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VIROPHARMA INC

FORM 10-Q
(Quarterly Report)

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

FORM 10-Q

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

For the quarterly period ended September 30, 2007

or

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

Commission File Number: 0-21699

VIROPHARMA INCORPORATED
(Exact Name of Registrant as Specified in its Charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**23-2789550** **(I.R.S. Employer Identification No.)**

397 Eagleview Boulevard
Exton, Pennsylvania 19341
(Address of Principal Executive Offices and Zip Code)

610-458-7300
(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 ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ☐ Accelerated Filer ☒ Non-accelerated filer ☐

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

Number of shares outstanding of the issuer's Common Stock, par value $.002 per share, as of October 26, 2007: 69,885,697 shares.

VIROPHARMA INCORPORATED
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ViroPharma Incorporated
Consolidated Balance Sheet
(unaudited)

(in thousands, except share and per share data)	September 30, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 71,749	$ 51,524
Short-term investments	480,475	203,885
Accounts receivable, net	21,796	9,447
Inventory	5,771	4,760
Interest receivable	5,370	3,290
Prepaid expenses and other	541	2,107
Deferred income taxes	9,382	9,225
Total current assets	595,084	284,238
Intangible assets, net	123,903	122,672
Property, plant and equipment, net	10,988	2,828
Deferred income taxes	5,783	19,907
Debt issue costs, net	7,754	—
Other assets	12	49
Total assets	743,524	$ 429,694
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 2,107	$ 2,743
Due to corporate partners	941	783
Accrued expenses and other current liabilities	16,943	14,129
Income taxes payable	1,776	140
Total current liabilities	21,767	17,795
Non-current income tax payable	1,262	—
Long-term debt	250,000	—
Total liabilities	273,029	17,795
Commitments and Contingencies		
Stockholders' equity:		
Preferred stock, par value $0.001 per share. 5,000,000 shares authorized; Series A convertible participating preferred stock; no shares issued and outstanding	—	—
Series A junior participating preferred stock, par value $0.001 per share. 200,000 shares designated; no shares issued and outstanding	—	—
Common stock, par value $0.002 per share. 175,000,000 shares authorized; issued and outstanding 69,885,705 shares at September 30, 2007 and 69,769,886 shares at December 31, 2006	140	140
Additional paid-in capital	492,382	508,436
Accumulated other comprehensive (loss) income	(275)	57
Accumulated deficit	(21,752)	(96,734)
Total stockholders' equity	470,495	411,899
Total liabilities and stockholders' equity	$ 743,524	$ 429,694

See accompanying notes to unaudited consolidated financial statements.

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ViroPharma Incorporated
Consolidated Statements of Operations
(unaudited)

(in thousands, except per share data)	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Revenues:				
Net product sales	$50,944	$55,105	$156,074	$128,163
License fee and milestone revenue	—	141	—	423
Total revenues	50,944	55,246	156,074	128,586
Costs and Expenses:				
Cost of sales	2,029	4,868	6,900	16,966
Research and development	10,543	7,529	23,365	14,834
Marketing, general and administrative	9,027	7,047	24,341	18,711
Intangible amortization	1,401	1,341	4,719	4,327
Total costs and expenses	23,000	20,785	59,325	54,838
Operating income	27,944	34,461	96,749	73,748
Other Income (Expense):				
Loss on bond redemption	—	—	—	(1,127)
Interest income	6,978	2,512	17,046	6,669
Interest expense	(1,435)	179	(2,961)	(686)
Income before income tax expense	33,487	37,152	110,834	78,604
Income tax expense	12,199	13,874	35,852	29,935
Net income	$21,288	$23,278	$ 74,982	$ 48,669
Net income per share:				
Basic	$ 0.30	$ 0.34	$ 1.07	$ 0.71
Diluted	$ 0.26	$ 0.33	$ 0.96	$ 0.69
Shares used in computing net income per share:				
Basic	69,835	69,119	69,807	68,756
Diluted	83,901	70,292	79,747	70,151

See accompanying notes to unaudited consolidated financial statements.

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ViroPharma Incorporated
Consolidated Statements of Stockholders' Equity
(unaudited)

(in thousands)	Preferred Stock Number of shares	Preferred Stock Amount	Common Stock Number of shares	Common Stock Amount	Additional paid-in capital	Accumulated other comprehensive income	Accumulated deficit	Total stockholders' equity
Balance, December 31, 2006	—	$ —	69,770	$ 140	$508,436	$ 57	$ (96,734)	$ 411,899
Exercise of common stock options	—	—	110	—	512	—	—	512
Issuance of common stock	—	—	6	—	81	—	—	81
Share-based compensation	—	—	—	—	5,491	—	—	5,491
Cost of call spread options, net	—	—	—	—	(23,250)	—	—	(23,250)
Unrealized gain on available for sale securities, net of income tax	—	—	—	—	—	(342)	—	(342)
Stock option tax benefits	—	—	—	—	39	—	—	39
Tax benefit of call spread options	—	—	—	—	1,073	—	—	1,073
Cumulative translation adjustment	—	—	—	—	—	10	—	10
Net income	—	—	—	—	—	—	74,982	74,982
Balance, September 30, 2007	—	$ —	69,886	$ 140	$492,382	$ (275)	$ (21,752)	$ 470,495

See accompanying notes to unaudited consolidated financial statements.

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ViroPharma Incorporated
Consolidated Statements of Cash Flows
(unaudited)

(in thousands)	Nine months ended September 30, 2007	2006
Cash flows from operating activities:		
Net income	$ 74,982	$ 48,669
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on bond redemption	—	1,127
Non-cash share-based compensation expense	5,455	3,662
Non-cash interest expense	421	75
Deferred tax provision	13,967	13,472
Depreciation and amortization expense	5,373	4,702
Changes in assets and liabilities:		
Accounts receivable	(12,349)	(1,914)
Inventory	(1,011)	7,372
Interest Receivable	(2,080)	—
Prepaid expenses and other current assets	1,566	(531)
Other assets and other liabilities	37	(27)
Accounts payable	(636)	(8,012)
Accrued expenses and other current liabilities	3,008	(3,834)
Deferred revenue	—	(423)
Income taxes payable	1,636	990
Non-current income tax payable	1,262	—
Net cash provided by operating activities	91,631	65,328
Cash flows from investing activities:		
Purchase of property, plant and equipment	(8,814)	(1,375)
Purchase of Vancocin assets	(5,950)	(6,650)
Purchases of short-term investments	(734,905)	(1,011,809)
Maturities of short-term investments	457,973	893,047
Net cash used in investing activities	(291,696)	(126,787)
Cash flows from financing activities:		
Net proceeds from the issuance of senior convertible notes	241,825	—
Net purchase of call spread transactions	(23,250)	—
Redemption of subordinated convertible notes	—	(79,596)
Tax benefit from call spread transactions	1,073	—
Net proceeds from issuance of common stock	593	10,439
Tax benefits due to debt conversions	—	1,349
Excess tax benefits from share-based payment arrangements	39	308
Net cash provided by (used in) financing activities	220,282	(67,500)
Effect of exchange rate changes on cash	10	—
Net increase (decrease) in cash and cash equivalents	20,225	(128,959)
Cash and cash equivalents at beginning of period	51,524	232,195
Cash and cash equivalents at end of period	$ 71,749	$ 103,236

See accompanying notes to unaudited consolidated financial statements.

ViroPharma Incorporated
Notes to the Unaudited Consolidated Financial Statements

Note 1. Organization and Business Activities

ViroPharma Incorporated and subsidiaries ("ViroPharma" or the "Company") is a biopharmaceutical company dedicated to the development and commercialization of products that address serious infectious diseases, with a focus on products used by physician specialists or in hospital settings. The Company intends to grow through sales of its marketed product, Vancocin, through continued development of its product pipeline and through potential acquisition or licensing of products or acquisition of companies.

ViroPharma has one marketed product and multiple product candidates in clinical development. The Company markets and sells Vancocin HCl capsules, the oral capsule formulation of vancomycin hydrochloride, in the U.S. and its territories. Vancocin is a potent antibiotic approved by the U.S. Food and Drug Administration, or FDA, to treat antibiotic-associated pseudomembranous colitis caused by *Clostridium difficile* , or *C. difficile* , and enterocolitis caused by *Staphylococcus aureus* , including methicillin-resistant strains.

ViroPharma is developing Camvia ™ (maribavir) for the treatment of cytomegalovirus, or CMV, infection and HCV-796 for the treatment of hepatitis C virus, or HCV, infection. The Company has licensed the U.S. and Canadian rights for a third product candidate, an intranasal formulation of pleconaril, to Schering-Plough for the treatment of picornavirus infections. In addition, ViroPharma has earlier stage programs in both *C. difficile* and hepatitis C.

Basis of Presentation

The consolidated financial information at September 30, 2007 and for the three and nine months ended September 30, 2007 and 2006, is unaudited but includes all adjustments (consisting only of normal recurring adjustments) which, in the opinion of management, are necessary to state fairly the consolidated financial information set forth therein in accordance with accounting principles generally accepted in the United States of America. The interim results are not necessarily indicative of results to be expected for the full fiscal year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2006 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Adoption of Standards

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertain Tax Positions* , ("FIN 48") to clarify the criteria for recognizing tax benefits related to uncertain tax positions under SFAS No. 109, *Accounting for Income Taxes,* and to require additional financial statement disclosure. FIN 48 requires that the Company recognize in its consolidated financial statements the impact of a tax position if that position is more likely than not to be sustained upon examination, based on the technical merits of the position. Adoption of FIN 48 as of January 1, 2007 is reflected in Note 8.

Reclassification

Certain prior year amounts have been reclassified to conform to the current year presentation. Specifically, certain expenses were reclassified within operating expenses.

ViroPharma Incorporated
Notes to the Unaudited Consolidated Financial Statements (continued)

Note 2. Short-Term Investments

Short-term investments consist of fixed income securities with remaining maturities of greater than three months at the date of purchase and debt securities. At September 30, 2007 and December 31, 2006, all of the investments were classified as available for sale investments.

The following summarizes the available for sale investments at September 30, 2007 and December 31, 2006:

(in thousands)	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
September 30, 2007				
Debt securities:				
US Treasury and other US Government Agencies	$216,549	$ 42	$ 350	$216,241
Foreign Governments	42,452	27	20	42,459
Corporate	221,913	116	254	221,775
	$480,914	$ 185	$ 624	$480,475
Maturities of investments were as follows:				
Less than one year	$470,916	$ 183	$ 624	$470,475
December 31, 2006				
Certificates of deposit	$ 300	$ —	$ —	$ 300
Debt securities:				
US Treasury and other US Government Agencies	46,430	12	41	46,401
Foreign Governments	44,494	225	32	44,687
Corporate	112,577	16	96	112,497
	$203,801	$ 253	$ 169	$203,885
Maturities of investments were as follows:				
Less than one year	$203,801	$ 253	$ 169	$203,885

Note 3. Inventory

Inventory is related to Vancocin and is stated at the lower of cost or market using the first-in first-out method. The following represents the components of the inventory at September 30, 2007 and December 31, 2006:

(in thousands)	September 30, 2007	December 31, 2006
Raw Materials	$ 4,385	$ 3,273
Finished Goods	1,386	1,487
Total	$ 5,771	$ 4,760

ViroPharma Incorporated
Notes to the Unaudited Consolidated Financial Statements (continued)

Note 4. Intangible Assets

The following represents the balance of the intangible assets at September 30, 2007:

(in thousands)	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Trademarks	$ 12,539	$ 1,450	$ 11,089
Know-how	87,774	10,147	77,627
Customer relationship	39,786	4,599	35,187
Total	$140,099	$ 16,196	$ 123,903

The following represents the balance of the intangible assets at December 31, 2006:

(in thousands)	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Trademarks	$ 12,007	$ 1,027	$ 10,980
Know-how	84,046	7,192	76,854
Customer relationship	38,096	3,258	34,838
Total	$134,149	$ 11,477	$ 122,672

In March 2006, as a result of the Office of Generic Drug's ("OGD") change in approach relating to generic bioequivalence determinations, the Company reviewed the value of the intangible asset and concluded that there was no impairment of the carrying value of the intangible assets or change to the useful lives as estimated at the acquisition date.

Additionally, on an ongoing periodic basis, the Company evaluates the useful life of these intangible assets and determine if any economic, governmental or regulatory event has modified their estimated useful lives. This evaluation did not result in a change to the life of the intangible assets during the quarter ended September 30, 2007.

In the event the OGD's revised approach for Vancocin remains in effect, the time period in which a generic competitor may enter the market would be reduced. This could result in a reduction to the useful life of the Vancocin-related intangible assets. Management currently believes there are no indicators that would require a change in useful life as management believes that Vancocin will continue to be utilized along with generics that may enter the market.

A reduction in the useful life, as well as the timing and number of generics, will impact cash flow assumptions and the estimate of fair value, perhaps to a level that could result in an impairment charge. The Company will continue to monitor the actions of the OGD and consider the effects of our opposition actions and the announcements by generic competitors or other adverse events for additional impairment indicators and will reevaluate the expected cash flows and fair value of our Vancocin-related assets at such time.

The Company is obligated to pay Eli Lilly and Company ("Lilly") additional purchase price consideration based on net sales of Vancocin within a calendar year. The additional purchase price consideration is determined by the annual net sales of Vancocin, is paid quarterly and is due each year through 2011. The Company accounts for these additional payments as additional purchase price in accordance with SFAS No. 141, *Business Combinations* , which requires that the additional purchase price consideration is recorded as an increase to the intangible assets of Vancocin, is allocated over the asset classifications described above and is amortized over the remaining estimated useful life of the intangible assets. In addition, at the time of recording the additional intangible assets, a cumulative adjustment is recorded to accumulated intangible amortization, in addition to ordinary amortization expense, in order to reflect amortization as if the additional purchase price had been paid in November 2004.

ViroPharma Incorporated
Notes to the Unaudited Consolidated Financial Statements (continued)

As of September 30, 2007, the Company has recorded an aggregate of $23.1 million in additional purchase price consideration, as net sales of Vancocin have surpassed the maximum obligation levels, as summarized below:

(in millions)

Year	Contractual Obligation	Additional Purchase Price	Cumulative Adjustment to Accumulated Amortization
2007	35% payment on net sales between $48 and $65	$ 6.0	$ 0.6
2006	35% payment on net sales between $46 and $65	6.6	0.4
2005	50% payment on net sales between $44 and $65	10.5	0.3
Total		$ 23.1	$ 1.3

The Company is obligated to pay Lilly additional amounts at 35% of net sales should annual net sales be between $45 million and $65 million during years 2008 through 2011. No additional payments are due to Lilly on net sales of Vancocin outside this threshold.

Note 5. Property, Plant and Equipment

The Company purchased its corporate headquarters in Exton, Pennsylvania for $7.65 million, which was funded from available cash. On January 30, 2007, the purchase was finalized and the operating lease was terminated. In connection with recording the acquisition of the building, the Company reduced the cost of the building by $0.5 million, which represented deferred rent, previously included as a current liability as of December 31, 2006.

Note 6. Long-Term Debt

On March 26, 2007, the Company issued $250.0 million of 2% senior convertible notes due March 2017 (the “senior convertible notes”) in a public offering. The $250.0 million includes an issuance pursuant to the underwriters’ exercise of an overalloment in the amount of $25.0 million that was closed concurrently on March 26, 2007. Net proceeds from the issuance of the senior convertible notes were $241.8 million. The senior convertible notes are unsecured unsubordinated obligations and rank equally with any other unsecured and unsubordinated indebtedness. The senior convertible notes bear interest at a rate of 2% per annum, payable semi-annually in arrears on March 15 and September 15 of each year commencing on September 15, 2007. As of September 30, 2007, the Company has accrued $0.2 million in interest payable to holders of the senior convertible notes. Debt issuance costs of $8.2 million have been capitalized and are being amortized over the term of the senior convertible notes, with the balance to be amortized as of September 30, 2007 being $7.8 million.

The senior convertible notes are convertible into shares of the Company’s common stock at an initial conversion price of $18.87 per share. The senior convertible notes may only be converted: (i) anytime after December 15, 2016; (ii) during the five business-day period after any five consecutive trading day period (the “measurement period”) in which the price per note for each trading day of that measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such day; (iii) during any calendar quarter (and only during such quarter) after the calendar quarter ending June 30, 2007, if the last reported sale price of our common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the applicable conversion price in effect on the last trading day of the immediately preceding calendar quarter; or (iv) upon the occurrence of specified corporate events. Upon conversion, holders of the senior convertible notes will receive shares of common stock, subject to ViroPharma’s option to irrevocably elect to settle all future conversions in cash up to the principal amount of the senior convertible notes, and shares for any excess. We can irrevocably elect this option at any time on or prior to the 35 th scheduled trading day prior to the maturity date of the senior convertible notes. The senior convertible notes may be required to be repaid on the occurrence of certain fundamental changes, as defined in the senior convertible notes. As of September 30, 2007, the fair value of the $250.0 million convertible senior notes outstanding was approximately $191.6 million, based on the quoted market price.

Concurrent with the issuance of the senior convertible notes the Company purchased call options on its common stock in private transactions with Credit Suisse International, Credit Suisse, New York Branch, as agent for Credit Suisse International, and Wells Fargo Bank, National Association (the “call spread holders”). The call options allow ViroPharma to receive up to approximately 13.25 million shares of its common stock at $18.87 from the call spread holders, equal to the amount of common stock related to

ViroPharma Incorporated
Notes to the Unaudited Consolidated Financial Statements (continued)

the excess conversion value that ViroPharma would pay to the holders of the senior convertible notes upon conversion. These call options will terminate upon the earlier of the maturity dates of the related senior convertible notes or the first day all of the related senior convertible notes are no longer outstanding due to conversion or otherwise. The cost of the call options, approximately $92.3 million, was recorded as a reduction to additional paid-in-capital.

In a separate transaction with the issuance of the senior convertible notes, ViroPharma sold warrants to Goldman Sachs and Credit Suisse (the "call spread holders") to issue shares of its common stock at an exercise price of $24.92 per share. Pursuant to this transaction, warrants for approximately 13.25 million shares of ViroPharma's common stock were issued. Proceeds received from the issuance of the warrants totaled approximately $69.0 million and were recorded as an increase to additional paid-in-capital. If we have insufficient shares of common stock available for settlement of the warrants, we may issue shares of a newly created series of preferred stock in lieu of our obligation to deliver common stock. Any such preferred stock would be convertible into 10% more shares of our common stock than the amount of common stock we would otherwise have been obligated to deliver under the warrants.

Note 7. Share-based Compensation

In accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R"), the Company recorded share-based compensation expense as follows:

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2007	2006	2007	2006
Research and development	$ 642	$ 352	$1,616	$ 825
Marketing, general and administrative	1,472	1,255	3,839	2,837
Total	$ 2,114	$ 1,607	$5,455	$3,662

Refer to Note 6 of the Company's 2006 Annual Report on Form 10-K for information on the valuation and accounting for these plans.

Employee Stock Option Plans

The Company currently has three option plans in place: a 1995 Stock Option and Restricted Share Plan ("1995 Plan"), a 2001 Equity Incentive Plan ("2001 Plan") and a 2005 Stock Option and Restricted Share Plan ("2005 Plan") (collectively, the "Plans").

The following table lists the balances available by Plan at September 30, 2007:

	1995 Plan	2001 Plan	2005 Plan	Combined
Number of shares authorized	4,500,000	500,000	2,850,000	7,850,000
Number of options granted since inception	(6,997,515)	(1,029,600)	(2,406,590)	(10,433,705)
Number of options cancelled since inception	2,940,233	759,837	140,907	3,840,977
Number of shares expired	(442,718)	—	—	(442,718)
Number of shares available for grant	—	230,237	584,317	814,554

The Company issued 1,237,090 stock options in the first nine months of 2007. The weighted average fair value of each option grant was estimated at $11.53 per share using the Black-Scholes option-pricing model using the following assumptions:

Expected dividend yield	—
Range of risk free interest rate	4.36% - 5.12%
Weighted-average volatility	92.8%
Range of volatility	90.9% - 94.6%
Range of expected option life (in years)	5.50 - 6.25

ViroPharma Incorporated
Notes to the Unaudited Consolidated Financial Statements (continued)

The Company has 4,969,228 million option grants outstanding at September 30, 2007 with exercise prices ranging from $0.99 per share to $38.70 per share and a weighted average remaining contractual life of 7.27 years. The following table lists the outstanding and exercisable option grants as of September 30, 2007:

	Number of options	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value (in thousands)
Outstanding	4,969,228	$ 11.16	7.27	$ 10,525
Exercisable	2,359,036	$ 10.11	5.66	$ 7,692

As of September 30, 2007, there was $20.6 million of total unrecognized compensation cost related to unvested share-based payments (including share options) granted under the Plans. That cost is expected to be recognized over a weighted-average period of 1.58 years.

Employee Stock Purchase Plan

The Company has an employee stock purchase plan. Under this plan, there are two plan periods: January 1 through June 30 (“Plan Period One”) and July 1 through December 31 (“Plan Period Two”). For Plan Period One in 2007, the fair value was approximately $27,100, with a risk free interest rate of 4.9%, volatility of 45.0% and an expected option life of 0.50 years. This fair value was amortized over the six month period ending June 30, 2007.

For Plan Period Two in 2007, the fair value was $31,000, with a risk free interest rate of 5.06%, volatility of 34.5% and an expected option life of 0.50 years. This fair value will be amortized over the six month period ending December 31, 2007, approximately $15,500 of which was amortized as of September 30 2007.

Under this plan, 6,329 shares were sold to employees during the first nine months of 2007, all related to Plan Period One. During the years ended December 31, 2006 and 2005, 14,395 and 15,894 shares, respectively, were sold to employees. As of September 30, 2007 there are approximately 286,851 shares available for issuance under this plan.

Non-employee Stock Options

The Company remeasured the fair value of 7,250 options as of September 30, 2007, which resulted in approximately $27,000 reduction to compensation expense in the first nine months of 2007. The fair value of the non-employee share options was estimated at approximately $20,000 using the Black-Scholes option-pricing model, with a risk free interest rate ranging from 3.4% to 4.2%, volatility ranging from 40.5% to 71.7%, weighted volatility of 55.4% and an expected option life ranging from 0.11 to 4.55 years.

There were no non-employee share options vested or exercised during the nine months ended September 30, 2007 or 2006.

Note 8. Income Taxes

The Company’s effective income tax rate was 36.4% and 37.3% for the quarters ended September 30, 2007 and 2006, respectively, and 32.3% and 38.1% for the nine months ended September 30, 2007 and 2006, respectively. Income tax expense includes federal, state and foreign income tax at statutory rates and the effects of various permanent differences. The decrease in the 2007 rate as compared to 2006 is primarily due to the Company’s current estimate of the impact of orphan drug credit for Camvia.

On January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (“FIN 48”). FIN 48 clarifies the criteria for recognizing tax benefits related to uncertain tax positions under SFAS No. 109, *Accounting for Income Taxes*, and requires additional financial statement disclosure. FIN 48 requires that the Company recognizes in its consolidated financial statements the impact of a tax position if that position is more likely than not to be sustained upon examination, based on the technical merits of the position. Adoption of FIN 48 had no net impact on the Company’s consolidated results of operations and financial position.

ViroPharma Incorporated
Notes to the Unaudited Consolidated Financial Statements (continued)

Upon adoption, the Company identified $1.7 million of uncertain tax positions that the Company currently does not believe meet the more likely than not recognition threshold under FIN 48 to be sustained upon examination. Since these tax positions have not been utilized and have a related full valuation allowance established, the Company reduced its gross deferred tax asset and valuation allowance by $1.7 million. This amount relates to unrecognized tax benefits that would impact the effective tax rate if recognized absent the valuation allowance.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various states and will be filing appropriate tax returns in the United Kingdom related to our subsidiary, ViroPharma Limited. The Company is subject to U.S. federal or state income tax examinations by tax authorities for years after 2002. During the periods open to examination, the Company has utilized net operating loss and tax credit carry forwards that have attributes from closed periods. Since these NOLs and credit carry forwards were utilized in the open periods, they remain subject to examination.

The Company's policy is to record interest and penalties on uncertain tax positions as income tax expense.

At September 30, 2007, the Company recorded a $1.3 million non-current liability for uncertain tax positions, which includes approximately $65,000 for interest, which is reflected in income tax expense. This uncertain tax position was recorded in the third quarter of 2007. The Company does not expect any material increase or decrease in its income tax expense, in the next twelve months, related to examinations or changes in uncertain tax positions.

Note 9. Comprehensive Income

In the Company's annual consolidated financial statements, comprehensive income (loss) is presented as a separate financial statement. For interim consolidated financial statements, the Company is permitted to disclose the information in the footnotes to the consolidated financial statements. The disclosures are required for comparative purposes. Comprehensive income (loss) items for the Company include unrealized gains and losses on available for sale securities and foreign currency translation adjustments. The following reconciles net income (loss) to comprehensive income (loss) for the three and nine months ended September 30, 2007 and 2006:

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2007	2006	2007	2006
Net income	$21,288	$23,278	$74,982	$48,669
Other comprehensive:				
Unrealized gains/(losses) on available for sale securities	294	305	(342)	475
Foreign currency translation adjustment	10	—	10	—
Comprehensive income	$21,592	$23,583	$74,650	$49,144

The unrealized gains are reported net of federal and state income taxes.

ViroPharma Incorporated
Notes to the Unaudited Consolidated Financial Statements (continued)

Note 10. Earnings per share

(in thousands, except per share data)	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Basic Earnings Per Share				
Net income	$21,288	$23,278	$74,982	$48,669
Common stock outstanding (weighted average)	69,835	69,119	69,807	68,756
Basic net income per share	$ 0.30	$ 0.34	$ 1.07	$ 0.71
Diluted Earnings Per Share				
Net income	$21,288	$23,278	$74,982	$48,669
Add interest expense on senior convertible notes, net of income tax	893	—	1,843	—
Diluted net income	$22,181	$23,278	$76,825	$48,669
Common stock outstanding (weighted average)	69,835	69,119	69,807	68,756
Add shares from senior convertible notes	13,249	—	9,172	—
Add “in-the-money” stock options	817	1,173	768	1,395
Common stock assuming conversion and stock option exercises	83,901	70,292	79,747	70,151
Diluted net income per share	$ 0.26	$ 0.33	$ 0.96	$ 0.69

The following common shares that are associated with stock options were excluded from the calculations as their effect would be anti-dilutive:

(in thousands)	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Common shares excluded	3,014	2,826	1,761	2,604

Note 11. Supplemental Cash Flow Information

(in thousands)	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Supplemental disclosure of non-cash transactions:		
Employee share-based compensation	$ 5,491	$ 3,719
Liability classified share-based compensation benefit	36	61
Unrealized gains on available for sale securities	342	475
Initial recognition of liability classified share-based awards	—	116
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$17,566	$14,065
Cash paid for interest	2,444	2,368
Cash received for stock exercises and employee stock purchase plan	652	529

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

We are a biopharmaceutical company dedicated to the development and commercialization of products that address serious infectious diseases, with a focus on products used by physician specialists or in hospital settings. We intend to grow through sales of our marketed product, Vancocin ® HCl capsules, through the continued development of our product pipeline and through potential acquisition or licensing of products or acquisition of companies

We have one marketed product and multiple product candidates in development. We market and sell Vancocin ® HCl capsules, the oral capsule formulation of vancomycin hydrochloride, in the U.S. and its territories. Vancocin is a potent antibiotic approved by the U.S. Food and Drug Administration, or FDA, to treat antibiotic-associated pseudomembranous colitis caused by *Clostridium difficile* , or *C. difficile* , and enterocolitis caused by *S. aureus* , including methicillin-resistant strains. We are developing Camvia ™ (maribavir) for the prevention and treatment of cytomegalovirus, or CMV, disease, and HCV-796 for the treatment of hepatitis C virus, or HCV, infection. We have licensed the U.S. and Canadian rights for a third product candidate, an intranasal formulation of pleconaril, to Schering-Plough for the treatment of picornavirus infections. In addition, we have earlier stage programs in both *C. difficile* and hepatitis C.

We intend to evaluate in-licensing or other opportunities to acquire products in development, or those that are currently on the market. We plan to seek products for diseases treated by physician specialists and in hospital settings to complement the markets that we hope our CMV and HCV programs will serve or in which Vancocin is prescribed.

Executive Summary

Since June 30, 2007, we experienced the following:

Development Activities

CMV:

- Began patient recruitment and dosing in a second phase 3 clinical study of Camvia, this one in liver transplant patients.
- Continued patient recruitment and dosing in an ongoing phase 3 clinical study of Camvia in patients undergoing allogeneic stem cell transplant.
- Began executing our plan for the Camvia program in Europe.

HCV (with our partner Wyeth):

- Discontinued dosing of HCV-796 in an ongoing phase 2 combination study of the drug following a review by the joint safety review board of safety data which showed elevated liver enzyme levels in a subset of patients; trial participants continue to receive pegylated interferon and ribavirin in this study.
- Continued to monitor and follow-up with patients in the phase 2 study.
- Began evaluation of potential risks to patients to understand if further clinical studies are appropriate.

Financial Results

- Increased working capital by $31.2 million to $573.3 million, primarily driven by operating income.
- Net sales decreased 8% as compared to the third quarter of 2006 and were impacted by fluctuations in:
  - prescriptions, which decreased 1% in the third quarter of 2007 as compared to the third quarter of 2006; and
  - wholesaler inventory levels. While levels increased in both comparative periods, the increase in the 2007 period was significantly lower than in the 2006 period.
  - pricing, which was higher in the third quarter of 2007 as compared to the third quarter of 2006.
- Increased development costs by $3.0 million over the third quarter of 2006 to $10.5 million.

Liquidity

- Generated net cash from operating activities of $40.4 million.
- Increased cash and cash equivalents and short-term investments by $35.4 million.

During the remainder of 2007 and going forward, we expect to face a number of challenges, which include the following:

The commercial sale of approved pharmaceutical products is subject to risks and uncertainties. There can be no assurance that future Vancocin sales will meet or exceed the historical rate of sales for the product, for reasons that include, but are not limited to, generic and non-generic competition for Vancocin and/or changes in prescribing habits or disease incidence.

Additionally, period over period fluctuations in net product sales are expected to occur as a result of wholesaler buying decisions.

We cannot assure you that generic competitors will not take advantage of the absence of patent protection for Vancocin to attempt to develop a competing product. We are not able to predict the time period in which a generic drug may enter the market. On March 17, 2006, we learned that the OGD changed its approach regarding the conditions that must be met in order for a generic drug applicant to request a waiver of in-vivo bioequivalence testing for copies of Vancocin. We are opposing this attempt. However, in the event this change in approach remains in effect, the time period in which a generic competitor may enter the market would be reduced and multiple generics may enter the market, which would materially impact our operating results, cash flows and asset valuations.

We will face intense competition in acquiring additional products to expand further our product portfolio. Many of the companies and institutions that we will compete with in acquiring additional products to expand further our product portfolio have substantially greater capital resources, research and development staffs and facilities than we have, and substantially greater experience in conducting business development activities. We may need additional financing in order to acquire new products in connection with our plans as described in this report.

The outcome of our clinical development programs is subject to considerable uncertainties. We cannot be certain that we will be successful in developing and ultimately commercializing any of our product candidates, that the FDA or other regulatory authorities will not require additional or unanticipated studies or clinical trial outcomes before granting regulatory approval, or that we will be successful in gaining regulatory approval of any of our product candidates in the timeframes that we expect, or at all. In August 2007, we and Wyeth decided to discontinue dosing with HCV-796 in a phase 2 study as a result of potential safety concerns. We and Wyeth continue to evaluate the observations that led to this decision in the hope of advancing this potential therapeutic agent in the future, however there can be no assurance that we will conduct additional HCV studies in the future as the FDA or other regulatory authorities may either prohibit any future studies with HCV-796 or alternatively may require additional or unanticipated studies or clinical trial outcomes before granting regulatory approval.

We cannot assure you that our current cash, cash equivalents and short-term investments or cash flows from Vancocin sales will be sufficient to fund all of our ongoing development and operational costs, as well as the interest payable on the senior convertible notes, over the next several years, that planned clinical trials can be initiated, or that planned or ongoing clinical trials can be successfully concluded or concluded in accordance with our anticipated schedule and costs. Moreover, the results of our business development efforts could require considerable investments.

Our actual results could differ materially from those results expressed in, or implied by, our expectations and assumption described in this Quarterly Report on Form 10-Q. In addition to the other information set forth above and elsewhere in this report, you should carefully consider the factors discussed under the heading “Risk Factors” in our Form 10-K for the year ended December 31, 2006 and in our Form 10-Q for the quarter ended March 31, 2007. The risks described in this report, our Form 10-K for the year ended December 31, 2006 and in our Form 10-Q for the quarter ended March 31, 2007, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Results of Operations

Three and Nine-months ended September 30, 2007 and 2006

	For the three months ended September 30,		For the nine months ended September 30,	
(in thousands, except per share data)	**2007**	**2006**	**2007**	**2006**
Net product sales	$ 50,944	$ 55,105	$ 156,074	$ 128,163
Total revenues	$ 50,944	$ 55,246	$ 156,074	$ 128,586
Gross product margin	$ 48,915	$ 50,237	$ 149,174	$ 111,197
Operating income	$ 27,944	$ 34,461	$ 96,749	$ 73,748
Net income	$ 21,288	$ 23,278	$ 74,982	$ 48,669
Net income per share:				
Basic	$ 0.30	$ 0.34	$ 1.07	$ 0.71
Diluted	$ 0.26	$ 0.33	$ 0.96	$ 0.69

The nine month increase in net income relates primarily to increased net sales, increased gross product margin rates and higher interest income, offset primarily by increased development costs related to our CMV and HCV programs. The three month decrease in net income is primarily attributable to increased development costs, which are partially offset by higher interest income.

Revenues

Revenues consisted of the following:

(in thousands)	For the three months ended September 30, 2007	For the three months ended September 30, 2006	For the nine months ended September 30, 2007	For the nine months ended September 30, 2006
Net product sales	$ 50,944	$ 55,105	$ 156,074	$ 128,163
License fees and milestones revenues	—	141	—	423
Total revenues	$ 50,944	$ 55,246	$ 156,074	$ 128,586

Revenue—Vancocin product sales

Our net product sales are solely related to Vancocin. We sell Vancocin only to wholesalers who then distribute the product to pharmacies, hospitals and long-term care facilities, among others. Our sales of Vancocin are influenced by wholesaler forecasts of prescription demand, wholesaler buying decisions related to their desired inventory levels, and, ultimately, end user prescriptions, all of which could be at different levels from period to period.

During the three and nine months ended September 30, 2007, net sales of Vancocin decreased 7.6% and increased 21.8%, respectively, compared to the same periods in 2006. The third quarter decrease of 7.6% was negatively impacted by changes in wholesaler inventory levels and was partially offset by the impact of a price increase in 2007. The nine month increase of 21.8% resulted from an increase in units sold, partially due to the positive impact of changes in wholesaler inventory levels, and the impact of a price increase in 2007. Specific to wholesalers' inventory levels, during the third quarter of 2007, wholesalers' inventory increased to a lesser degree than in the third quarter of 2006. For the nine month period of 2007, wholesalers' inventory increased; whereas, the comparable 2006 period saw a decrease. Specific to prescriptions, we believe, based upon data reported by IMS Health Incorporated, that prescriptions during the three months ended September 30, 2007 decreased 1.0% as compared to the third quarter in 2006 and prescriptions during the nine months ended September 30, 2007 exceeded prescriptions in the nine months of 2006 periods by 5.1%.

Approximately 92% of our sales are to three wholesalers. Vancocin product sales are influenced by prescriptions and wholesaler forecasts of prescription demand, which could be at different levels from period to period. We receive inventory data from two of our three largest wholesalers. We do not independently verify this data. Based on this inventory data and our estimates, we believe that as of September 30, 2007, the wholesalers did not have excess channel inventory.

Revenue—License fee and milestone revenues

License fee and milestone revenues in 2006 represent amortization of payments received under our agreement with Wyeth. There are no comparable amounts in 2007 as the amortization period ended in December 2006.

Our license fee and milestone revenues result from existing or future collaborations of development-stage products and currently vary greatly from period to period. See " **Liquidity** , ***Operating Cash Inflows*** " for additional information.

Cost of sales and gross product margin

(in thousands)	For the three months ended September 30, 2007	For the three months ended September 30, 2006	For the nine months ended September 30, 2007	For the nine months ended September 30, 2006
Net product sales	$ 50,944	$ 55,105	$ 156,074	$ 128,163
Cost of sales	2,029	4,868	6,900	16,966
Gross product margin	$ 48,915	$ 50,237	$ 149,174	$ 111,197

Vancocin cost of sales includes the cost of materials and distribution costs. Our gross product margin rate (net product sales less cost of sales as a percent of net product sales) for Vancocin increased in the 2007 periods to approximately 95% as compared to the 2006 periods, which were 91% for the quarter ended September 30, 2006 and 87% for the nine months ended September 30, 2006. This increase primarily results from the sale of units manufactured by Norwich Pharmaceuticals, Inc. (formerly known as OSG Norwich) during the 2007 periods, which carry a lower inventory cost. Additionally, the nine months of 2006 includes $4.4 million resulting from the November 2005 amendment to our manufacturing agreement with Lilly whereby we increased the amount of Vancocin that Lilly supplied to us, which increased our cost of sales in the first half of 2006 as specific higher cost units were sold.

Since units are shipped based upon earliest expiration date, our actual margins will be impacted by the cost associated with the specific units that are sold. Additionally, we may experience fluctuations in quarterly manufacturing yields and if this occurs, we would expect the cost of product sales of Vancocin, and accordingly, gross product margin percentage, to fluctuate from quarter to quarter.

Research and development expenses

For each of our research and development programs, we incur both direct and indirect expenses. Direct expenses include third party costs related to these programs such as contract research, consulting, cost sharing payments or receipts, and preclinical and development costs. Indirect expenses include personnel, facility, and other overhead costs. Due to advancements in our clinical development programs, we expect future costs to materially exceed current costs.

Research and development expenses were divided between our research and development programs in the following manner:

(in thousands)	For the three months ended September 30, 2007	For the three months ended September 30, 2006	For the nine months ended September 30, 2007	For the nine months ended September 30, 2006
Direct – Core programs				
CMV	$ 6,262	$ 5,297	$ 13,329	$ 8,517
HCV	451	377	832	378
Vancocin / *C. difficile*	257	135	635	789
Indirect				
Development	3,573	1,720	8,569	5,150
Total	$ 10,543	$ 7,529	$ 23,365	$ 14,834

Direct Expenses—Core Development Programs

Related to our CMV program, during the first nine months of 2007 we continued recruitment into an ongoing phase 3 study of Camvia in patents undergoing allogeneic stem cell transplant and began recruiting patients into a second phase 3 study in patients undergoing liver transplantation. We began executing on our plans for our clinical, regulatory and commercial activities for the Camvia program in Europe. During the first nine months of 2006, we concluded a preliminary analysis of data from our phase 2 clinical trial with Camvia and were in discussions with FDA regarding our phase 3 plans for Camvia. Included in the CMV expenses during the third quarter and nine months of 2006 was $3.0 million related to a milestone payment due to GlaxoSmithKline associated with the initiation of the phase 3 study of Camvia.

Related to our HCV program, costs in 2007 primarily represent those paid to Wyeth in connection with our cost-sharing arrangement related to discovery efforts to identify potential back-ups/follow-on compounds to HCV-796. Development activity for our HCV product candidate, HCV-796, during the first nine months of 2007 included completion of enrollment in the 500 mg BID arms of a phase 2 study of HCV-796 when dosed in combination with pegylated interferon and ribavirin and ongoing follow-up of patients in that study. In August 2007, we announced that elevated liver enzyme levels in a subset of patients in this study indicated a potential safety issue. Consequently, all dosing with HCV-796 was discontinued, although patients in the phase 2 study had the option of continuing to receive pegylated interferon and ribavirin as per standard of care. Therefore, monitoring and follow-up of patients in the phase 2 study will continue. During the first nine months of 2006, we initiated a phase 1b clinical trial of HCV-796 in combination with pegylated interferon and prepared for the current phase 2 study. Wyeth pays a substantial portion of the collaboration's predevelopment and development expenses.

Related to our Vancocin/ *C. difficile* program, costs in 2007 and 2006 related to research and development activities, including costs related to non-toxigenic strains of *C. difficile* .

Anticipated fluctuations in future direct expenses are discussed under " **Liquidity** – ***Development Programs*** . "

Indirect Expenses

These costs primarily relate to the compensation of and overhead attributable to our development team, primarily due to increased personnel.

Marketing, general and administrative expenses

Marketing, general and administrative expenses increased for the three and nine months ending September 30, 2007, $2.0 million and $5.6 million, respectively, comparative to the same periods in 2006. For the nine month period, the largest contributors to the $5.6 million increase were medical education costs ($2.1 million), legal and consulting costs ($1.2 million) and stock compensation expense ($1.0 million). Other contributors included corporate franchise taxes and compensation and recruiting costs, due to increased number of employees, which collectively increased by $1.3 million. These increases were partially offset by lower business development costs. For the three month period, the largest contributors to the $2.0 million increase were medical education and legal and consulting costs. During the remainder 2007, we anticipate to continue to increase spending in marketing, general and administrative expenses, driven by additional medical education expenses and legal and consulting costs.

Included in the increased legal and consulting costs are expenses incurred related to our opposition to the attempt by the OGD regarding the conditions that must be met in order for a generic drug application to request a waiver of in-vivo bioequivalence testing for copies of Vancocin, which were $2.4 million in the first nine months of 2007 as compared to $1.7 million the same period in 2006. We anticipate that these additional legal and consulting costs will continue at higher levels in future periods.

Intangible amortization

Intangible amortization is the result of the Vancocin product rights acquisition in the fourth quarter of 2004. Additionally, as described in our agreement with Lilly, to the extent that we incur an obligation to Lilly for additional payments on Vancocin sales, we have contingent consideration. We record the obligation as an adjustment to the carrying amount of the related intangible asset and a cumulative adjustment to the intangible amortization upon achievement of the related sales milestones. Contingent consideration and Lilly related additional payments are more fully described in Note 4 of the Unaudited Consolidated Financial Statements.

Intangible amortization increased in all comparative periods, with $1.4 million and $1.3 million for the three months ended September 30, 2007 and 2006, respectively, and $4.7 million and $4.3 million for the nine months ended September 30, 2007 and 2006, respectively. The increase for the nine month comparative period was primarily related to the $0.2 million increase in the cumulative adjustment, which was $0.6 million for the first half of 2007 and $0.4 million for the first half of 2006.

In March 2006, as a result of OGD's change in approach relating to generic bioequivalence determinations, we reviewed the value of the intangible asset and concluded that there was no impairment of the carrying value of the intangible assets or change to the useful lives as estimated at the acquisition date. Additionally, on an ongoing periodic basis, we evaluate the useful life of these intangible assets and determine if any economic, governmental or regulatory event has modified their estimated useful lives. This evaluation did not result in a change in the life of the intangible assets during the quarter ended September 30, 2007. We will continue to monitor the actions of the OGD and consider the effects of our opposition efforts and the announcements by generic competitors or other adverse events for additional impairment indicators and we will reevaluate the expected cash flows and fair value of our Vancocin-related assets, as well as estimated useful lives, at such time.

Other Income (Expense)

Interest Income

Interest income for three months ended September 30, 2007 and 2006 was $7.0 million and $2.5 million, and for the nine months ended September 30, 2007 and 2006 was $17.0 million and $6.7 million, respectively. Interest income increased primarily due to increased short-term investments during the 2007 period and to a lesser extent, an increased rate of return.

Interest Expense

	For the three months ended September 30,		For the nine months ended September 30,	
(in thousands)	2007	2006	2007	2006
Interest expense on 2% senior convertible notes	$ 1,231	$ —	$ 2,541	$ —
Interest expense on 6% subordinated convertible notes	—	—	—	790
Beneficial conversion feature	—	(179)	—	(179)
Amortization of finance costs	204	—	420	75
Total interest expense	$ 1,435	$ (179)	$ 2,961	$ 686

Interest expense and amortization of finance costs in 2007 relates entirely to the senior convertible notes issued on March 26, 2007, as described in Note 6 to the Unaudited Consolidated Financial Statements.

Interest expense in 2006 relates entirely to the subordinated convertible notes, which were redeemed on March 1, 2006. In the third quarter of 2006, we recorded a credit to interest expense related to the beneficial conversion feature because we released the remaining liability associated with the auto-conversion provisions as the likelihood of payment was remote.

Income Tax Expense

Our effective income tax rate was 36.4% and 37.3% for the quarters ended September 30, 2007 and 2006, respectively, and 32.3% and 38.1% for the nine months ended September 30, 2007 and 2006, respectively. Income tax expense includes federal, state and foreign income taxes at statutory rates and the effects of various permanent differences. The decrease in the 2007 rate as compared to 2006 is primarily due to our current estimate of the impact of orphan drug credit for Camvia. Our income tax expense for the three and nine months ended September 30, 2007 and 2006 also includes the impact of finalizing the federal and state tax provisions for 2006 and 2005, respectively. We currently anticipate an effective tax rate of approximately 33% for the year ended December 31, 2007, which includes an estimate related to orphan drug credit based upon estimates of qualified expenses and excludes the impact of discrete items. We continue to evaluate our qualified expenses and, to the extent that actual qualified expenses vary significantly from our estimates, our effective tax rate will be impacted.

Liquidity

We expect that our near term sources of revenue will arise from Vancocin product sales. However, we cannot predict what the actual sales of Vancocin will be in the future, the outcome of our effort to oppose the OGD's approach to bioequivalence determinations for generic copies of Vancocin is uncertain. In addition, there are no assurances that demand for Vancocin will continue at historical or current levels.

Our ability to generate positive cash flow is also impacted by the timing of anticipated events in our CMV and HCV programs, including the scope of the clinical trials required by regulatory authorities, results from clinical trials, the results of our product development efforts, and variations from our estimate of future direct and indirect expenses.

While we anticipate that cash flows from Vancocin, as well as our current cash, cash equivalents and short-term investments, should allow us to fund substantially all of our ongoing development and other operating costs, as well as the interest payable on the senior convertible notes, we may need additional financing in order to expand our product portfolio. At September 30, 2007, we had cash, cash equivalents and short-term investments of $552.2 million. At September 30, 2007, the annualized weighted average nominal interest rate on our short-term investments was 5.2%.

Overall Cash Flows

During the nine months ended September 30, 2007, we generated $91.6 million of net cash from operating activities, primarily from the cash contribution of Vancocin, which includes the impact of net income. Partially offsetting this cash contribution is the impact of higher accounts receivables, which is related to the timing of orders and the price increase. We also used $291.7 million of cash for investing activities, as we purchased short-term investments and our corporate headquarters building. Our net cash provided by financing activities for the quarter ended September 30, 2007 was $220.3 million, primarily from the March 2007 issuance of senior convertible notes, net of issuance costs, in the amount of $241.8 million, partially offset by $23.3 million used to purchase the call spread as described in Note 6 of the Unaudited Consolidated Financial Statements.

Operating Cash Inflows

We began to receive cash inflows from the sale of Vancocin in January 2005. We cannot reasonably estimate the period in which we will begin to receive material net cash inflows from our product candidates currently under development. Cash inflows from development-stage products are dependent on several factors, including the achievement of milestones and regulatory approvals. We may not receive milestone payments from any existing or future collaborations if a development-stage product fails to meet technical or performance targets or fails to obtain the required regulatory approvals. Further, our revenues from collaborations will be affected by efforts of our collaborative partners. Even if we achieve technical success in developing drug candidates, our collaboration partners may not devote the resources necessary to complete development and commence marketing of these products, when and if approved, or they may not successfully market these products. The most significant of our near-term operating development cash inflows are as described under " ***Development Programs*** ".

Operating Cash Outflows

The cash flows we have used in operations historically have been applied to research and development activities, marketing and business development efforts, general and administrative expenses, servicing our debt, and income tax payments. Bringing drugs from the preclinical research and development stage through phase 1, phase 2, and phase 3 clinical trials and FDA approval is a time consuming and expensive process. Because our product candidates are currently in the clinical stage of development, there are a variety of events that could occur during the development process that will dictate the course we must take with our drug development efforts and the cost of these efforts. As a result, we cannot reasonably estimate the costs that we will incur through the commercialization of any product candidate. However, due to advancements in our trials and our initiative to develop non-toxigenic strains of C. *difficile* , we expect future costs to exceed current costs. The most significant of our near-term operating development cash outflows are as described under " ***Development Programs*** ".

Development Programs

For each of our development programs, we incur both direct and indirect expenses. Direct expenses include third party costs related to these programs such as contract research, consulting, cost sharing payments or receipts, and preclinical and clinical development costs. Indirect expenses include personnel, facility and other overhead costs. Additionally, for some of our development programs, we have cash inflows and outflows upon achieving certain milestones.

Core Development Programs

CMV program —From the date we in-licensed Camvia through September 30, 2007, we paid $35.5 million of direct costs in connection with this program, including the acquisition fee of $3.5 million paid to GSK for the rights to Camvia in September 2003 and a $3.0 million milestone payment in February 2007.

During the remainder of 2007, we expect Camvia-related activities to include continued recruitment into the ongoing phase 3 study in patients undergoing allogeneic stem cell transplant, as well as recruitment into a phase 3 study in patients who have received a liver transplant. We will also continue to conduct phase 1 clinical pharmacology studies to support the overall clinical development program. Based on the execution of phase 3 clinical development studies, we expect our expenses in 2007 for the CMV program to be substantially higher than in 2006. We are solely responsible for the cost of developing our CMV product candidate.

In May 2007, we announced our decision to pursue commercialization of Camvia in Europe, independent of strategic partners. We anticipate development and commercialization expenses related to this initiative to increase significantly beginning in 2008.

Should we achieve certain product development events, we are obligated to make certain milestone payments to GSK, the licensor of Camvia.

HCV program —From the date that we commenced predevelopment activities for compounds in this program that are currently active through September 30, 2007, we paid $3.7 million in direct expenses for the predevelopment and development activities relating to such compounds. These costs are net of contractual cost sharing arrangements between Wyeth and us. Wyeth pays a substantial portion of the collaboration's predevelopment and development expenses.

In August, we announced a potential safety issue identified during a phase 2 study of our HCV product candidate, HCV-796, dosed in combination with pegylated interferon and ribavirin. Specifically, elevated liver enzyme levels were observed in a subset of patients. Consequently, all dosing with HCV-796 was discontinued, although patients in the phase 2 study had the option of continuing to receive pegylated interferon and ribavirin as per standard of care. During the remainder of 2007, the planned activities for the HCV-796 program include continuing monitoring and follow-up of patients enrolled in the phase 2 study. In addition, there will be extensive evaluation of available preclinical and clinical safety data in order to understand the potential risks to patients and whether further clinical studies are appropriate. No additional clinical studies with HCV-796 will be initiated until this evaluation is complete. The results of the investigation into liver enzyme findings observed in the phase 2 study, along with other predevelopment activities performed during the year, will significantly impact the timing and amount of expenses we will incur related to this program in future periods. In addition, discussions with the FDA regarding our plans may impact the timing, nature and cost of future planned studies. During 2007 we will continue to incur costs associated with discovery activities to identify a follow-on/back-up molecule to HCV-796.

Should we achieve certain additional product development events, Wyeth is required to pay us certain cash milestones pursuant to terms of our collaboration agreement. However, there can be no assurances that we will be successful in achieving these milestones.

Vancocin and *C. difficile* related – We acquired Vancocin in November 2004 and through September 30, 2007, we have spent approximately $1.0 million in direct research and development costs related to Vancocin or on related *C. difficile* activities.

During the remainder of 2007, we expect our research and development activities in the field of *C. difficile* to increase significantly, primarily related to our rights to develop non-toxigenic strains of *C. difficile* for the treatment and prevention of CDAD. Therefore, we expect direct costs to increase above 2006 levels.

Direct Expenses—Non-Core Development Programs

Common Cold —From the date that we commenced predevelopment activities for the intranasal formulation of pleconaril through December 31, 2004, we incurred $1.9 million in direct expenses. We have not incurred any significant direct expenses in connection with this program since 2004, nor will we in the future, as Schering-Plough has assumed responsibility for all future development and commercialization of pleconaril.

In November 2004, we entered into a license agreement with Schering-Plough under which Schering-Plough has assumed responsibility for all future development and commercialization of pleconaril. Schering-Plough paid us an initial license fee of $10.0

million in December 2004 and purchased our existing inventory of bulk drug substance for an additional $6.0 million in January 2005. We will also be eligible to receive up to an additional $65.0 million in milestone payments upon achievement of certain targeted regulatory and commercial events, as well as royalties on Schering-Plough's sales of intranasal pleconaril in the licensed territories.

Business development activities

Through September 30, 2007, we paid an acquisition price of $116.0 million, recorded $23.1 million related to additional purchase price consideration tied to product sales (see Note 4 of the Unaudited Consolidated Financial Statements) and incurred $2.0 million of fees and expenses in connection with the Vancocin acquisition.

In addition, we intend to seek to acquire additional products or product candidates. The costs associated with evaluating or acquiring any additional product or product candidate can vary substantially based upon market size of the product, the commercial effort required for the product, the product's current stage of development, and actual and potential generic and non-generic competition for the product, among other factors. Due to the variability of the cost of evaluating or acquiring business development candidates, it is not feasible to predict what our actual evaluation or acquisition costs would be, if any; however, the costs could be substantial.

Senior Convertible Notes

On March 26, 2007, we issued $250.0 million principal amount of senior convertible notes due in March 2017. The senior convertible notes bear interest at a rate of 2% per annum, payable semi-annually in arrears on March 15 and September 15 of each year commencing on September 15, 2007. The senior convertible notes are convertible into shares of the Company's common stock at an initial conversion price of $18.87 per share. Upon conversion, holders of the senior convertible notes will receive shares of common stock, subject to ViroPharma's option to irrevocably elect to settle all future conversions in cash up to the principal amount of the senior convertible notes, and shares for any excess. We can irrevocably elect this option at any time on or prior to the 35 th scheduled trading day prior to the maturity date of the senior convertible notes. Prior to the conversion period, which begins on December 15, 2016, the senior convertible notes are convertible by the holder under specific criteria, as more fully described in Note 6 of the Unaudited Consolidated Financial Statements.

Concurrent with the issuance of the senior convertible notes we purchased call options on our common stock in private transactions with Credit Suisse International, Credit Suisse, New York Branch, as agent for Credit Suisse International, and Wells Fargo Bank, National Association (the "call spread holders"). The call options allow ViroPharma to receive up to approximately 13.25 million shares of its common stock at $18.87 from the call spread holders, equal to the amount of common stock related to the excess conversion value that we would pay to the holders of the senior convertible notes upon conversion. These call options will terminate upon the earlier of the maturity dates of the related senior convertible notes or the first day all of the related senior convertible notes are no longer outstanding due to conversion or otherwise. The cost of the call options, approximately $92.3 million, was recorded as a reduction to additional paid-in-capital. The cost of call option for tax purposes creates a tax deduction since it is classified as Original Issue Discount (OID). The deduction is considered a permanent difference and as such does not create a deferred tax asset. The benefit of deduction is recorded as an increase to additional paid-in-capital.

In a separate transaction with the issuance of the senior convertible notes, we sold warrants to Goldman Sachs and Credit Suisse (the "call spread holders") to issue shares of our common stock at an exercise price of $24.92 per share. Pursuant to this transaction, we issued warrants for approximately 13.25 million shares of our common stock. Proceeds received from the issuance of the warrants totaled approximately $69.0 million and were recorded as an increase to additional paid-in-capital. If we have insufficient shares of common stock available for settlement of the warrants, we may issue shares of a newly created series of preferred stock in lieu of our obligation to deliver common stock. Any such preferred stock would be convertible into 10% more shares of our common stock than the amount of common stock we would otherwise have been obligated to deliver under the warrants.

Capital Resources

We anticipate that cash flows from Vancocin, as well as our current cash, cash equivalents and short-term investments, should allow us to fund substantially all of our ongoing development and other operating costs, as well as the interest payable on the senior convertible notes. However, we may need additional financing in order to expand our product portfolio. Should we need financing, we would seek to access the public or private equity or debt markets, enter into additional arrangements with corporate collaborators to whom we may issue equity or debt securities or enter into other alternative financing arrangements that may become available to us.

Financing

If we raise additional capital by issuing equity securities, the terms and prices for these financings may be much more favorable to the new investors than the terms obtained by our existing stockholders. These financings also may significantly dilute the ownership of existing stockholders.

If we raise additional capital by accessing debt markets, the terms and pricing for these financings may be much more favorable to the new lenders than the terms obtained from our prior lenders. These financings also may require liens on certain of our assets that may limit our flexibility.

Additional equity or debt financing, however, may not be available on acceptable terms from any source as a result of, among other factors, our operating results, our current indebtedness, our inability to achieve regulatory approval of any of our product candidates, our inability to generate revenue through our existing collaborative agreements, and our inability to file, prosecute, defend and enforce patent claims and or other intellectual property rights. If sufficient additional financing is not available, we may need to delay, reduce or eliminate current development programs, or reduce or eliminate other aspects of our business.

Critical Accounting Policies

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. Preparing consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and contingent assets and liabilities. Actual results could differ from such estimates. These estimates and assumptions are affected by the application of our accounting policies. Critical policies and practices are both most important to the portrayal of a company's financial condition and results of operations, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

Our summary of significant accounting policies is described in Note 2 to our Consolidated Financial Statements included in this Form 10-K. However, we consider the following policies and estimates to be the most critical in understanding the more complex judgments that are involved in preparing our consolidated financial statements and that could impact our results of operations, financial position, and cash flows:

- Product Sales—Product revenue is recorded upon delivery to the wholesaler, when title has passed, price is determined and collectibility is reasonably assured. At the end of each reporting period, as part of an analysis of returns, utilizing our revenue recognition policy (derived from the criteria of SEC Staff Accounting Bulletin No. 104, including Statement of Financial Accounting Standards No. 48, " *Revenue Recognition When Right of Return Exists"*) we analyze our estimated channel inventory and we would defer recognition of revenue on product that has been delivered if we believe that channel inventory at a period end is in excess of ordinary business needs and if we believe the value of potential returns is materially different than our returns accrual. Further, in connection with our analysis of returns, if we believe channel inventory levels are increasing without a reasonably correlating increase in prescription demand, we proactively delay the processing of wholesaler orders until these levels are reduced.

  We establish accruals for chargebacks and rebates, sales discounts, product returns and inventory management related fees. These accruals are primarily based upon the history of Vancocin, including both Lilly and our ownership periods, and contracts. We also consider the volume and price of our products in the channel, trends in wholesaler inventory, conditions that might impact patient demand for our product (such as incidence of disease and the threat of generics) and other factors.

  In addition to internal information, such as unit sales, we use information from external resources, which we do not verify, to estimate the channel inventory. Our external resources include prescription data reported by IMS Health Incorporated and written information obtained from two of our three largest wholesaler customers with respect to their inventory levels.

  Chargebacks and rebates are the most subjective sales related accruals. While we currently have no contracts with private third party payors, such as HMO's, we do have contractual arrangements with governmental agencies, including Medicaid.

We establish accruals for chargebacks and rebates related to these contracts in the period in which we record the sale as revenue. These accruals are based upon historical experience of government agencies' market share, governmental contractual prices, our current pricing and then-current laws, regulations and interpretations. We analyze the accrual at least quarterly and adjust the balance as needed. We believe that if our estimates of the rate of chargebacks and rebates as a percentage of annual gross sales were incorrect by 10%, our operating income and accruals would be impacted by approximately $1.0 million in the period of correction.

During 2007, while continuing to monitor the implementation process of Medicare Part D and consistent with our normal process, we performed an analysis on the share of Vancocin sales that ultimately go to Medicaid recipients and result in a Medicaid rebate. As part of that analysis, we considered our actual Medicaid historical rebates processed, total units sold and fluctuations in channel inventory. As such, during the first nine months of 2007, we reduced our rebates accrual related to prior years by approximately $0.7 million. While we anticipate that our Medicaid rebate accrual should remain at this lower level based on actual experience since the implementation of Medicare Part D, the factors addressed above could ultimately result in a material impact on future periods.

Product returns are minimal. Product return accruals are estimated based on Vancocin's history of damage and product expiration returns and are recorded in the period in which we record the sale of revenue. At each reporting period, we also compare our returns accrual balance to the estimated channel inventory to ensure the accrual balance is reasonable and within an acceptable range. For example, if the estimated channel inventory is at a high level, we could be required to adjust our accrual upward. In the third quarter of 2007, we increased our accrual by approximately $0.6 million.

Discounts, related to payment terms, and fees for service arrangements with wholesalers are fully accrued in the period in which we record the sale of revenue. Since our customers consistently take the payment discount and fees for service are contractual, we do not believe that future periods will be materially impacted by a change in a previous accrual.

- Impairment of Long-lived Assets—We review our fixed and intangible assets for possible impairment whenever events occur or circumstances indicate that the carrying amount of an asset may not be recoverable. Assumptions and estimates used in the evaluation of impairment may affect the carrying value of long-lived assets, which could result in impairment charges in future periods. Such assumptions include, for example, projections of future cash flows and the timing and number of generic/competitive entries into the market, in determining the undiscounted cash flows, and if necessary, the fair value of the asset and whether an impairment exists. These assumptions are subjective and could result in a material impact on operating results in the period of impairment. While we reviewed our intangible assets in March 2006 in light of the actions taken by the OGD, we did not recognize any impairment charges. See Note 4 of the Unaudited Consolidated Financial Statements for further information. We will continue to monitor the actions of the OGD and consider the effects of our opposition actions and the announcements by generic competitors or other adverse events for additional impairment indicators and we will reevaluate the expected cash flows and fair value of our Vancocin-related assets at such time.

  On an ongoing periodic basis, we evaluate the useful life of intangible assets and determine if any economic, governmental or regulatory event has modified their estimated useful lives. While we reviewed the useful life of our intangible assets in March 2006 in light of the actions taken by the OGD, we have not changed the useful life of our intangible assets. See Note 4 of the Unaudited Consolidated Financial Statements for further information.

- Share-Based Employee Compensation—We adopted Statement of Financial Accounting Standards No. 123R, *Share-based Payment* , (SFAS 123R) effective January 1, 2006. The calculation of this expense includes judgment related to the period of time used in calculating the volatility of our common stock, the amount of forfeitures and an estimate of the exercising habits of our employees. Changes in the volatility of our common stock or the habits of our employees could result in variability in the fair value of awards granted.

- Income Taxes—Our annual effective tax rate is based on expected pre-tax earnings, existing statutory tax rates, limitations on the use of tax credits and net operating loss carryforwards and tax planning opportunities available in the jurisdictions in which we operate. Significant judgment is required in determining our annual effective tax rate and in evaluating our tax position.

  On a periodic basis, we evaluate the realizability of our deferred tax assets and liabilities and will adjust such amounts in light of changing facts and circumstances, including but not limited to future projections of taxable income, tax legislation,

rulings by relevant tax authorities, tax planning strategies and the progress of tax audits. We recognize the benefit of tax positions that we have taken or expect to take on the income tax returns we file if such tax position is more likely than not of being sustained. Settlement of filing positions that may be challenged by tax authorities, including, but not limited to, uncertain tax positions as defined by FIN 48, could impact the income tax position in the year of resolution. Additionally, our annual effective tax rate will be impacted to the extent that actual qualified expenses related to our orphan drug designation vary significantly from our estimates. Our current tax liability is presented in the consolidated balance sheet within income taxes payable.

In the third quarter of 2007, we established a $1.3 million liability for uncertain tax positions. This liability is subjective and could increase or decrease in any future period depending on new case law, other precedence setting events, changes or clarifications in tax law or upon settlement if challenged by tax authorities.

In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the period in which those temporary differences becomes deductible or the NOLs and credit carryforwards can be utilized. When considering the reversal of the valuation allowance, we consider the level of past and future taxable income, the utilization of the carryforwards and other factors. Revisions to the estimated net realizable value of the deferred tax asset could cause our provision for income taxes to vary significantly from period to period. Should we further reduce the valuation allowance of deferred tax assets, a current year tax benefit will be recognized and future periods would then include income taxes at a higher rate than the effective rate in the period that the adjustment is made.

As our business evolves, we may face additional issues that will require increased levels of management estimation and complex judgments.

Recently Issued Accounting Pronouncements

In June 2007, the Emerging Issues Task Force (“EITF”) issued EITF No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities* , (“EITF 7-03”) that provides guidance for upfront payments related to goods and services of research and development costs. EITF 07-03 is effective for fiscal years beginning after December 15, 2007. While we are currently evaluating the impact of EITF 7-03 on our financial statements upon adoption, we do not anticipate a material impact on operating results or financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* , (“SFAS 157”) that provides guidance on performing fair value measurements. It does not require new fair value measurements, although it could change current practice for some companies. SFAS 157 is effective for fiscal years beginning after November 15, 2007. While we are currently evaluating the impact of SFAS 157 on our financial statements upon adoption, we do not anticipate a material impact on operating results or financial position.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Our holdings of financial instruments are primarily comprised of a mix of U.S. corporate debt, government securities and commercial paper. All such instruments are classified as securities available for sale. Our debt security portfolio represents funds held temporarily pending use in our business and operations. We manage these funds accordingly. Our primary investment objective is the preservation of principal, while at the same time maximizing the generation of investment income. We seek reasonable assuredness of the safety of principal and market liquidity by investing in cash equivalents (such as Treasury bills and money market funds) and fixed income securities (such as U.S. government and agency securities, municipal securities, taxable municipals, and corporate notes) while at the same time seeking to achieve a favorable rate of return. Our market risk exposure consists principally of exposure to changes in interest rates. Our holdings are also exposed to the risks of changes in the credit quality of issuers. Historically, we have typically invested in financial instruments with maturities of less than one year. The carrying amount, which approximates fair value, and the annualized weighted average nominal interest rate of our investment portfolio at September 30, 2007, was approximately $480.5 million and 5.2%, respectively. A one percentage point change in the interest rate would have resulted in a $1.2 million impact to interest income for the quarter ended September 30, 2007.

Since 2006, we have also been exposed to movements in foreign currency exchange rates, specifically the Euro, for certain immaterial expenses. We have used foreign currency forward exchange contracts based on forecasted transactions to reduce this exposure to the risk that the eventual net cash outflows, resulting from purchases from foreign testing sites, will be adversely affected by changes in exchange rates. The nominal amount of these forwards as of September 30, 2007 was $0.3 million and the associated fair value was approximately $33,000, which is credited to research and development expense.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer, or CEO, and our Chief Financial Officer, or CFO, of the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of September 30, 2007. Based on that evaluation, our management, including our CEO and CFO, concluded that as of September 30, 2007 our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to the Company’s management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

During the third quarter of 2007 there were no significant changes in our internal control over financial reporting identified in connection with the evaluation of such controls that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1a. Risk Factors

We are providing the following information regarding changes that have occurred to previously disclosed risk factors from our Annual Report on Form 10-K for the year ended December 31, 2006 and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2007. In addition to the other information set forth below and elsewhere in this report, you should carefully consider the factors discussed under the heading " **Risk Factors** " in our Form 10-K for the year ended December 31, 2006 and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2007. The risks described in this Quarterly Report on Form 10-Q and our prior periodic reports are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Our long-term success depends upon our ability to develop, receive regulatory approval for and commercialize drug product candidates and if we are not successful, our ability to generate revenues from the commercialization and sale of products resulting from our product candidates will be limited.

All of our drug candidates will require governmental approvals prior to commercialization. We have not completed the development of or received regulatory approval to commercialize any of our existing product candidates. Our failure to develop, receive regulatory approvals for and commercialize our development stage product candidates successfully will prevent us from generating revenues from the sale of products resulting from our product candidates. Our product candidates are in the development stage and may not be shown to be safe or effective.

We initiated a phase 3 study in stem cell transplant patients for maribavir in September 2006 and a second phase 3 study in liver transplant patients in July 2007. While our phase 2 data for maribavir were positive, maribavir requires significant additional development efforts and regulatory approvals prior to any commercialization. The primary end point for our phase 3 studies with maribavir is different than the end point used in our phase 2 stem cell transplant study. Moreover, our phase 3 study in liver transplant patients is in a population that we have never studied. The results of ongoing and future studies of maribavir may be inconsistent with the results from previous studies and may not support further clinical development or regulatory approval.

We initiated our phase 2 program with Wyeth for HCV-796 in October 2006. In August 2007, we and Wyeth decided to discontinue dosing with HCV-796 in combination with pegylated interferon and ribavirin in our phase 2 study as 8% of patients showed elevated liver enzyme levels after 8 weeks or more of therapy with HCV-796 with pegylated interferon and ribavirin. We and Wyeth continue to evaluate the observations that led to this decision in the hope of advancing this potential therapeutic agent in the future, however there can be no assurance that we will conduct additional HCV studies in the future as the FDA or other regulatory authorities may either prohibit any future studies with HCV-796 or alternatively may require additional or unanticipated studies or clinical trial outcomes before granting regulatory approval.

We cannot be certain that our efforts and the efforts of our partners in this regard will lead to commercially viable products. Negative, inconclusive or inconsistent clinical trial results could prevent regulatory approval, increase the cost and timing of regulatory approval, cause us to perform additional studies or to file for a narrower indication than planned. We do not know what the final cost to manufacture product candidates in commercial quantities will be, or the dose required to treat patients and, consequently, what the total cost of goods for a treatment regimen will be.

If we are unable to successfully develop our product candidates, we will not have a source of revenue other than Vancocin. Moreover, the failure of one or more of our product candidates in clinical development could harm our ability to raise additional capital. Furthermore, results from our clinical trials may not meet the level of statistical significance required by the FDA or other regulatory authorities for approval of a drug candidate.

The development of any of our product candidates is subject to many risks, including that:

- the product candidate is found to be ineffective or unsafe;
- the clinical test results for the product candidate delay or prevent regulatory approval;

- the FDA forbids us to initiate or continue testing of the product candidates in human clinical trials;
- the product candidate cannot be developed into a commercially viable product;
- the product candidate is difficult and/or costly to manufacture;
- the product candidate later is discovered to cause adverse effects that prevent widespread use, require withdrawal from the market, or serve as the basis for product liability claims;
- third party competitors hold proprietary rights that preclude us from marketing the product candidate; and
- third party competitors market a more clinically effective, safer, or more cost-effective product.

Even if we believe that the clinical data demonstrates the safety and efficacy of a product candidate, regulators may disagree with us, which could delay, limit or prevent the approval of such product candidate. As a result, we may not obtain regulatory approval, or even if a product is approved, we may not obtain the labeling claims we believe are necessary or desirable for the promotion of the product. In addition, regulatory approval may take longer than we expect as a result of a number of factors, including failure to qualify for priority review of our application. All statutes and regulations governing the approval of our product candidates are subject to change in the future. These changes may increase the time or cost of regulatory approval, limit approval, or prevent it completely.

Even if we receive regulatory approval for our product candidates, or acquire the rights to additional already approved products, the later discovery of previously unknown problems with a product, manufacturer or facility may result in adverse consequences, including withdrawal of the product from the market. Approval of a product candidate may be conditioned upon certain limitations and restrictions as to the drug’s use, or upon the conduct of further studies, and may be subject to continuous review.

The regulatory process is expensive, time consuming and uncertain and may prevent us from obtaining required approvals for the commercialization of our product candidates.

We have product candidates for the prevention and treatment of CMV and treatment of HCV in clinical development. Schering-Plough is conducting the clinical development of pleconaril. We must complete significant laboratory, animal and clinical testing on these product candidates before we submit marketing applications in the U.S. and abroad.

The rate of completion of clinical trials depends upon many factors, including the rates of initiation of clinical sites and enrollment of patients. For example, our enrollment of patients in our phase 2 clinical trial for maribavir was impacted by our ability to identify and successfully recruit a sufficient number of patients who have undergone allogeneic hematopoietic stem cell/bone marrow transplantation. Our phase 3 studies for maribavir will require substantially more clinical sites and patients than were required for the phase 2 studies, and many of these clinical sites and patients are expected to be in Europe. We do not have extensive experience in executing clinical trials in Europe. We also initiated a second phase 3 study of maribavir in liver transplant patients. We have never conducted clinical studies in this population. If we are unable to initiate a sufficient number of clinical sites and accrue sufficient clinical patients who are eligible to participate in the trials during the appropriate period, we may need to delay our clinical trials and incur significant additional costs. In addition, the FDA, Independent Safety Monitoring Boards or Institutional Review Boards may require us to delay, restrict, or discontinue our clinical trials on various grounds, including a finding that the subjects or patients are being exposed to an unacceptable health risk such as the partial clinical hold we have received with regard to HCV-796. We expect to submit an NDA filing in 2009 for maribavir. However, we may be unable to submit a NDA to the FDA for our product candidates within the time frame we currently expect. Once a NDA is submitted, it must be approved by the FDA before we can commercialize the product described in the application. The cost of human clinical trials varies dramatically based on a number of factors, including:

- the order and timing of clinical indications pursued;
- the extent of development and financial support from corporate collaborators;
- the number of patients required for enrollment;

- the length of time required to enroll these patients;
- the costs and difficulty of obtaining clinical supplies of the product candidate; and
- the difficulty in obtaining sufficient patient populations and clinicians.

Even if we obtain positive preclinical or clinical trial results in initial studies, future clinical trial results may not be similarly positive. As a result, ongoing and contemplated clinical testing, if permitted by governmental authorities, may not demonstrate that a product candidate is safe and effective in the patient population and for the disease indications for which we believe it will be commercially advantageous to market the product. The failure of our clinical trials to demonstrate the safety and efficacy of our product candidate for the desired indications could delay the commercialization of the product.

In 2003, Congress enacted the Pediatric Research Equity Act requiring the development and submission of pediatric use data for new drug products. Our failure to obtain these data, or to obtain a deferral of, or exemption from, this requirement could adversely affect our chances of receiving regulatory approval, or could result in regulatory or legal enforcement actions.

Item 5. Other Information.

On October 26, 2007, ViroPharma Incorporated ("ViroPharma") and Alpharma Inc. ("Alpharma") entered into an Amended and Restated Bulk Supply Agreement (the "Supply Agreement") related to the manufacture and supply by Alpharma to ViroPharma of vancomycin hydrochloride, the active pharmaceutical ingredient for Vancocin® (the "API"). The Supply Agreement allows for a second manufacturing location of API and contains the general ordering and commercial supply terms and conditions as well as the specific economic terms for purchase of the API, including price and minimum purchase requirements.

ITEM 6. Exhibits

List of Exhibits:

10.1††	ViroPharma Board Compensation Policy.
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

†† Compensation plans and arrangements for executives and others.

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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.

VIROPHARMA INCORPORATED

Date: October 30, 2007

By: /s/ Michel de Rosen
Michel de Rosen
President, Chief Executive Officer and
Chairman of the Board of Directors
(Principal Executive Officer)

By: /s/ Vincent J. Milano
Vincent J. Milano
Vice President, Chief Operating Officer, Chief Financial
Officer and Treasurer
(Principal Financial and Accounting Officer)

Exhibit 10.1

ViroPharma Board Compensation Policy

Directors that are non-executive officers of ViroPharma, and directors that are not affiliated with a person or entity that has been granted a contractual right to appoint a director to the Board of Directors ("Eligible Directors"), shall receive a cash retainer of $15,000 annually. The Audit Committee Chairman shall receive an annual retainer of $5,000. The Compensation Committee Chairman shall receive an annual retainer of $3,500. Eligible Directors shall receive $2,500 for each board meeting attended, provided that no payments shall be made for teleconferences lasting less than one (1) hour, and $1,000 for each committee meeting, plus travel expenses, for each board and committee meeting that they attend.

Eligible Directors shall receive an option grant of 25,000 shares, vesting in equal increments over 3 years, upon his or her initial election to the Board. These directors also shall receive option grants once each year to purchase 10,000 shares of our common stock, vesting in full after one year from the date of grant. In a director's initial year of service, he or she will be entitled to receive (1) the 25,000 share initial election grant, and (2) a pro-rata portion of the 10,000 share annual grant.

Exhibit 31.1

CHIEF EXECUTIVE OFFICER'S
CERTIFICATION UNDER
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Michel de Rosen, President, Chief Executive Officer and Chairman of the Board of Directors of the registrant, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of ViroPharma Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Michel de Rosen
Michel de Rosen
President, Chief Executive Officer and
Chairman of the Board of Directors

October 30, 2007

Exhibit 31.2

CHIEF FINANCIAL OFFICER'S
CERTIFICATION UNDER
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Vincent J. Milano, Vice President, Chief Operating Officer, Chief Financial Officer and Treasurer of the registrant, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of ViroPharma Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Vincent J. Milano
Vincent J. Milano
Vice President, Chief Operating Officer, Chief Financial Officer and Treasurer

October 30, 2007

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of ViroPharma Incorporated (the "Company") on Form 10-Q for the period ending September 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned officers of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Michel de Rosen
Michel de Rosen
President, Chief Executive Officer and
Chairman of the Board of Directors
October 30, 2007

/s/ Vincent J. Milano
Vincent J. Milano
Vice President, Chief Operating Officer, Chief Financial
Officer and Treasurer
October 30, 2007