about those measures. Companies will need to adopt FAS 157 for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of FAS 157 on its results of operations and financial condition.

In September 2006, the Staff of the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of determining whether the current year's financial statements are materially misstated. SAB 108 is effective for the Company in the fourth quarter of 2006. The Company is currently evaluating

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the requirements of SAB 108; however, the Company does not believe that its adoption will have a material effect on its financial statements.

5. Earnings per share

Net loss attributable to common stockholders per share is calculated in accordance with SFAS No. 128, Earnings per Share and Staff Accounting Bulletin (SAB) No. 98. Basic earnings per share (EPS) is calculated by dividing the net income or loss attributable to common stockholders by the weighted average number of shares of common stock outstanding, reduced by the weighted average unvested shares of common stock subject to repurchase.

Diluted EPS is computed by dividing the net income or loss attributable to common stockholders by the weighted average number of other potential common stock outstanding for the period. Other potential common stock includes the Company's Series A Preferred Stock and Series B Preferred Stock outstanding prior to the consummation of the Company's initial public offering, stock options and warrants to purchase common stock, but only to the extent that their inclusion is dilutive. The Company incurred a net loss in all periods presented, causing inclusion of any potentially dilutive securities to have an anti-dilutive affect, resulting in dilutive loss per share attributable to common stockholders and basic loss per share attributable to common stockholders being equivalent. The Company did not have any shares of common stock issued for nominal consideration as defined under the terms of SAB No. 98, which would be included in EPS calculations.

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Notes to condensed consolidated financial statements
(unaudited) (continued)

	Three months ended		Nine months ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Numerator:				
Net loss attributable to common stockholders	\$ (12,124,161)	\$ (24,204,893)	\$ (51,619,693)	\$ (35,540,429)
Denominator:				
Weighted average shares of common stock outstanding	21,907,188	23,876	13,904,719	11,745
Weighted average unvested shares of common stock subject to repurchase	(35,646)	(5,383)	(42,106)	(260)
Denominator for basic and diluted net loss per share	21,871,542	18,493	13,862,613	11,485
Basic and diluted net loss per share applicable to common stockholders	\$ (0.55)	\$ (1,308.87)	\$ (3.72)	\$ (3,094.51)
Anti-dilutive securities not included in diluted net loss per share calculation:				
Series A and B Preferred Stock		12,110,038		12,110,038
Options to purchase common stock	1,673,361	1,143,111	1,673,361	1,143,111
Warrants to purchase common stock		50,335		50,335
	1,673,361	13,303,484	1,673,361	13,303,484

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Notes to condensed consolidated financial statements
(unaudited) (continued)

6. Short-term investments

The following is a summary of the Company's available-for-sale short-term investments as of September 30, 2006:

	Amortized cost	Net unrealized gains	Net unrealized losses	Fair market value
U.S. government agencies	\$ 6,763,476	\$ 1,037	\$ (70)	\$ 6,764,443
U.S. corporate debt	4,331,518	545		4,332,063
	\$ 11,094,994	\$ 1,582	\$ (70)	\$ 11,096,506

The following is a summary of the Company's available-for-sale short-term investments as of December 31, 2005:

	Amortized cost	Net unrealized gains	Net unrealized losses	Fair market value
U.S. government agencies	\$ 6,054,023	\$ 847	\$	\$ 6,054,870
U.S. corporate debt	4,084,488	1,831		4,086,319
	\$ 10,138,511	\$ 2,678	\$	\$ 10,141,189

7. Prepaid expenses and other current assets

The following is a summary of the Company's prepaid expenses and other current assets:

	September 30, 2006	December 31, 2005
Current deposits with vendors	\$ 790,000	\$ 220,000
Prepaid insurance	449,154	194,418
Accrued interest income	130,495	81,557

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Other prepaid expenses	433,446	911,943
Prepaid initial public offering costs		794,099
Other receivables	24,418	15,943
	\$ 1,827,513	\$ 2,217,960

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8. Property and equipment

Property and equipment at cost:

	Estimated useful life (years)	September 30, 2006	December 31, 2005
Laboratory equipment	5	\$ 1,550,906	\$ 1,102,270
Computer equipment	3	691,378	366,963
Furniture and fixtures	7	163,973	101,556
Leasehold improvements	10	727,727	302,228
Construction in progress			120,851
		3,133,984	1,993,868
Less accumulated depreciation and amortization		(1,285,714)	(883,292)
		\$ 1,848,270	\$ 1,110,576

Depreciation and amortization expense for the nine months ended September 30, 2006 and 2005 was \$415,197 and \$316,435, respectively, and \$1,295,480 for the period from March 13, 2003 (inception) to September 30, 2006.

9. Accrued expenses

Accrued expenses consist of the following:

	September 30, 2006	December 31, 2005
Accrued research and development expenses	\$ 6,609,494	\$ 1,862,288
Bonus accrual	542,878	530,311
Accrued professional fees	180,863	71,000
Employee benefits	172,098	46,063
Other accrued expenses	334,098	18,429

Total accrued expenses	\$ 7,839,431	\$ 2,528,091
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10. Commitments and contingencies

Operating leases

The Company has commitments totaling approximately \$4.8 million under operating real estate leases for its current and former headquarters located in Rockville, Maryland, expiring in 2016 and 2008, respectively, and for its research facility in Singapore expiring in 2006. The Company intends to renew its Singapore lease by the end of 2006 under similar terms.

The Company vacated its previous headquarters in January 2006. According to SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*, a liability for costs that will continue to be

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incurred under a lease for its remaining term without economic benefit to the company shall be recognized and measured when the company ceases using the right conveyed by the lease, reduced by estimated sublease rentals that could be reasonably obtained. In accordance with SFAS 146 the Company has recorded non-cash charges relating to the abandonment of its former office of approximately \$267,000 during the nine months ended September 30, 2006.

Guarantees and indemnifications

The Company has entered into a number of standard intellectual property indemnification agreements in the ordinary course of its business. Pursuant to these agreements, the Company indemnifies, holds harmless, and agrees to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally the Company's business partners or customers, in connection with any U.S. patent or any copyright or other intellectual property infringement claim by any third party with respect to the Company's products. The term of these indemnification agreements is generally perpetual from the date of execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. Since inception, the Company has not incurred costs to defend lawsuits or settle claims related to these indemnification agreements. The Company has no liabilities recorded for these agreements as of September 30, 2006, as the Company believes the fair value of these indemnification agreements is minimal.

The Company also indemnifies its officers and directors for certain events or occurrences, subject to certain limits. The Company believes that the fair value of these indemnification agreements is minimal, and accordingly the Company has not recognized any liabilities relating to these agreements as of September 30, 2006.

11. Licensing agreements

The Company's rights to develop and commercialize the clinical-stage product candidates are subject to the terms and conditions of licenses granted to the Company by other pharmaceutical companies.

Iloperidone

The Company acquired exclusive worldwide rights to patents for iloperidone through a sublicense agreement with Novartis. A predecessor company of Sanofi-Aventis, Hoechst Marion Roussel, Inc. (HMRI), discovered iloperidone and completed early clinical work on the compound. In 1996, following a review of its product portfolio, HMRI licensed its rights to the iloperidone patents to Titan Pharmaceuticals, Inc. on an exclusive basis. In 1997, soon after it had acquired its rights, Titan sublicensed its rights to iloperidone on an exclusive basis to Novartis. In June 2004, the Company acquired exclusive worldwide rights to these patents to develop and commercialize iloperidone through a sublicense agreement with Novartis. In partial consideration for this sublicense, the Company paid Novartis an initial license fee of \$500,000 and is obligated to make future milestone payments to Novartis of less than \$100 million in the aggregate (the majority of which are tied to sales milestones), as well as royalty payments to Novartis at a rate which, as a percentage of net sales, is in the mid-twenties. The rights with respect to the patents to develop and commercialize iloperidone may terminate, in whole or in

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part, if the Company fails to meet certain development or commercialization milestones relating to the time it takes for the Company to launch iloperidone commercially following regulatory approval, and the time it takes for the Company to receive regulatory approval following the submission of an NDA (New Drug Application) or equivalent foreign filing. Additionally, the Company's rights may terminate in whole or in part if the Company does not meet certain other obligations under the sublicense agreement to make royalty and milestone payments, if the Company fails to comply with requirements in the sublicense agreement regarding its financial condition, or if the Company does not abide by certain restrictions in the sublicense agreement regarding other development activities. If the Company does not cure any breaches by Novartis or Titan of their respective obligations under their agreements with Titan and Sanofi-Aventis, respectively, the Company's rights to develop and commercialize iloperidone may revert back to Novartis, although the Company is not aware of any such breaches by Titan or Novartis.

VEC-162

In February 2004, the Company entered into a license agreement with Bristol-Myers Squibb (BMS) under which the Company received an exclusive worldwide license under certain patents and patent applications, and other licenses to intellectual property, to develop and commercialize VEC-162. In partial consideration for the license, the Company paid BMS an initial license fee of \$500,000 and is obligated to make future milestone payments to BMS of less than \$40 million in the aggregate (the majority of which are tied to sales milestones) as well as royalty payments based on the net sales of VEC-162 at a rate which, as a percentage of net sales, is in the low teens. The Company is also obligated under this agreement to pay BMS a percentage of any sublicense fees, upfront payments and milestone and other payments (excluding royalties) that the Company receives from a third party in connection with any sublicensing arrangement, at a rate which is in the mid-twenties. The Company has agreed with BMS in the license agreement for VEC-162 to use commercially reasonable efforts to develop and commercialize VEC-162 and to meet certain milestones in initiating and completing certain clinical work. During March 2006, the Company recorded an expense of \$1,000,000 as it met its first milestone relating to the initiation of the Phase III clinical trial for VEC-162.

BMS holds certain rights with respect to VEC-162 in the license agreement. For example, BMS has a right of first negotiation to enter into a commercialization and development agreement with the Company after the completion of the first Phase III trial. Additionally, if the Company has not agreed to one or more partnering arrangements to develop and commercialize VEC-162 in certain significant markets with one or more third parties after the completion of the entire Phase III program, which may consist of several Phase III trials, BMS has the option to exclusively develop and commercialize VEC-162 on its own on pre-determined financial terms, including milestone and royalty payments.

Either party may terminate the VEC-162 license agreement under certain circumstances, including a material breach of the agreement by the other. In the event that BMS has not exercised its option to reacquire the rights to VEC-162 and the Company terminates the license, or if BMS terminates the license due to the Company's breach, all rights licensed and developed by the Company under this agreement will revert or otherwise be licensed back to BMS on an exclusive basis.

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VSF-173

In June 2004, the Company entered into a license agreement with Novartis under which the Company received an exclusive worldwide license to develop and commercialize VSF-173. In consideration for the license, the Company paid Novartis an initial license fee of \$500,000. The Company is also obligated to make future milestone payments to Novartis of less than \$50 million in the aggregate (the majority of which are tied to sales milestones) and royalty payments at rates which, as a percentage of net sales, range from the low-to-mid teens. Novartis has the right to co-develop and exclusively commercialize VSF-173 on its own after Phase II and Phase III in exchange for certain milestones and royalty payments. In the event that Novartis chooses not to exercise either of these options and the Company decides to enter into a partnering arrangement to commercialize VSF-173, Novartis has a right of first refusal to negotiate such an agreement with the Company, as well as a right to submit a last matching counteroffer regarding such an agreement. In addition, the rights with respect to VSF-173 may terminate, in whole or in part, if the Company fails to meet certain development and commercialization milestones described in the license agreement relating to the time it takes the Company to complete the development work on VSF-173. These rights may also terminate in whole or in part if the Company fails to make royalty or milestone payments or if the Company does not comply with requirements in the license agreement regarding its financial condition. In the event of an early termination of the license agreement, all rights licensed and developed by the Company under this agreement may revert back to Novartis.

12. Income taxes

The Company has not recorded any tax provision or benefit for the three and nine months ended September 30, 2006 or September 30, 2005. The Company has provided a valuation allowance for the full amount of its net deferred tax assets since realization of any future benefit from deductible temporary differences and net operating loss cannot be reasonably assured at September 30, 2006 and December 31, 2005.

13. Warrants

In 2003, in connection with entering into the line of credit facility to finance the purchase of equipment, the Company granted to the lender a freely exercisable warrant to purchase 13,626 shares of the Company's common stock (the Lender Warrant) at an exercise price of \$1.32 per share. The Lender Warrant was valued using the Black-Scholes option pricing model at \$0.93 per share and the aggregate value was \$12,628, which was recorded as general and administrative for the period from March 13, 2003 through December 31, 2003.

In February 2004, the Company issued a warrant to a consultant to purchase 36,709 shares of the Company's common stock (the Consultant Warrant) at an exercise price of \$1.32 per share. The Consultant Warrant was valued using the Black-Scholes option pricing model at \$0.76 per share and the aggregate value was \$27,945, which was recorded as general and administrative for the year ended December 31, 2004.

In connection with the Company's initial public offering, the holder of the Lender Warrant exercised the warrant in full by using the warrant's net exercise feature, such that 11,827 shares

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of the Company's common stock were issued to the lender upon exercise. Additionally, in connection with the Company's initial public offering, the holder of the Consultant Warrant exercised the warrant in full.

14. Beneficial conversion feature

In September 2005, the Company completed the sale of an additional 15,040,654 shares of Series B Preferred Stock for proceeds of approximately \$18.5 million. After evaluating the fair value of the Company's common stock obtainable upon conversion by the stockholders, the Company determined that the issuance of the Series B Preferred Stock sold in September 2005 resulted in a beneficial conversion feature calculated in accordance with EITF Issue No. 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*, (EITF 98-5) as interpreted by EITF Issue No. 00-27, *Application of Issue No. 98-5 to Certain Convertible Instruments*, (EITF 00-27) of approximately \$18.5 million which was fully accreted in September 2005 and was recorded as a deemed dividend to preferred stockholders during the three and nine months ended September 30, 2005.

In December 2005, the Company closed an additional private placement of 12,195,129 shares of Series B Preferred Stock for proceeds of approximately \$15.0 million. The Company evaluated the fair value of the Company's common stock obtainable upon conversion by the stockholders using EITF 98-5 and EITF 00-27 and determined that the issuance of the Series B Preferred Stock sold in December 2005 resulted in a beneficial conversion feature of approximately \$15.0 million that was fully accreted in December 2005 and was recorded as a deemed dividend to preferred stockholders for the year ended December 31, 2005.

3,500,000 shares

Common stock

Prospectus

JPMorgan

Morgan Stanley

Banc of America Securities LLC

Natexis Bleichroeder Inc.

, 2007

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. We are offering to sell, and seeking offers to buy, common shares only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of shares of our common stock.

No action is being taken in any jurisdiction outside the United States to permit a public offering of the common shares or possession or distribution of this prospectus in that jurisdiction. Persons who come into possession of this prospectus in jurisdictions outside the United States are required to inform themselves about and to observe any restrictions as to this offering and the distribution of this prospectus applicable to that jurisdiction.

Part II
Information not required in prospectus

Item 13. *Other expenses of issuance and distribution.*

Estimated expenses payable in connection with the sale of the common stock in this offering are as follows:

SEC registration fee	\$ 11,245
NASD filing fee	11,009
Blue Sky qualification fees and expenses	10,000
Printing and engraving expenses	200,000
Legal fees and expenses	600,000
Accounting fees and expenses	100,000
Transfer agent and registrar fees and expenses	3,500
Miscellaneous	300,000
Total	 \$ 1,235,754

The registrant will bear all of the expenses shown above.

Item 14. *Indemnification of directors and officers.*

The Delaware General Corporation Law and the registrant's charter and bylaws provide for indemnification of the registrant's directors and officers for liabilities and expenses that they may incur in such capacities. In general, directors and officers are indemnified with respect to actions taken in good faith in a manner reasonably believed to be in, or not opposed to, the best interests of the registrant, and with respect to any criminal action or proceeding, actions that the indemnitee had no reasonable cause to believe were unlawful. Reference is made to the registrant's amended and restated certificate of incorporation and by-laws, filed as Exhibit 3.2 and Exhibit 3.3 to our Registration Statement on Form S-1 for our initial public offering, each of which is incorporated in this Registration Statement by reference.

The registrant has entered into indemnification agreements with its officers and directors, a form of which is attached as Exhibit 10.11 to our Registration Statement on Form S-1 for our initial public offering and incorporated herein by reference. The Indemnification Agreements provide the registrant's officers and directors with further indemnification to the maximum extent permitted by the Delaware General Corporation Law. The underwriting agreement provides that the underwriters are obligated, under certain circumstances, to indemnify directors, officers and controlling persons of the registrant against certain liabilities, including liabilities under the Securities Act. Reference is made to the form of underwriting agreement filed as Exhibit 1.1 hereto.

The registrant currently maintains a directors and officers liability insurance policy.

Item 15. *Recent sales of unregistered securities.*

In the three years preceding the filing of this registration statement, the registrant has sold the following securities that were not registered under the Securities Act:

Common stock

In March 2003, the Company issued a total of 100 shares of its Series A common stock to three accredited investors at an aggregate purchase price of \$4,000. These shares were subsequently converted into a total of 3,020 shares of common stock.

In April 2005, the Company issued a total of 555 shares of its common stock to employees, officers and directors upon exercises of options granted pursuant to its Second Amended and Restated Management Equity Plan, for an aggregate purchase price of \$183.80.

In June 2005, the Company issued a total of 18,641 shares of its common stock to employees, officers and directors upon exercises of options granted pursuant to its Second Amended and Restated Management Equity Plan, for an aggregate purchase price of \$6,170.00.

In August 2005, the Company issued a total of 1,117 shares of its common stock to employees, officers and directors upon exercises of options granted pursuant to its Second Amended and Restated Management Equity Plan, for an aggregate purchase price of \$370.00.

In September 2005, the Company issued a total of 22,204 shares of its common stock to employees, officers and directors upon exercises of options granted pursuant to its Second Amended and Restated Management Equity Plan, for an aggregate purchase price of \$7,350.10.

In October 2005, the Company issued a total of 40,420 shares of its common stock to employees, officers and directors upon exercises of options granted pursuant to its Second Amended and Restated Management Equity Plan, for an aggregate purchase price of \$13,379.60.

In November 2005, the Company issued a total of 12,988 shares of its common stock to employees, officers and directors upon exercises of options granted pursuant to its Second Amended and Restated Management Equity Plan, for an aggregate purchase price of \$4,300.

In January 2006, the Company issued a total of 887 shares of its Common Stock to one employee upon the exercise of options granted pursuant to its Second Amended and Restated Management Equity Plan, for an aggregate purchase price of \$293.90.

No underwriters were involved in the foregoing sales of securities. Such sales were made in reliance upon the exemption provided by Section 4(2) of the Securities Act for transactions not involving a public offering.

On April 12, 2006, in connection with the Company's initial public offering, the holders of a warrant to purchase 36,709 shares of the Company's common stock at an exercise price of \$1.32 per share exercised that warrant in full. In consideration of this exercise, the holders paid a total of \$48,592 to the Company. The issuance of shares of common stock upon such exercise was made in reliance upon the exemption from the registration requirements of the Securities Act afforded by Section 4(2) of the Securities Act.

Additionally, on April 12, 2006, in connection with the Company's initial public offering, the holder of a warrant to purchase 13,626 shares of the Company's common stock at an exercise price of \$1.32 per share exercised that warrant in full pursuant to the warrant's net exercise feature, such that 11,827 shares of the Company's common stock were issued to such holder upon such exercise. No cash was paid to the Company for such exercise. The issuance of shares of common stock upon such exercise was made in reliance upon the exemption from the registration requirements of the Securities Act afforded by Section 4(2) of the Securities Act.

During the nine months ended September 30, 2006, we issued an aggregate of 887 shares of common stock pursuant to the exercise of stock options for cash consideration with an aggregate exercise price of \$294. These transactions were undertaken in reliance upon the exemption from the registration requirements of the Securities Act afforded by Rule 701 promulgated under the Securities Act and Section 4(2) of the Securities Act.

Series A Preferred Stock

In March 2003, the Company sold an aggregate of 10,000,000 shares of its Series A Preferred Stock to three accredited investors at an aggregate purchase price of \$10,000,000. These shares were converted into 3,021,368 shares of common stock in connection with the closing of our initial public offering.

No underwriters were involved in the foregoing sales of securities. Such sales were made in reliance upon the exemption provided by Section 4(2) of the Securities Act for transactions not involving a public offering.

Series B Preferred Stock

In September 2004, the Company sold an aggregate of 15,040,654 shares of its Series B Preferred Stock to twelve accredited investors at an aggregate purchase price of \$18,500,004.42. These shares were converted into 4,544,335 shares of common stock in connection with the closing of our initial public offering.

In September 2005, the Company sold an aggregate of 15,040,654 shares of its Series B Preferred Stock to twelve accredited investors at an aggregate purchase price of \$18,500,004.42. These shares were converted into 4,544,335 shares of common stock in connection with the closing of our initial public offering.

In December 2005, the Company sold an aggregate of 12,195,529 shares of its Series B Preferred Stock to twelve accredited investors at an aggregate purchase price of \$15,000,008.67. These shares were converted into 3,684,594 shares of common stock in connection with the closing of our initial public offering.

No underwriters were involved in the foregoing sales of securities. Such sales were made in reliance upon the exemption provided by Section 4(2) of the Securities Act for transactions not involving a public offering.

Options

The Company has granted currently outstanding options to purchase an aggregate of 1,706,732 shares, at prices ranging from \$0.33 to \$25.50. These options have been granted to employees, directors and consultants in accordance with the terms of the registrant's equity compensation plans. Of these options, outstanding options to purchase an aggregate of 1,348,321 were granted in reliance upon the exemption provided by Rule 701 promulgated under the Securities Act and, in the case of certain consultants, Section 4(2) of the Securities Act.

Warrants

In October 2003, the Company granted a warrant to purchase 451 shares of its Class A Common Stock which, with the subsequent conversion of Class A Common Stock to the company's common stock, became exercisable for 13,626 shares of the Company's common stock. On April 12, 2006, in connection with the Company's initial public offering, the holder of the warrant exercised that warrant in full pursuant to the warrant's net exercise feature, such that 11,827 shares of the Company's common stock were issued to such holder upon such exercise. No cash was paid to the Company for such exercise.

In February 2004, the Company granted a warrant to purchase 1,215 shares of its Class A Common Stock which, with the subsequent conversion of Class A Common Stock to the Company's common stock, became exercisable for 36,709 shares of the Company's common stock. The warrant was exercised for 36,709 shares on April 12, 2006.

No underwriters were involved in the foregoing sales of securities. Such sales were made in reliance upon the exemption provided by Section 4(2) of the Securities Act for transactions not involving a public offering.

Item 16. Exhibits.

(a) *Exhibits:*

Exhibit no.	Exhibit index
1.1	Form of Underwriting Agreement
3.6	Amended and Restated Bylaws of the registrant (filed as Exhibit 3.6 to Amendment No. 2 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as filed on March 17, 2006, and incorporated herein by reference)
3.8	Form of Amended and Restated Certificate of Incorporation of the registrant (filed as Exhibit 3.8 to Amendment No. 2 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as filed on March 17, 2006, and incorporated herein by reference)
4.1	2004 Securityholder Agreement (as amended) (filed as Exhibit 4.1 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
4.4	Specimen certificate representing the common stock of the registrant (filed as Exhibit 4.4 to Amendment No. 2 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as filed on March 17, 2006, and incorporated herein by reference)
5.1*	Opinion of Gunderson Dettmer Stough Villeneuve Franklin & Hachigian, LLP
10.1	Registrant's Second Amended and Restated Management Equity Plan (filed as Exhibit 10.1 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
10.2#	Sublicense Agreement between the registrant and Novartis Pharma AG dated June 4, 2004 (as amended) (relating to iloperidone) (filed as Exhibit 10.2 to Amendment No. 1 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as filed on February 16, 2006, and incorporated herein by reference)
10.3#	Amended and Restated License, Development and Commercialization Agreement by and between Bristol-Myers Squibb Company and the registrant dated July 24, 2005 (relating to VEC-162) (filed as Exhibit 10.3 to Amendment No. 1 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as filed on February 16, 2006, and incorporated herein by reference)
10.4#	NDD-094 License Agreement between Novartis Pharma AG, Novartis AG and the registrant dated June 4, 2004 (relating to VSF-173) (filed as Exhibit 10.4 to Amendment No. 1 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as filed on February 16, 2006, and incorporated herein by reference)

Exhibit no.	Exhibit index
10.7	Lease Agreement between the registrant and Red Gate III LLC dated June 25, 2003 (lease of Rockville, MD office space) (filed as Exhibit 10.7 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
10.8	Amendment to Lease Agreement between the registrant and Red Gate III LLC dated September 27, 2003 (filed as Exhibit 10.8 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
10.9	Lease Agreement between the registrant and MCC3 LLC (by Spaulding and Slye LLC) dated August 4, 2005 (filed as Exhibit 10.9 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
10.10	Summary Plan Description provided for the registrant's 401(k) Profit Sharing Plan & Trust (filed as Exhibit 10.10 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
10.11	Form of Indemnification Agreement entered into by directors (filed as Exhibit 10.11 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
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10.13	Employment Agreement for William D. Clark dated February 10, 2005 (filed as Exhibit 10.13 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
10.14	Employment Agreement for Steven A. Shallcross dated October 18, 2005 (filed as Exhibit 10.14 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
10.15	Employment Agreement for Deepak Phadke dated August 15, 2005 (filed as Exhibit 10.15 to the Registrant's registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
10.16	Employment Agreement for Thomas Copmann dated May 27, 2005 (filed as Exhibit 10.16 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
10.17	2006 Equity Incentive Plan (filed as Exhibit 10.17 to Amendment No. 2 to the registrant's Registration Statement on Form S-1 (File No. 333-130759), as filed on March 17, 2006, and incorporated herein by reference)
10.18	Employment Agreement for Paolo Baroldi dated July 6, 2006 (filed as Exhibit 10.18 to the registrant's report on Form 10-Q (File No. 000-51863) for the period ending June 30, 2006 and incorporated herein by reference)

Exhibit no.	Exhibit index
21.1	List of Subsidiaries (filed as Exhibit 21.1 to the Registrant's Registration Statement on Form S-1 (File No. 333-130759), as originally filed on December 29, 2005, and incorporated herein by reference)
23.1**	Consent of Gunderson Dettmer Stough Villeneuve Franklin & Hachigian, LLP (included in Exhibit 5.1)
23.2	Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm
23.3*	Consent of LEK Consulting
24.1	Power of Attorney

* Previously filed.

** Included as part of Exhibit 5.1.

Previously included on page II-7 of Registration Statement originally filed on December 19, 2006.

Application has been made to the Securities and Exchange Commission to seek confidential treatment of certain provisions. Omitted material for which confidential treatment has been requested has been filed separately with the Securities and Exchange Commission.

Signatures

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this Amendment No. 2 to the Registration Statement on Form S-1 to be signed on its behalf by the undersigned, thereunto duly authorized, in Rockville, Maryland, on January 17, 2007

Vanda Pharmaceuticals Inc.

By: /s/ Mihael H. Polymeropoulos, M.D.

Mihael H. Polymeropoulos, M.D.
Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, this Amendment No. 2 to the registration statement has been signed below by the following persons in the capacities and on the dates indicated.

Name	Title	Date
/s/ Mihael H. Polymeropoulos, M.D.	President and Chief Executive Officer and Director (principal executive officer)	January 17, 2007
Mihael H. Polymeropoulos, M.D.		
/s/ Steven A. Shallcross	Senior Vice President, Chief Financial Officer and Treasurer (principal financial and accounting officer)	January 17, 2007
Steven A. Shallcross		
*	Director	January 17, 2007
Argeris N. Karabelas, Ph.D.		
*	Director	January 17, 2007
Brian K. Halak, Ph.D.		
*	Director	January 17, 2007
H. Thomas Watkins		
*	Director	January 17, 2007
David Ramsay		

Name	Title	Date
*	Director	January 17, 2007
James B. Tananbaum, M.D.		
*	Director	January 17, 2007
Richard W. Dugan		
*By: /s/ Mihael H. Polymeropoulos		
Mihael H. Polymeropoulos		
Attorney-in-fact		

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