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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2002
OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 000-19319

VERTEX PHARMACEUTICALS INCORPORATED

(Exact name of registrant as specified in its charter)

MASSACHUSETTS (State or other jurisdiction of incorporation or organization)	04-3039129 (I.R.S. Employer Identification No.)
130 WAVERLY STREET, CAMBRIDGE, MASSACHUSETTS (Address of principal executive offices, including zip code)	02139-4242 (zip code)

(617) 444-6100
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES /X/ NO / /

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

Class	Outstanding at May 10, 2002
Common Stock, par value $.01 per share	75,738,966

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VERTEX PHARMACEUTICALS INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS

MARCH 31, DECEMBER 31, 2002 2001 ----------- ------------ (UNAUDITED) (IN THOUSANDS EXCEPT SHARE AND PER SHARE AMOUNTS) ASSETS Current assets: Cash and cash equivalents..... $176,229 $189,205 Marketable securities, available for sale..... 522,801 553,997 Accounts receivable..... 14,342 20,265 Prepaid expenses..... 5,178 6,636 Other current assets..... 5,233 5,989 -------- -------- Total current assets..... 723,783 776,092 Restricted cash..... 26,134 26,190 Property and equipment, net..... 84,628 80,377 Investments..... 26,433 26,433 Other assets..... 14,532 16,039 -------- -------- Total assets..... $875,510 $925,131 ======== ======== LIABILITIES AND STOCKHOLDERS' EQUITY Current liabilities: Accounts payable..... $ 10,913 $ 11,628 Accrued expenses and other current liabilities..... 22,298 31,381 Accrued interest..... 529 4,467 Deferred revenue..... 27,879 39,498 Obligations under capital leases and other obligations.... 3,928 4,579 -------- -------- Total current liabilities..... 65,547 91,553 Obligations under capital leases and other obligations, excluding current portion..... 7,331 8,026 Deferred revenue, excluding current portion..... 37,523 35,201 Convertible subordinated notes..... 315,000

315,000 -------- -------- Total liabilities..... 425,401 449,780 -------- -------- Stockholders' equity: Preferred stock, $0.01 par value; 1,000,000 shares authorized; none issued and outstanding..... -- -- Common stock, $0.01 par value; 200,000,000 shares authorized; 75,289,635 and 75,055,160 shares issued and outstanding at March 31, 2002 and December 31, 2001, respectively..... 753 751 Additional paid-in capital..... 781,023 778,018 Deferred compensation, net..... (10) (20) Accumulated other comprehensive income..... 4,942 11,134 Accumulated deficit..... (336,599) (314,532) -------- -------- Total stockholders' equity..... 450,109 475,351 -- ------ -------- Total liabilities and stockholders' equity..... $875,510 $925,131 ======== ========

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

VERTEX PHARMACEUTICALS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, ---------- 2002 2001* --------- --------- (UNAUDITED) (IN THOUSANDS EXCEPT PER SHARE DATA) Pharmaceutical revenues: Royalties..... $ 2,474 $ 2,596 Collaborative and other research and development revenues..... 18,077 15,573 Discovery tools and service revenues: Product sales..... 15,210 11,529 Service revenues..... 4,934 5,258 -------- -------- Total revenues..... 40,695 34,956 -------- -------- Costs and expenses: Royalty payments..... 817 881 Cost of product sales..... 4,590 6,869 Cost of service revenues..... 3,234 2,790 Research and development..... 47,022 32,540 Sales, general and administrative..... 11,095 10,948 Merger related costs..... -- 1,179 ---- ---- -------- Total costs and expenses..... 66,758 55,207 -------- -------- Loss from operations..... (26,063) (20,251) Interest income..... 8,458 13,070 Interest and other expense, net..... (4,462) (5,033) -------- -------- Loss before cumulative effect of change in accounting principle..... (22,067) (12,214) Cumulative effect of change in accounting principle..... -- (25,901) -------- ------ -- Net loss..... $(22,067) $(38,115) ======== ======== Basic and diluted loss per common share before cumulative effect of change in accounting principle--revenue recognition..... $ (0.29) $ (0.17) Basic and diluted cumulative effect of change in accounting principle--revenue recognition..... -- (0.35) -------

- -------- Basic and diluted net loss per common share..... $ (0.29) ($ 0.52) ======== ======== Basic and diluted weighted average number of common shares outstanding..... 75,161 73,922

* Results have been adjusted to reflect the adoption of the Substantive Milestone method of revenue recognition in the third quarter of 2001, retroactive to January 1, 2001. See Note 3, "Change in Accounting Principle--Revenue Recognition," for more information.

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

VERTEX PHARMACEUTICALS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

THREE MONTHS ENDED MARCH 31, ------------------- 2002 2001 -------- -------- (UNAUDITED) (IN THOUSANDS) Cash flows from operating activities: Net loss..... $(22,067) $(38,115) Adjustments to reconcile net loss to net cash used in operating activities: Depreciation and amortization..... 5,282 3,438 Other non-cash items, net..... 410 180 Realized (gains)/losses on marketable securities..... (835) 98 Cumulative effect of change in accounting principle..... -- 25,901 Changes in operating assets and liabilities: Accounts receivable..... 5,923 5,625 Prepaid expenses..... 1,458 68 Other current assets..... 1,081 (1,001) Accounts payable..... (715) 1,474 Accrued expenses and other current liabilities..... (7,583) (93) Accrued interest..... (3,938) (4,328) Deferred revenue..... (9,297) (3,334) -------- -------- Net cash used in operating activities..... (30,281) (10,087) -------- -------- Cash flows from investing activities: Purchase of marketable securities..... (244,679) (292,722) Sales and maturities of marketable securities..... 270,669 211,452 Expenditures for property and equipment..... (9,812) (16,055) Restricted cash and other assets..... (305) (13,570) ----- --- -------- Net cash provided by (used in) investing activities... 15,873 (110,895) -------- -------- Cash flows from financing activities: Issuances of common stock, net..... 2,929 8,940 Principal payments on notes payable, capital leases and other obligations..... (1,346) (1,191) -------- -------- Net cash provided by financing activities..... 1,583 7,749 ---- ---- -------- Effect of changes in exchange rates on cash..... (151) (397) -------- -------- Net decrease in cash and cash equivalents..... (12,976) (113,630) Cash and cash equivalents--beginning of period..... 189,205 346,659 --- ----- -------- Cash and cash equivalents--end of period..... $176,229 $233,029 ======== ========

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

1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements are unaudited and have been prepared by Vertex Pharmaceuticals Incorporated ("Vertex" or the "Company") in accordance with generally accepted accounting principles.

The condensed consolidated financial statements reflect the operations of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Certain information and footnote disclosures normally included in the Company's annual financial statements have been condensed or omitted. Certain prior year amounts have been reclassified to conform with current year presentation. The interim financial statements, in the opinion of management, reflect all adjustments (including normal recurring accruals) necessary for a fair statement of the results for the interim periods ended March 31, 2002 and 2001.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the fiscal year, although the Company expects to incur a substantial loss for the year ended December 31, 2002. These interim financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2001, which are contained in the Company's 2001 Annual Report to its stockholders and in its Form 10-K filed with the Securities and Exchange Commission.

2. ACCOUNTING POLICIES

BASIC AND DILUTED LOSS PER COMMON SHARE

Basic earnings per share is based upon the weighted average number of common shares outstanding during the period. Diluted earnings per share is based upon the weighted average number of common shares outstanding during the period plus additional weighted average common equivalent shares outstanding during the period when the effect is not anti-dilutive. Common equivalent shares result from the assumed exercise of outstanding stock options, the proceeds of which are then assumed to have been used to repurchase outstanding stock using the treasury stock method, and the assumed conversion of convertible notes. Common equivalent shares have not been included in the net loss per share calculations as their effect would be anti-dilutive.

The following table sets forth potential common equivalent shares outstanding at March 31 (shares in thousands):

FOR THE THREE MONTHS ENDED MARCH 31,			
	2002	2001	
Stock options outstanding	16,429	14,419	Weighted average exercise price
	$ 27.21	$ 27.26	
Convertible notes	3,414	3,739	Weighted average conversion price
	$ 92.26	$ 92.26	

SEGMENT INFORMATION

On July 18, 2001, the Company completed a merger with Aurora Biosciences Corporation ("Aurora"). Aurora specializes in assay development, screening and cell biology services and systems.

2. ACCOUNTING POLICIES (CONTINUED)

On March 1, 2001, Aurora completed a merger with PanVera Corporation ("PanVera"). PanVera is a biotechnology company engaged in the development, manufacture and worldwide supply of proteins and reagents for evaluation as targets and drug screening assays for high-throughput screening.

In the first quarter of 2002, following the acquisitions, the Company has aligned its business into two operating segments: (i) Pharmaceuticals and (ii) Discovery Tools and Services.

The Company's Pharmaceuticals business seeks to discover, develop and commercialize major pharmaceutical products independently and with partners. The Company's Discovery Tools and Services business specializes in assay development, screening services and the manufacture and sale of proteins and reagents.

3. CHANGE IN ACCOUNTING PRINCIPLE--REVENUE RECOGNITION

In the third quarter of 2001, in connection with an overall review of accounting policies concurrent with the merger with Aurora, Vertex elected to change its revenue recognition policy for collaborative and other research and development revenues from the EITF 91-6 method to the substantive milestone method. Vertex believes this method is preferable because it is more reflective of the Company's on going business operations and because it is consistent with industry practices following the prior year implementation of SAB 101, "Revenue Recognition in Financial Statements," throughout the biotechnology industry. Under the new accounting method, adopted retroactively to January 1, 2001, the Company recognizes revenue from non-refundable, up-front, license and milestone payments, not specifically tied to a separate earnings process, ratably over the period of performance. Research funding is recognized as earned ratably over the period of effort. Milestones, based on designated achievement points that are considered at risk and substantive at the inception of the contract, are recognized as earned when the corresponding payment is reasonably assured. The Company evaluates whether milestones are at risk and substantive based on the contingent nature of the milestone, specifically reviewing factors such as the technological and commercial risk that needs to be overcome and the level of investment required.

Previously, the Company had recognized revenue from collaborative research and development arrangements in a manner similar to that prescribed by EITF 91-6. Under that model, revenue was recognized for non-refundable license fees, milestones, and collaborative research and development funding using the lesser of the non-refundable cash received or the result achieved using percentage of completion accounting. Where the Company had no continuing involvement, non-refundable license fees were recorded as revenue upon receipt and milestones were recorded as revenue upon achievement of the milestone by the collaborative partner.

Pursuant to this change in accounting principle, Vertex recorded a one-time non-cash charge of $25,901,000 in the first quarter of 2001. The impact of the adoption of this new accounting policy for revenue recognition for collaborative and other research and development revenues was to defer revenue recognition for certain portions of revenue previously recognized in prior accounting periods under our collaborative agreements into future accounting periods. The results for the quarter ended March 31, 2001 have been restated in accordance with the new revenue recognition policy.

4. SEGMENT INFORMATION

The Company has aligned its business into two operating segments: (i) Pharmaceuticals and (ii) Discovery Tools and Services. The Company's Pharmaceuticals business seeks to discover, develop and commercialize major pharmaceutical products independently and with partners. The Company's Discovery Tools and Services business specializes in assay development, screening services and the manufacture and sale of proteins and reagents. The Company evaluates segment performance based on the loss before merger related charges and the cumulative effect of the change in accounting principle. The Company does not evaluate segment performance based on the segment's total assets and therefore the Company's assets are not reported by segment. The following table presents, by segment, the results of operations for the periods ending March 31, 2002. For the period ending March 31, 2001, the Company was unable to restate the results of operations into the new operating segments: Pharmaceuticals and Discovery Tools and Services. Thus, for comparative purposes, the table also presents results of operations information for the three month periods ended March 31, 2002 and 2001 by the former segments: Vertex and Aurora.

	DISCOVERY TOOLS AND SERVICES	(IN THOUSANDS) PHARMACEUTICALS	TOTAL
Three Months Ended March 31, 2002:			
Revenues	$ 20,551	$20,144	$ 40,695
Reportable segment income			

(loss)..... $(31,030) $ 8,963 $(22,067) -------- ------- --------

VERTEX AURORA TOTAL ------ -------- -------- Three Months Ended 31, 2002: Revenues..... $ 20,193 $20,502 $ 40,695 Reportable segment income (loss)..... $(23,148) $ 1,081 $(22,067) -------- ------- -------- Three Months Ended 31, 2001: Revenues..... $ 17,435 $17,521 $ 34,956 Reportable segment loss..... $(10,492) $ (543) $(11,035) -------- ------- --------

MARCH 31, MARCH 31, 2002 2001 --------- ----- ---- Total loss for reportable segments..... $(22,067) $(11,035) Merger related charges..... -- (1,179) Cumulative effect of change in accounting principle--revenue recognition..... -- (25,901) -------- -------- Total net loss..... $(22,067) $(38,115) ======== ========

VERTEX PHARMACEUTICALS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

5. COMPREHENSIVE LOSS

For the three months ended March 31, 2002 and 2001, respectively, comprehensive loss was as follows (in thousands):

FOR THE THREE MONTHS ENDED MARCH 31, ----------- ----- 2002 2001 --------- --------- Net loss..... $(22,067) $(38,115) Changes in other comprehensive income: Unrealized holding gains (losses) on marketable securities..... (6,041) 5,281 Foreign currency translation adjustment..... (151) (397) Total change in other comprehensive income..... (6,192) 4,884 -------- -------- Total comprehensive loss..... $(28,259) $(33,231) ======== ========

6. LEGAL PROCEEDINGS

Chiron Corporation (Chiron) filed suit on July 30, 1998 against Vertex and Eli Lilly and Company in the United States District Court for the Northern District of California, alleging infringement by the defendants of three U.S. patents issued to Chiron. The infringement action relates to research activities by Vertex and Eli Lilly in the hepatitis C viral protease field and the alleged use of inventions claimed by Chiron in connection with that research. Chiron has requested damages in an unspecified amount, as well as an order permanently enjoining the defendants from unlicensed use of the claimed Chiron inventions. During 1999, Chiron requested and was granted a reexamination by the U.S. Patent and Trademark Office of all three of the patents involved in the suit. Chiron also requested and, over the opposition of Vertex and Eli Lilly, was granted a stay in the infringement lawsuit, pending the outcome of the patent re-examination. That reexamination proceeding is still on going for one of the three patents and the stay is still in effect. However, a Reexamination Certificate has been issued in the other two Chiron patents in suit. While the length of the stay and the final outcome of the lawsuit cannot be determined, Vertex maintains that Chiron's claims are without merit and intends to defend the lawsuit, if and when it resumes, vigorously.

On December 7, 2001 Oregon Health Sciences University filed suit against Vertex in the District Court of Oregon. The complaint in the suit seeks to name Dr. Bruce Gold, an employee of Oregon Health Sciences University, as an inventor and Oregon Health Sciences University as part owner of five of Vertex's

neurophilin patents. The suit stems from assays run on Vertex compounds by Dr. Gold under a sponsored research agreement in 1996. Vertex has investigated the inventorship on these patents and believes that Dr. Gold is not an inventor, Oregon Health Sciences has no ownership interest in any of these patents, and that the claims made in this complaint are without merit. The suit is ongoing and Vertex intends to contest this claim vigorously.

7. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets," which requires that ratable amortization of goodwill be replaced with periodic tests of the goodwill's impairment and that intangible assets other than goodwill be amortized over their useful lives. The provisions of SFAS No. 142 are effective for fiscal years beginning after December 15, 2001. The

7. RECENT ACCOUNTING PRONOUNCEMENTS (CONTINUED)
Company adopted the provisions of SFAS 142 on January 1, 2002 as required; the adoption did not have a material effect on the Company's financial position and results of operations.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets." SFAS No. 144 supercedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and provides a single accounting model for long-lived assets to be disposed of. The provisions of SFAS No. 144 are effective for fiscal years beginning after December 15, 2001. The Company adopted the provisions of SFAS 144 on January 1, 2002 as required; the adoption did not have a material effect on the Company's financial position and results of operations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

We are a global biotechnology company with more than 1,000 employees located in Cambridge, MA, Madison, WI, San Diego, CA and Abingdon, UK. We have two operating businesses: Pharmaceuticals, and Discovery Tools and Services.

Our Pharmaceuticals business seeks to discover, develop, and commercialize major pharmaceutical products independently and with collaborators. Chemogenomics, our proprietary, systematic, genomics-based platform, is designed to accelerate the discovery of new drugs and to expand intellectual property coverage of drug candidate compounds and classes of related compounds. We believe this approach, which targets gene families, has formed the basis for successful drug discovery and for the advancement of drug candidates by Vertex and its collaborators. We are developing several drug candidates in commercial collaborations in which we retain rights to downstream product revenue.

Our first approved product is Agenerase-Registered Trademark- (amprenavir), an HIV protease inhibitor, which we co-promote with GlaxoSmithKline. We earn a royalty from GlaxoSmithKline on sales of Agenerase. Agenerase has received approval in 34 countries worldwide, including the United States, the 15 member states of the European Union (E.U.), and Japan, where the drug is sold under the trade name Prozei-TM-. We have more than twelve drug candidates in development to treat viral diseases, cancer, autoimmune and inflammatory diseases and neurological disorders. We have significant collaborations with large pharmaceutical companies including Aventis, Eli Lilly, GlaxoSmithKline, Novartis, and Serono.

Our Discovery Tools and Services business specializes in assay development, screening services and products, and the manufacture and sale of proteins and reagents. This business has collaborations with large pharmaceutical companies for assay development, screening services and the development of specialized screening platforms, as well as the sale of proteins and reagents to the Pharmaceuticals industry.

Our Discovery Tools and Services business has contracts in place that require the delivery of products, licenses and services throughout 2002. These contracts account for over $70 million of potential 2002 revenue of which approximately $12 million relates to one specific contract.

Our collaborations and contracts in the Pharmaceuticals and Discovery Tools and Services businesses provide us with financial support and other valuable resources for our research programs, development of our clinical drug candidates, and marketing and sales of our products. We believe that we are

positioned to commercialize multiple products in the coming years, which we expect will generate increased milestone payments, product revenues and royalty payments.

We have incurred operating losses since our inception and expect to incur losses for the foreseeable future. We plan to make significant investments in research and development for our other potential products. We expect that losses will fluctuate from year to year and that such fluctuations may be substantial.

In the third quarter of 2001, in connection with our overall review of accounting policies concurrent with our merger with Aurora, we elected to change our revenue recognition policy for collaborative and other research and development revenues from the Emerging Issues Task Force No. 91-6 (EITF 91-6) method to the Substantive Milestone Method. We believe this method is preferable because it is reflective of the Company's on going business operations and is more consistent with the industry practices following the prior year implementation of SAB 101 throughout the biotechnology industry.

The cumulative effect of the 2001 change in accounting principle related to revenue recognition recorded in the third quarter of 2001, retroactive to January 1, 2001, resulted in a non-cash charge to income of $25,901,000 in the first quarter of 2001. Included in the charge to income was $1,591,000 of

revenue recognized in the three months ended March 31, 2002 and $1,825,000 of revenue recognized in the three months ended March 31, 2001.

THREE MONTHS ENDED MARCH 31, 2002 COMPARED WITH THREE MONTHS ENDED MARCH 31, 2001

Our net loss for the three months ended March 31, 2002 was $22,067,000 or $0.29 per basic and diluted common share compared to a net loss, before our change in accounting principle and merger related costs, of $11,035,000 or $0.15 per basic and diluted common share for the three months ended March 31, 2001. The net loss, for the three months ended March 31, 2001 including a $25,901,000 non-cash charge for the cumulative effect of our change in accounting principle relating to revenue recognition and merger related costs of $1,179,000, was $38,115,000 or $0.52 per basic and diluted common share.

Total revenues increased to $40,695,000 for the three months ending March 31, 2002 compared to $34,956,000 for the three months ending March 31, 2001. In the first quarter of 2002 Pharmaceuticals revenue was comprised of $2,474,000 in royalty revenue and $18,077,000 in collaborative and other research and development revenue, as compared with $2,596,000 in royalty revenue and $15,573,000 in collaborative and other research and development revenue in the first quarter of 2001. In the first quarter of 2002 Discovery Tools and Services revenue was comprised of $15,210,000 in product sales revenue and $4,934,000 in service revenue, as compared with $11,529,000 in product sales revenue and $5,258,000 in service revenue in the first quarter of 2001.

Royalties consist primarily of Agenerase royalty revenue. Agenerase royalty revenue is based on estimated and actual worldwide net sales of Agenerase.

Collaborative and other research and development revenue consists of research support payments, development reimbursements, milestones and amortization of previously received up-front or license payments.

Collaborative and other research and development revenue increased in the first quarter of 2002 by 16% or $2,504,000 as compared with the first quarter of 2001 due primarily to additional revenue earned under the Novartis collaboration. In the first quarter of 2002, we recognized $10,032,000 of revenue under the Novartis collaboration compared with $7,111,000 in the first quarter of 2001. Effort related to our kinase research program increased significantly in the first quarter of 2002.

Product sales include instrumentation sales, technology licensing and biotechnology product sales.

Product sales increased $3,681,000, or 32%, to $15,210,000 in the first quarter of 2002 from $11,529,000 in the first quarter of 2001. The increase in product sales is due primarily to technology licensing revenue earned under the Pfizer contract.

Service revenue includes assay development, screening services and contracted product development.

Service revenue decreased $324,000 or 6% to $4,934,000 in the first quarter of 2002 from $5,258,000 in the first quarter of 2001. The decrease is a result of the completion of several significant screening agreements in late 2001.

Royalty costs of $817,000 and $881,000 in the first quarter of 2002 and 2001, respectively, consist primarily of royalty payments on the sales of Agenerase.

Product costs decreased $2,279,000 or 33% to $4,590,000 in the first quarter of 2002 from $6,869,000 in the first quarter of 2001. The decrease in product costs is attributable to a strategic shift in focus of the Discovery Tools and Services business towards technology licensing and discovery tools which have higher gross margins. Product gross margins will fluctuate from period to period based upon the product mix.

Cost of service revenue increased from $2,790,000 in the first quarter of 2001 to $3,234,000 in the first quarter of 2002. The increase is primarily due to increased overhead to service such agreements.

Research and development expenses increased to $47,022,000 in the first quarter of 2002 from $32,540,000 in the first quarter 2001 primarily due to our continued investment in advancing our broad clinical pipeline and fueling our drug discovery engine. We focused our clinical investment into the advancement of our p38 MAP kinase, IMPDH and caspase inhibitor programs. These oral drugs are currently focused on large market opportunities such as rheumatoid arthritis, hepatitis C and psoriasis. We continued to expand our multi-target gene family research programs, of which kinases is our most advanced. Also related to our expansion, were increases in personnel and facilities expenses.

We have more than 12 drug candidates in development targeting a range of major diseases. Our collaborative partners have agreed to fund portions of our research and development programs and/or to conduct certain research and development related to specified drug candidates. The following table details our Collaborator and Company-sponsored research and development expenses for the three months ended March 31 (in thousands):

2002		
RESEARCH DEVELOPMENT	TOTAL	
Collaborator-Sponsored	$14,663	$7,424
Company-Sponsored	15,241	9,694
Total	$29,904	$17,118

2001		
RESEARCH DEVELOPMENT	TOTAL	
Collaborator-Sponsored	$10,952	$5,188
Company-Sponsored	11,387	5,013
Total	$22,339	$10,201

To date we have incurred in excess of $677,000,000 in research and development costs associated with drug discovery and development. We anticipate research and development expenses will continue to increase as we add personnel and expand research and development activities to accommodate our existing collaborations and additional commitments we may undertake.

We estimate that it takes from 10 to 15 years (industry average is 12 years) to discover, develop and bring to market a pharmaceutical product. Drug development in the United States is a process that includes several steps defined by the FDA as outlined below:

ESTIMATED PHASE: OBJECTIVE:	DURATION:
Discovery	Lead

identification and target validation 2 to 4 years Pre-Clinical Toxicology to identify risks for humans; gather early pharmacokentic data 1 to 2 years Phase I Establish safety in humans, study how the drug works, metabolizes and interacts with other drugs 1 to 2 years Phase II Establish effectiveness of the drug and its optimal dosage 2 to 4 years Phase III Confirm efficacy, dose regime and safety profile of the drug 2 to 4 years FDA approval Approval by the FDA to sell and market the drug under certain prescribed labelling 6 mths to 2 years

The successful development of our products is highly uncertain and subject to a number of risk factors. The duration of clinical trials may vary substantially according to the type, complexity and novelty of the pharmaceutical product. The FDA and comparable agencies in foreign countries impose substantial requirements on the introduction of therapeutic pharmaceutical products through lengthy and detailed laboratory and clinical testing procedures, sampling activities and other costly and time-consuming procedures. Data obtained from pre-clinical and clinical activities are susceptible to varying interpretations, which could delay, limit or prevent regulatory approval. The duration and the cost related to discovery, pre-clinical and clinical trials may vary significantly over the life of a project and are difficult to predict. The most significant costs associated with drug discovery and development are those costs associated with Phase II and Phase III clinical trials.

Below is a summary of our drug candidates currently in clinical development:

DRUG	CLINICAL INDICATIONS	PHASE	PROGRAM COLLABORATOR
INFECTIOUS DISEASE			
VX-175	HIV	III	HIV

GlaxoSmithKline
Merimepodib
Chronic
hepatitis C II
IMPDH -- (VX-
497) VX-950
Chronic
hepatitis C
Preclin
Hepatitis C Eli
Lilly protease
VX-799 Sepsis
Preclin
Caspases
Serono; Taisho
VX-385 HIV
Preclin HIV
GlaxoSmithKline
INFLAMMATION
AND AUTOIMMUNE
DISEASE
Pralnacasan
Rheumatoid
arthritis (RA);
II ICE Aventis
(VX-740)
inflammatory
diseases VX-148
Psoriasis;
autoimmune
diseases I
IMPDH -- VX-944
Autoimmune
diseases
Preclin IMPDH -
- VX-850
Inflammatory
diseases
Preclin p38 MAP
Kinase Kissei
VX-702
Inflammatory
diseases
Preclin p38 MAP
Kinase Kissei
VX-765
Inflammatory
diseases
Preclin ICE --
CANCER Incel-
TM- Multidrug
resistant solid
tumor II MDR --
cancers VX-853
Multidrug
resistant solid
tumor I/II MDR
-- cancers
GENETIC
DISORDERS VX-
563 Multiple
indications
Preclin Histone
-- Deacetylase

We organize our research and development efforts based on the target gene families and target program. The programs detailed above identify the targets for therapeutic intervention.

Sales, general and administrative expenses remained consistent with the prior period. We have established an infrastructure to support our growth and we are committed to managing such investment prudently.

Interest income decreased approximately $4,612,000 to $8,458,000 in the first quarter of 2002 from $13,070,000 in the first quarter of 2001. This is a reflection of lower funds invested and lower portfolio yields.

Interest expense decreased $553,000 to approximately $4,450,000 in the first quarter of 2002 from $5,003,000 in the first quarter of 2001. The decrease in interest expense is a result of the reduction in principal amount of our

convertible notes from $345,000,000 at March 31, 2001 to $315,000,000 at March 31, 2002. In October 2001, we repurchased $30,000,000 in principal amount of our 5% convertible subordinated notes due September 2002.

LIQUIDITY AND CAPITAL RESOURCES

Our operations have been funded principally through strategic collaborative agreements, strategic technology alliances, revenues from assay development and screening services, product sales, royalties, public offerings and private placements of our equity and debt securities, equipment lease financing, and investment income. With the approval and launch of Agenerase in April 1999, we began receiving product royalty revenues. In 2000, we completed private placements of $175,000,000 of 5% Convertible Subordinated Notes due March 2007 and $345,000,000 of 5% Convertible Subordinated Notes due September 2007.

We have continued to increase and advance products in our research and development pipeline. Consequently, we expect to incur losses on a quarterly and annual basis as we continue to develop existing and future compounds and to conduct clinical trials of potential drugs. We also expect to incur substantial administrative and commercialization expenditures in the future and additional expenses related to filing, prosecution, defense and enforcement of patent and other intellectual property rights.

We expect to finance these substantial cash needs with future payments under our existing and future collaborative agreements, strategic technology alliances, royalties from the sales of Agenerase, revenues from assay development and screening services, product sales, existing cash and marketable securities of $699,030,000 at March 31, 2002, together with investment income earned thereon, and facilities and equipment financing. To the extent that funds from these sources are not sufficient to fund our activities, it will be necessary to raise additional funds through public offerings or private placements of securities or other methods of financing. There can be no assurance that such financing will be available on acceptable terms, if at all.

Our aggregate cash and marketable securities decreased $44,172,000 to $699,030,000, including cash and cash equivalents of $176,229,000, at March 31, 2002 from $743,202,000, including cash and cash equivalents of $189,205,000, at December 31, 2001. Net cash used in operations was $30,281,000 for the three months ended March 31, 2002. Included in the cash used in operations was the net loss of $22,067,000 and a decrease in deferred revenue of $9,297,000, partially offset by $4,857,000 of non-cash charges and gains. Deferred revenue decreased due to cash received for research funding and the receipt of a milestone payment in late 2001, the majority of which will be recognized in 2002. Net cash provided by investing activities for the three months ended March 31, 2002 was $15,873,000, including net sales of marketable securities of $25,990,000 partially offset by property and equipment expenditures of $9,812,000. Cash provided by financing activities during the three months ended March 31, 2002 was $1,583,000 including $2,929,000 from the issuance of common stock under employee stock option and benefit plans offset by $1,346,000 in principal payments on capital leases and other obligations. The decrease in cash and marketable securities from December 31, 2001 is not indicative of the expected quarterly cash spend for the remainder of 2002.

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements about our business, including our expectation that (i) we are positioned to commercialize multiple products in the coming years that we expect will generate increased revenues, (ii) our losses will continue, (iii) our research and development expenses, our administrative and commercialization expenses and our expenses related to filing, prosecuting and defending our patents and intellectual property rights will increase, and sales, general and administrative expenses will remain consistent with current levels, and (iv) the Chiron Corporation and Oregon Health Sciences University litigation will not have a material adverse effect on us. While management makes its best efforts to be accurate in making forward-looking statements, such statements are subject to risks and uncertainties that could cause our actual results to vary materially. These risks and uncertainties include, among other things, our inability to successfully integrate Aurora into our existing business, our inability to further identify, develop and achieve commercial success for new products and technologies, the possibility of delays in the research and development necessary to

select drug development candidates and delays in clinical trials, the risk that clinical trials may not result in marketable products, the risk that we may be unable to successfully finance and secure regulatory approval of and market our drug candidates, our dependence upon pharmaceutical and biotechnology

collaborations, the levels and timing of payments under our collaborative agreements, uncertainties about our ability to obtain new corporate collaborations and acquire new technologies on satisfactory terms, if at all, the development of competing systems, our ability to protect our proprietary technologies, patent-infringement claims, risks of new, changing and competitive technologies and regulations in the U.S. and internationally. Please see the "Risk Factors" appearing in our 2001 Annual Report to Stockholders and in our Form 10-K filed with the Securities and Exchange Commission for more details regarding these and other risks. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

LEGAL PROCEEDINGS

Chiron filed suit on July 30, 1998 against Vertex and Eli Lilly and Company in the United States District Court for the Northern District of California, alleging infringement by the defendants of three U.S. patents issued to Chiron. The infringement action relates to research activities by Vertex and Eli Lilly in the hepatitis C viral protease field and the alleged use of inventions claimed by Chiron in connection with that research. Chiron has requested damages in an unspecified amount, as well as an order permanently enjoining the defendants from unlicensed use of the claimed Chiron inventions. During 1999, Chiron requested and was granted a reexamination by the U.S. Patent and Trademark Office of all three of the patents involved in the suit. Chiron also requested and, over the opposition of Vertex and Eli Lilly, was granted a stay in the infringement lawsuit, pending the outcome of the patent re-examination. That reexamination proceeding is still on going for one of the three patents and the stay is still in effect. However, a Reexamination Certificate has been issued in the other two Chiron patents in suit. While the length of the stay and the final outcome of the lawsuit cannot be determined, we maintain that Chiron's claims are without merit and we intend to defend the lawsuit, if and when it resumes, vigorously.

On December 7, 2001 Oregon Health Sciences University filed suit against Vertex in the District Court of Oregon. The complaint in the suit seeks to name Dr. Bruce Gold, an employee of Oregon Health Sciences University, as an inventor and Oregon Health Sciences University as part owner of five of Vertex's neurophilin patents. The suit stems from assays run on Vertex compounds by Dr. Gold under a sponsored research agreement in 1996. We have investigated the inventorship on these patents and believe that Dr. Gold is not an inventor, Oregon Health Sciences has no ownership interest in any of these patents, and that the claims made in this complaint are without merit. The suit is ongoing and we intend to contest this claim vigorously.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets," which requires that ratable amortization of goodwill be replaced with periodic tests of the goodwill's impairment and that intangible assets other than goodwill be amortized over their useful lives. The provisions of SFAS No. 142 are effective for fiscal years beginning after December 15, 2001. We adopted the provisions of SFAS 142 on January 1, 2002 as required. That adoption did not have a material effect on our financial position and results of operations.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets." SFAS No. 144 supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and provides a single accounting model for long-lived assets to be disposed of. The provisions of SFAS No. 144 are effective for fiscal years beginning after December 15, 2001. We adopted the provisions of SFAS 144 on January 1, 2002 as required. That adoption did not have a material effect on our financial position and results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As part of its investment portfolio, Vertex owns financial instruments that are sensitive to market risks. The investment portfolio is used to preserve Vertex's capital until it is required to fund operations, including Vertex's research and development activities. None of these market risk sensitive instruments are held for trading purposes. Vertex does not have derivative financial instruments in its investment portfolio.

INTEREST RATE RISK

Vertex invests its cash in a variety of financial instruments, principally securities issued by the U.S. government and its agencies, investment grade corporate bonds and notes and money market instruments. These investments are denominated in U.S. dollars. All of its interest-bearing securities are subject

to interest rate risk, and could decline in value if interest rates fluctuate. Substantially all of Vertex's investment portfolio consists of marketable securities with active secondary or resale markets to help ensure portfolio liquidity, and Vertex has implemented guidelines limiting the term to maturity of its investment instruments. Due to the conservative nature of these instruments, Vertex does not believe that it has a material exposure to interest rate risk.

PART II. OTHER INFORMATION

ITEM 5. OTHER INFORMATION

On December 27, 2001, Vicki L. Sato, the Company's President, entered into a plan with Goldman, Sachs & Co., pursuant to which Goldman will undertake to sell, subject to a limit order, an aggregate of 100,000 shares of the Company's stock issuable upon exercise of options held by Dr. Sato. Sales under the plan are to begin no earlier than 90 days after adoption of the plan, and will take place at specified intervals between April 3, 2002 and March 19, 2003.

On March 22, 2002, Roger W. Brimblecombe, a non-employee director of the Company, entered into a plan with Goldman, Sachs & Co., pursuant to which Goldman will undertake to sell, subject to a limit order, an aggregate of 15,000 shares of the Company's stock issuable upon exercise of options held by Dr. Brimblecombe. Sales under the plan are to begin no earlier than 90 days after adoption of the plan, and will take place at specified intervals between July 3, 2002 and June 4, 2003.

On April 26, 2002, Joshua S. Boger, the Company's Chairman and CEO, entered into a plan with Goldman, Sachs & Co., pursuant to which Goldman will undertake to sell, subject to a limit order, an aggregate of 520,000 shares of the Company's stock issuable upon exercise of options held by Dr. Boger. Sales under the plan are to begin no earlier than 90 days after adoption of the plan, and will take place at specified intervals between July 30, 2002 and July 22, 2003.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

None

(b) Reports on Form 8-K:

None

SIGNATURE

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.

VERTEX PHARMACEUTICALS INCORPORATED

May 15, 2002

By: /s/ IAN F. SMITH

Ian F. Smith
VICE PRESIDENT AND
CHIEF FINANCIAL OFFICER