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

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 000-19319

VERTEX PHARMACEUTICALS INCORPORATED

(Exact name of registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES x NO o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o NO x

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

Common Stock, par value $0.01 per share	99,126,621
Class	Outstanding at November 7, 2005

Vertex Pharmaceuticals Incorporated

Form 10-Q

For the Quarter Ended September 30, 2005

Table of Contents

Part I. Financial Information

Item 1. Condensed Consolidated Financial Statements

Vertex Pharmaceuticals Incorporated

Condensed Consolidated Balance Sheets

(Unaudited)

(In thousands, except share and per share data)

	September 30, 2005	December 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 101,619	$ 55,006
Marketable securities, available for sale	297,546	337,314
Accounts receivable	20,764	11,891
Prepaid expenses	4,405	2,501
Total current assets	424,334	406,712
Restricted cash	46,607	49,847
Property and equipment, net	56,127	64,225
Investments	18,863	18,863
Other assets	4,644	5,806
Total assets	$ 550,575	$ 545,453
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 6,460	$ 6,660
Accrued expenses and other current liabilities	38,713	32,951
Accrued interest	1,827	5,862
Deferred revenue	32,511	47,741
Accrued restructuring expense	39,324	55,843
Other obligations	2,975	4,688
Total current liabilities	121,810	153,745
Collaborator development loan	19,997	19,997
Other obligations, excluding current portions	—	2,925
Deferred revenue, excluding current portion	906	18,345
Convertible subordinated notes (due September 2007)	42,102	82,552
Convertible senior subordinated notes (due February 2011)	232,448	232,448
Total liabilities	417,263	510,012
Commitments and contingencies:		
Stockholders' equity:		
Preferred stock, $0.01 par value; 1,000,000 shares authorized; none issued and outstanding at September 30, 2005 and December 31, 2004, respectively	—	—
Common stock, $0.01 par value; 200,000,000 shares authorized; 98,880,651 and 80,764,904 shares issued and outstanding at September 30, 2005 and December 31, 2004, respectively	989	807
Additional paid-in capital	1,101,174	833,832
Deferred compensation, net	(14,684)	(11,657)
Accumulated other comprehensive loss	(2,714)	(1,374)
Accumulated deficit	(951,453)	(786,167)
Total stockholders' equity	133,312	35,441
Total liabilities and stockholders' equity	$ 550,575	$ 545,453

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

Vertex Pharmaceuticals Incorporated

Condensed Consolidated Statements of Operations

(Unaudited)

(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenues:				
Royalties	$ 9,466	$ 4,403	$ 23,086	$ 10,996
Collaborative and other research and development revenues	26,741	22,425	74,048	51,886
Total revenues	36,207	26,828	97,134	62,882
Costs and expenses:				
Royalty payments	2,796	1,466	7,315	3,640
Research and development	63,590	48,790	180,382	137,915
Sales, general and administrative	10,738	10,600	31,179	30,482
Restructuring expense	1,565	1,561	1,736	5,216
Total costs and expenses	78,689	62,417	220,612	177,253
Loss from operations	(42,482)	(35,589)	(123,478)	(114,371)
Interest income	3,733	2,445	8,299	7,981
Interest expense	(4,505)	(4,634)	(13,783)	(13,642)
Charge for exchange of 2007 convertible subordinated notes	(36,324)	—	(36,324)	—
Charge for retirement of 2007 convertible subordinated notes	—	(993)	—	(3,446)
Net loss	$ (79,578)	$ (38,771)	$ (165,286)	$ (123,478)

Basic and diluted net loss per common share	$ (0.84)	$ (0.49)	$ (1.93)	$ (1.57)
Basic and diluted weighted average number of common shares outstanding	94,590	78,742	85,462	78,403

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

Vertex Pharmaceuticals Incorporated

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2005	2004
Cash flows from operating activities:		
Net loss	$ (165,286)	$ (123,478)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	20,400	21,617
Non-cash based compensation expense	5,277	3,000
Realized loss/(gain) on marketable securities	53	(379)
Write-off of property and equipment	302	—
Charge for exchange of a portion of 2007 convertible subordinated notes	36,324	—
Charge for retirement of a portion of 2007 convertible subordinated notes	—	3,446
Changes in operating assets and liabilities:		
Accounts receivable	(8,873)	(1,156)
Prepaid expenses	(1,904)	(2,607)
Accounts payable	(200)	(2,802)
Accrued expenses and other liabilities	1,124	(2,965)
Accrued restructuring expense	(16,519)	(19,403)
Accrued interest	(3,080)	(2,966)
Deferred revenue	(32,669)	9,175
Net cash used in operating activities	(165,051)	(118,518)
Cash flows from investing activities:		
Purchase of marketable securities	(149,106)	(132,010)
Sales and maturities of marketable securities	187,964	232,812
Expenditures for property and equipment	(11,817)	(8,691)
Restricted cash	3,240	(22,355)
Investments and other assets	51	(219)
Net cash provided by investing activities	30,332	69,537
Cash flows from financing activities:		
Issuances of common stock from employee benefit plans, net	16,474	5,181
Issuances of common stock from stock offering, net	165,386	—
Principal payments on notes payable, capital lease and other obligations	—	(100)
Issuance costs related to convertible senior subordinated notes (due February 2011)	(45)	(4,722)
Repayments of collaborator loan	—	(12,463)
Net cash provided by (used in) financing activities	181,815	(12,104)
Effect of changes in exchange rates on cash	(483)	(37)
Net increase(decrease) in cash and cash equivalents	46,613	(61,122)
Cash and cash equivalents—beginning of period	55,006	98,159
Cash and cash equivalents—end of period	$ 101,619	$ 37,037
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 16,077	$ 15,607

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

Vertex Pharmaceuticals Incorporated

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

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

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

Certain information and footnote disclosures normally included in the Company's annual financial statements have been condensed or omitted. The interim financial statements, in the opinion of management, reflect all adjustments (including normal recurring accruals) necessary for a fair statement of the financial position and results of operations for the interim periods ended September 30, 2005 and 2004.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the fiscal year, although the Company expects to incur a substantial loss for the year ending December 31, 2005. These interim financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2004, which are contained in the Company's 2004 Annual Report to its Stockholders on Form 10-K that was filed with the Securities and Exchange Commission on March 16, 2005.

2. Accounting Policies

Basic and Diluted Net Loss per Common Share

Basic net loss per share is based upon the weighted average number of common shares outstanding during the period, excluding restricted stock that has been issued but is not yet vested. Diluted net loss per share is based upon the weighted average number of common shares outstanding during the period, plus additional weighted average common equivalent shares outstanding during the period when the effect is dilutive. Common equivalent shares result from the assumed exercise of outstanding stock options (the proceeds of which are then presumed to have been used to repurchase outstanding stock using the treasury stock method), the assumed conversion of convertible notes, and the vesting of unvested restricted shares of common stock. Common equivalent shares have not been included in the net loss per share calculations because their effect would have been anti-dilutive. Total potential gross common equivalent shares consisted of the following (in thousands, except per share amounts):

	At September 30,	
	2005	2004
Stock options	15,792	15,795
Weighted-average exercise price, per share	$ 22.33	$ 22.98
Convertible notes	16,015	16,454
Weighted-average conversion price, per share	$ 17.14	$ 19.15
Unvested restricted shares	1,717	1,288

Stock-Based Compensation

In accordance with Statements of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure", the Company has adopted the disclosure-only provisions of Statements of Financial Accounting Standards No. 123, "Accounting for Stock-Based

Compensation" ("SFAS 123") and also applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations in accounting for all stock awards granted to employees. Under APB 25, provided that other criteria are met, when the exercise price of stock options or the issue price of restricted shares granted to employees equals the market price of the common stock on the date of the grant, no compensation cost is recognized. When the exercise price of stock options or the issue price of restricted shares granted to employees is less than the market price of the common stock on the date of grant, compensation costs are expensed over the vesting period of the grants. Subsequent changes to option terms also can give rise to compensation costs. For stock options granted to non-employees, the Company recognizes compensation costs in accordance with the requirements of SFAS 123, which requires that companies recognize compensation expense for grants of stock, stock options and other equity instruments based on fair value.

At September 30, 2005, the Company had one Employee Stock Purchase Plan ("ESPP") and three stock-based employee compensation plans: the 1991 Stock Option Plan, the 1994 Stock and Option Plan and the 1996 Stock and Option Plan (collectively, the "Plans"). All options granted under the Plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

At September 30, 2005 and 2004, the Company had approximately 1,717,023 and 1,287,808 restricted shares unvested and outstanding, respectively. During the three and nine months ended September 30, 2005, the Company issued approximately 129,133 and 464,955 shares of restricted stock, net of cancellations, respectively, to employees, not including 30,875 shares cancelled in accordance with an officer's severance agreement during the nine months ended September 30, 2005. During the three and nine months ended September 30, 2004, the Company issued approximately 31,374 and 1,163,327 shares of restricted stock, net of cancellations, respectively, to employees, including a one-time grant to senior managers and executives in May 2004.

The price per share of restricted stock granted to employees is equal to $0.01, the par value of the Company's common stock. In general, restricted share awards vest over four years in four equal annual installments, although different vesting schedules are sometimes applied. The Company has recorded deferred compensation, net of cancellations, of approximately $2,545,000 and $6,009,000 for restricted shares issued during the three and nine months ended September 30, 2005, respectively. During the three and nine months ended September 30, 2004, the Company recorded deferred compensation, net of cancellations, of approximately $309,000 and $10,658,000, respectively, for restricted shares issued during these periods.

The Company recorded compensation expense related to restricted stock of approximately $915,000 and $2,982,000 for the three and nine months ended September 30, 2005, respectively. During the three and nine months ended September 30, 2004, the Company recorded compensation expense related to restricted stock of approximately $539,000 and $1,015,000, respectively. The compensation expense of $2,982,000 recorded for the nine months ended September 30, 2005 consisted of approximately $479,000 of expense related to the accelerated vesting of restricted stock awards in accordance with an officer's severance agreement, and approximately $2,503,000 related to restricted shares outstanding during the period.

The following table illustrates the effect on net loss and net loss per common share if the fair value recognition provisions of SFAS 123 had been applied to the Company's stock-based employee compensation. Employee stock-based compensation expense is amortized on a straight-line basis, since the Company's valuation of options subject to SFAS 123 assumes a single weighted-average expected life for each award. Included in employee stock-based compensation expense for the nine months ended September 30, 2005 is expense related to the modification of certain stock awards in accordance with an officer's severance agreement.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	2004	2005	2004
	(In thousands, except per share data)			
Net loss attributable to common shareholders, as reported	$ (79,578)	$ (38,771)	$ (165,286)	$ (123,478)

Add: Employee stock-based compensation expense included in net loss	915	539	3,075	1,015
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards	(8,680)	(9,657)	(29,964)	(29,786)
Pro forma net loss	$ (87,343)	$ (47,889)	$ (192,175)	$ (152,249)
Basic and diluted net loss per common share, as reported	$ (0.84)	$ (0.49)	$ (1.93)	$ (1.57)
Basic and diluted net loss per common share, pro forma	$ (0.92)	$ (0.61)	$ (2.25)	$ (1.94)

Research and Development

All research and development costs, including amounts funded by research collaborators, are expensed as incurred. Research and development expenses are comprised of costs incurred in performing research and development activities, including salaries and benefits; laboratory supplies; contract services, including clinical trial costs; and infrastructure costs, including facilities costs and depreciation. The Company's collaborators have agreed to fund portions of the Company's research and development programs related to specific research targets and drug candidates, including, in 2005, VX-950, VX-702, kinases and certain cystic fibrosis research targets, and in 2004, VX-950, kinases, caspase inhibitors, and certain cystic fibrosis research targets. The following table details the collaborator- and Company-sponsored research and development expenses for the three months ended September 30, 2005 and 2004 (in thousands):

	For the Three Months Ended September 30, 2005			For the Three Months Ended September 30, 2004		
	Research	Development	Total	Research	Development	Total
Collaborator-sponsored	$ 16,777	$ 20,106	$ 36,883	$ 14,249	$ 3,915	$ 18,164
Company-sponsored	12,887	13,820	26,707	14,116	16,510	30,626
Total	$ 29,664	$ 33,926	$ 63,590	$ 28,365	$ 20,425	$ 48,790

The following table details the collaborator- and Company-sponsored research and development expenses for the nine months ended September 30, 2005 and 2004 (in thousands):

	For the Nine Months Ended September 30, 2005			For the Nine Months Ended September 30, 2004		
	Research	Development	Total	Research	Development	Total
Collaborator-sponsored	$ 50,204	$ 46,537	$ 96,741	$ 43,913	$ 10,754	$ 54,667
Company-sponsored	39,274	44,367	83,641	38,864	44,384	83,248
Total	$ 89,478	$ 90,904	$ 180,382	$ 82,777	$ 55,138	$ 137,915

Restructuring Expense

The Company records costs and liabilities associated with exit and disposal activities, as defined in Statements of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"), at fair value in the period the liability is incurred. In periods subsequent to initial measurement, changes to the liability are measured using the credit-adjusted risk-free discount rate applied in the initial period.

Debt Issuance Costs

Debt issuance costs related to expenses incurred in connection with Vertex's convertible subordinated note offerings are deferred and included in other assets on the condensed consolidated balance sheets. The costs are amortized based on the effective interest method over the term of the related debt issuance. The amortization expense is included in interest expense on the condensed consolidated statements of operations.

Stock Offering Costs

Expenses incurred in connection with common stock issuances are recorded as an offset to additional paid-in capital on the condensed consolidated balance sheets. These expenses consist of underwriters' discounts and commissions and related offering expenses.

3. Comprehensive Loss

For the three and nine months ended September 30, 2005 and 2004, comprehensive loss was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net loss	$ (79,578)	$ (38,771)	$ (165,286)	$ (123,478)
Changes in other comprehensive income/(loss):				
Unrealized holding gains (losses) on marketable securities	(719)	835	(857)	(3,191)
Foreign currency translation adjustment	(149)	(28)	(483)	(37)
Total change in other comprehensive income/(loss)	(868)	807	(1,340)	(3,228)
Total comprehensive loss	$ (80,446)	$ (37,964)	$ (166,626)	$ (126,706)

4. Restructuring Expense

On June 10, 2003, Vertex adopted a plan to restructure its operations to coincide with its increasing internal emphasis on advancing drug candidates through clinical development to commercialization. The restructuring was designed to re-balance the Company's relative investments in research and development, to better support the Company's long-term objective of becoming a profitable pharmaceutical company. The restructuring plan included a workforce reduction, write-offs of certain assets and a decision not to occupy approximately 290,000 square feet of specialized laboratory and office space in Cambridge, Massachusetts under lease to Vertex (the "Kendall Square Lease"). The Kendall Square Lease commenced in January 2003 and has a 15-year term. Based on developments in the Company's clinical pipeline in the second quarter of 2005, the Company revised its assessment of its real estate requirements. The Company now expects to occupy approximately 120,000 square feet of the facility subject to the Kendall Square lease (the "Kendall Square Facility") in the future. The Company has sublease arrangements in place or commitments, subject to final approvals, to enter into subsublease agreements for the remaining rentable square footage of the Kendall Square Facility.

For the nine months ended September 30, 2005 the Company recorded net restructuring expense of $1.7 million. This net expense includes a $10.0 million credit to the restructuring accrual related to the portion of the Kendall Square Facility that Vertex now expects to occupy, which is offset by (i) the estimated incremental net ongoing lease obligations associated with the portion of the Kendall Square Facility that the Company does not intend to occupy and (ii) imputed interest costs relating to the restructuring accrual.

For the three months ended September 30, 2005, the Company recorded approximately $1.6 million of additional restructuring expense, which was primarily attributable to the imputed interest cost relating to the restructuring accrual.

The activity related to the restructuring accrual and related expense for the three months ended September 30, 2005 is as follows (in thousands):

	Accrual as of June 30, 2005	Cash Payments, third quarter 2005	Cash received from subleases, third quarter 2005	Charge, third quarter 2005	Accrual as of September 30, 2005
Lease restructuring expense	$ 43,813	$ (6,645)	$ 591	$ 1,565	$ 39,324

The activity related to the restructuring accrual and related expense for the nine months ended September 30, 2005 is as follows (in thousands):

	Accrual as of December 31, 2004	Cash Payments, nine months ended Sept. 30, 2005	Cash received from subleases, nine months ended Sept. 30, 2005	Credit for portion of facility Vertex expects to occupy, nine months ended Sept. 30, 2005	Charge, nine months ended Sept. 30, 2005	Accrual as of Sept. 30, 2005
Lease restructuring expense	$ 55,843	$ (19,662)	$ 1,407	$ (10,018)	$ 11,754	$ 39,324

During the three and nine months ended September 30, 2004, the Company recorded $1.6 million and $5.2 million, respectively, of additional restructuring expense, which was primarily attributable to the imputed interest cost relating to the restructuring accrual.

The activity related to the restructuring accrual and related expense for the three months ended September 30, 2004 is as follows (in thousands):

	Accrual as of June 30, 2004	Cash payments, third quarter 2004	Charge, third quarter 2004	Accrual as of Sept. 30, 2004
Lease restructuring expense and other operating lease expense	$ 56,701	$ (8,139)	$ 1,561	$ 50,123

The activity related to the restructuring accrual and related expense for the nine months ended September 30, 2004 is as follows (in thousands):

	Accrual as of December 31, 2003	Cash payments, nine months ended Sept. 30, 2004	Charge, nine months ended Sept. 30, 2004	Accrual as of Sept. 30, 2004
Lease restructuring expense and other operating lease expense	$ 69,526	$ (24,619)	$ 5,216	$ 50,123

In accordance with SFAS 146, the Company's initial estimate of its liability for its net ongoing costs associated with the Kendall Square Lease obligation was recorded in the second quarter of 2003 at fair value. The restructuring accrual will continue to be estimated in accordance with SFAS 146, but will relate only to the portion of the building that the Company still does not intend to occupy. The lease obligations associated with the portion of the Kendall Square Facility that the Company expects to occupy are recorded as rental expense in the period incurred. The Company reviews its assumptions and estimates quarterly and updates its estimates of this liability as changes in circumstances require. As prescribed by SFAS 146, the expense and liability recorded is calculated using probability-weighted discounted cash-flows of the Company's estimated ongoing lease obligations, including contractual rental and build-out commitments, net of estimated sublease rentals, offset by related sublease costs.

In estimating the expense and liability under its Kendall Square Lease obligation, the Company estimated the costs that would be incurred to satisfy its build-out commitments under the lease, the time necessary to sublease the space, the projected sublease rental rates and the anticipated durations of subleases. The Company validates its estimates and assumptions through consultations with independent third parties having relevant expertise. The Company used a credit-adjusted risk-free rate of approximately 10% to discount the estimated cash flows. The Company will review its estimates and assumptions on at least a quarterly basis, until the termination of the Kendall Square Lease, and will make whatever modifications management believes necessary, based on the Company's best judgment, to reflect any changed circumstances. The Company's estimates have changed in the past, and may change in the future, resulting in additional adjustments to the estimate of liability, and the effect of any such adjustments could be material. Because the Company's estimate of the liability includes the application of a discount rate to reflect the time-value of money, the estimate of the liability will increase each quarter simply as a result of the passage of time. Changes to the Company's estimate of the liability are recorded as additional restructuring expense or credit.

5. Convertible Subordinated Notes

On February 13, 2004, the Company issued approximately $153.1 million in aggregate principal amount of 5.75% Convertible Senior Subordinated Notes due in February 2011 (the "February 2011 Notes") in exchange for an equal principal amount of its outstanding 5% Convertible Subordinated Notes due in September 2007 (the "2007 Notes"). On September 17, 2004, the Company issued approximately $79.3 million in aggregate principal amount of 5.75% Convertible Senior Subordinated Notes due in February 2011 (the "September 2011 Notes") in exchange for an equal principal amount of its 2007 Notes. The terms of the September 2011 Notes are identical to those of the February 2011 Notes (the February 2011 Notes and the September 2011 Notes are referred to together as the "2011 Notes").

The 2011 Notes are convertible, at the option of the holder, into common stock at a price equal to $14.94 per share, subject to adjustment under certain circumstances. The 2011 Notes bear interest at the rate of 5.75% per annum, and the Company is required to make semi-annual interest payments on the outstanding principal balance of the 2011 Notes on February 15 and August 15 of each year. On or after February 15, 2007, the Company may redeem the 2011 Notes at a redemption price equal to the principal amount plus accrued and unpaid interest, if any. The deferred issuance costs associated with the issuance of the 2011 Notes, which are classified as long-term other assets, were approximately $3.0 million for the February 2011 Notes and $1.9 million for the September 2011 Notes.

The 2007 Notes are convertible, at the option of the holder, into common stock at a price equal to $92.26 per share, subject to adjustment under certain circumstances. The 2007 Notes bear interest at the rate of 5% per annum, and the Company is required to make semi-annual interest payments on the outstanding principal balance of the 2007 Notes on March 19 and September 19 of each year. The 2007 Notes are redeemable by the Company at any time at specific redemption prices if the closing price of the Company's common stock exceeds 120% of the conversion price for at least 20 trading days within a period of 30 consecutive trading days. The deferred issuance costs associated with the original sale of the 2007 Notes were $9.3 million.

As a result of the exchanges of the 2007 Notes for 2011 Notes, the Company recorded a charge on the retirement of $153.1 million in aggregate principal amount of the 2007 Notes in February 2004 in the amount of $2.5 million, and a charge on the retirement of $79.3 million in aggregate principal amount of the 2007 Notes in September 2004 in the amount of $1.0 million. These charges represent that portion of the unamortized deferred issuance costs applicable to the amount of 2007 Notes retired. For the three and nine months ended September 30, 2005, $0.3 million and $0.8 million, respectively, were amortized to interest expense for the issuance costs of the remaining 2007 Notes and the 2011 Notes. For the three and nine months ended September 30, 2004, $0.3 million and $1.0 million, respectively, were amortized to interest expense for the issuance costs of the 2007 Notes and the 2011 Notes.

On September 9, 2005, the Company issued approximately 2,500,000 shares of common stock to certain holders of 2007 Notes in exchange for approximately $40.5 million principal amount of those notes, plus an amount equal to accrued interest. As a result of the exchange, the Company incurred a non-cash charge of $36.3 million. This charge is related to the incremental shares issued in the transaction over the number that would have been issued upon conversion of the 2007 Notes under their original terms, at the original conversion price of $92.26 per share. The following items related to the exchange were recorded as an offset to additional paid-in capital on the condensed consolidated balance sheets: accrued interest of approximately $955,000, remaining unamortized issuance costs of the exchanged 2007 Notes of approximately $341,000, and $29,000 of issuance costs of the common stock. At September 30, 2005, there was approximately $42.1 million in aggregate principal amount of the 2007 Notes and approximately $232.4 million in aggregate principal amount of the 2011 Notes outstanding.

6. Equity Offering

In June 2005, the Company completed a public offering of 13,512,500 shares of common stock at a price of $13.00 per share, resulting in gross proceeds to the Company of approximately $175.7 million. The Company incurred offering costs of approximately $10.3 million associated with this offering, which were recorded as an offset to additional paid-in-capital on the condensed consolidated balance sheets, resulting in net proceeds to the Company of approximately $165.4 million.

7. Guarantees

As permitted under Massachusetts law, Vertex's Articles of Organization and By-laws provide that the Company will indemnify certain of its officers and directors for certain claims asserted against them in

connection with their service as officers or directors. The maximum potential amount of future payments that the Company could be required to make under these indemnification provisions is unlimited. However, the Company has purchased directors' and officers' liability insurance policies that reduce its monetary exposure and enable it to recover a portion of any future amounts paid. The Company believes the estimated fair value of these indemnification arrangements is immaterial.

Vertex customarily agrees in the ordinary course of its business to indemnification provisions in agreements with clinical trials investigators and sites in its drug development programs, in sponsored research agreements with academic and not-for-profit institutions, in various comparable agreements involving parties performing services for the Company in the ordinary course of business, and in its real estate leases. The Company also customarily agrees to certain indemnification provisions in its drug discovery and development collaboration agreements. With respect to the Company's clinical trials and sponsored research agreements, these indemnification provisions typically apply to any claim asserted against the investigator or the investigator's institution relating to personal injury or property damage, violations of law or certain breaches of the Company's contractual obligations arising out of the research or clinical testing of the Company's compounds or drug candidates. With respect to lease agreements, the indemnification provisions typically apply to claims asserted against the landlord relating to personal injury or property damage caused by the Company, to violations of law by the Company or to certain breaches of the Company's contractual obligations. The indemnification provisions appearing in the Company's collaboration agreements are similar, but in addition provide some limited indemnification for the collaborator in the event of third-party claims alleging infringement of intellectual property rights. In each of the cases above, the indemnification obligation generally survives the termination of the agreement for some extended period, although the obligation typically has the most relevance during the contract term and for a short period of time thereafter. The maximum potential amount of future payments that the Company could be required to make under these provisions generally is unlimited. The Company has purchased insurance policies covering personal injury, property damage and general liability that reduce its exposure for indemnification and would enable it in many cases to recover a portion of any future amounts paid. The Company has never paid any material amount to defend lawsuits or settle claims related to these indemnification provisions. Accordingly, the Company believes the estimated fair value of these indemnification arrangements is immaterial.

On March 28, 2003, the Company sold certain assets of PanVera LLC to Invitrogen Corporation for approximately $97 million. The agreement with Invitrogen requires the Company to indemnify Invitrogen against any loss it may suffer by reason of Vertex's breach of certain representations and warranties, or failure to perform certain covenants, contained in the agreement. The representations, warranties and covenants are of a type customary in agreements of this sort. The Company's aggregate obligations under the indemnity are, with a few exceptions that the Company believes are not material, capped at one-half of the purchase price, and apply to claims under representations and warranties made within fifteen months after closing (which period has ended), although there is no corresponding time limit for claims made based on breaches of covenants. Invitrogen has made no claims to date under this indemnity, and the Company believes that the estimated fair value of the remaining indemnification obligation is immaterial.

On December 3, 2003, the Company sold certain instrumentation assets to Aurora Discovery, Inc. for approximately $4.3 million. The agreement with Aurora requires the Company to indemnify Aurora against any loss it may suffer by reason of the Company's breach of certain representations and warranties, or failure to perform certain covenants, contained in the agreement. The representations, warranties and covenants are of a type customary in agreements of this sort. The Company's aggregate obligations under the indemnity are capped at one-half of the purchase price, and apply to claims under representations and warranties made

within fifteen months after closing (which period has ended), although there is no corresponding time limit for claims made based on breaches of covenants. Aurora has made no claims to

date under this indemnity, and the Company believes that the estimated fair value of the remaining indemnification obligation is immaterial.

On February 10, 2004, Vertex entered into a Dealer Manager Agreement with UBS Securities LLC in connection with the exchange by the Company of approximately $153.1 million in principal amount of its 2011 Notes for an equal principal amount of its 2007 Notes. On September 13, 2004, the Company entered into a second Dealer Manager Agreement with UBS Securities in connection with the exchange of approximately $79.3 million in principal amount of 2011 Notes for approximately $79.3 million in principal amount of outstanding 2007 Notes. Each of the Dealer Manager Agreements requires the Company to indemnify UBS Securities against any loss UBS Securities may suffer by reason of the Company's breach of representations and warranties relating to the exchanges of the convertible notes, the Company's failure to perform certain covenants in those agreements, the inclusion of any untrue statement of material fact in the materials provided to purchasers of the 2011 Notes, the omission of any material fact needed to make those materials not misleading, and any actions taken by the Company or its representatives in connection with the exchanges. The representations, warranties and covenants in the Dealer Manager Agreements are of a type customary in agreements of this sort. The Company believes the estimated fair value of these indemnification obligations is immaterial.

On June 7, 2005, the Company entered into a Purchase Agreement with Merrill Lynch, Pierce, Fenner & Smith Incorporated, as the representative of the several underwriters named therein, relating to the public offering and sale of shares of the Company's common stock. The Purchase Agreement requires the Company to indemnify the underwriters against any loss they may suffer by reason of the Company's breach of representations and warranties relating to that public offering, the Company's failure to perform certain covenants in those agreements, the inclusion of any untrue statement of material fact in the prospectus used in connection with that offering, the omission of any material fact needed to make those materials not misleading, and any actions taken by the Company or its representatives in connection with the offering. The representations, warranties and covenants in the Purchase Agreement are of a type customary in agreements of this sort. The Company believes the estimated fair value of these indemnification obligations is immaterial.

8. Legal Proceedings

The Company is not a party to any material legal proceedings.

9. New Accounting Pronouncements

In December 2004, the Financial Accouting Standards Board ("FASB") issued FASB Statement No. 123(R), "Share-Based Payments" ("FASB 123(R)"). FASB 123(R) revises FASB Statement No. 123, "Accounting for Stock-Based Compensation," supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and amends FASB Statement No. 95, "Statement of Cash Flows." FASB 123(R) requires companies to expense the fair value of employee stock options and other forms of stock-based compensation over the employees' service periods. Compensation cost is measured at the fair value of the award at the grant date and is adjusted to reflect actual forfeitures and the outcome of certain conditions. The fair value of an award is not re-measured after its initial estimation on the grant date. The FASB has determined that the effective date of FASB 123(R) should be the first interim or annual reporting period that begins after June 15, 2005. Therefore, Vertex is required to comply with FASB 123(R) beginning January 1, 2006. The impact of adopting FASB 123(R) cannot be accurately estimated at this time, as it will depend on the market value and the amount of share-based awards granted in future periods. However, had the Company adopted FASB 123(R) in prior periods, the impact of the standard would have approximated the impact of SFAS 123 as described in "Stock Based Compensation" under Note 2. The Company is currently evaluating the transition methods and option valuation methods for accounting for and reporting stock options in preparation for the adoption of FASB 123(R).

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

Overview

We are a biotechnology company in the business of discovering, developing, and commercializing small molecule drugs for serious diseases, including HIV infection, chronic hepatitis C virus ("HCV") infection, inflammatory and autoimmune disorders, cancer, and pain. We earn a royalty on sales of Lexiva®/Telzir®, a Vertex-discovered product for the treatment of HIV infection, and co-promote this product in collaboration with GlaxoSmithKline plc. Our drug candidate pipeline is principally focused, at present, on the development and commercialization of new treatments for viral diseases, inflammatory and autoimmune diseases, and cancer. We have built a drug discovery capability that integrates biology, chemistry, biophysics, automation and information technologies, with a goal of making the drug discovery process more efficient and productive.

Drug Discovery and Development

Discovery and development of a single new pharmaceutical product is a lengthy and resource-intensive process, which may take ten to fifteen years or more. Throughout this process, potential drug candidates are subjected to rigorous evaluation, driven in part by stringent regulatory considerations. This evaluation process is designed to generate information concerning efficacy, proper dosage levels and a variety of other physical and chemical characteristics that are important in determining whether a proposed drug candidate should be approved for marketing. The toxicity characteristics and profile of drug candidates at varying dose levels administered for varying periods of time are also monitored continually and evaluated during the non-clinical and clinical development process. Most chemical compounds that are investigated as potential drug candidates never progress into formal development, and most drug candidates that do advance into formal development never become commercial products. A drug candidate's failure to progress or advance may be the result of any one or more of a wide range of adverse experimental outcomes including, for example, the lack of acceptable absorption characteristics or other physical properties, lack of sufficient efficacy against the disease target, difficulties in developing a cost-effective manufacturing or formulation method, or the discovery of toxicities that are unacceptable for the disease indication being treated.

We have a variety of drug candidates in clinical development and a broad-based drug discovery effort. Given the uncertainties of the research and development process, it is not possible to predict with confidence which, if any, of these efforts will result in a marketable pharmaceutical product. We constantly monitor the results of our discovery research and our non-clinical and clinical trials and regularly evaluate our portfolio investments with the objective of balancing risk and potential return in light of new data and scientific, business and commercial insights. This process can result in relatively abrupt changes in focus and priority as new information becomes available and we gain additional insights into ongoing programs and potential new programs.

Business Strategy

We have elected to diversify our research and development activities across a relatively broad array of investment opportunities, due in part to the high risks associated with the biotechnology and pharmaceutical business. We focus our efforts on programs that we expect to control throughout the development and commercialization process in North America, as well as on programs that we anticipate will be controlled principally by a collaborator. This strategy requires more significant financial resources than would be required if we took a more limited approach. Because we have incurred losses from our inception and expect to incur losses for the foreseeable future, we are dependent on our continued ability to raise significant funding to finance our discovery and development operations, including overhead, and to meet our long-term contractual commitments and obligations. In the past, we have secured funds

principally through capital market transactions, strategic collaborative agreements, proceeds from the disposition of assets, investment income and the issuance of common stock under our employee benefit programs.

On September 9, 2005, we issued approximately 2.5 million shares of common stock to certain holders of our 5% Convertible Subordinated Notes due 2007 (the "2007 Notes") in exchange for approximately $40.5 million in aggregate principal amount of those notes, plus an amount equal to accrued interest. At September 30, 2005, we had approximately $399.2 million of cash, cash equivalents and available for sale securities, approximately $42.1 million in aggregate principal amount of 2007 Notes and approximately $232.4 million in aggregate principal amount of 5.75% Convertible Senior Subordinated Notes due 2011 (the "2011 Notes"). As part of our strategy for managing our capital structure, we have, from time to time, adjusted the amount and maturity of our debt obligations through new issues, privately negotiated transactions and market purchases. We expect to continue pursuit of a general financial strategy that may lead us to undertake one or more additional capital transactions, which may or may not be similar to transactions in which we have engaged in the past.

Clinical Development Programs

In the second quarter of 2005, we reported positive results from our Phase Ib clinical trial of VX-950, an oral inhibitor of HCV protease, for the treatment of HCV infection. Based on those trial results, we revised our clinical development plans to increase our 2005 investment in VX-950 product development. In October 2005, we initiated a 20-patient Phase Ib clinical trial of VX-950 in combination with pegylated interferon. By the end of 2005, we plan to initiate a one-month Phase II clinical trial in the United States to evaluate VX-950 in combination with pegylated interferon and ribavirin.

In October 2005, we further revised our clinical development plans to increase our 2006 investment in product development for VX-950 and for our p38 MAP kinase inhibitor, VX-702, which is being studied as a treatment for rheumatoid arthritis. We also plan to bring an investigational drug candidate for the treatment of cystic fibrosis into clinical development in 2006. We based our decision to accelerate the clinical development of these three product candidates on an analysis of both commercial opportunity and available clinical data across our portfolio of programs. We currently expect to minimize our future investment in both merimepodib, which currently is being evaluated in the clinic for the treatment of HCV infection, and VX-765, which is being studied as a treatment for psoriasis. While we plan to complete ongoing trials for these two compounds, we do not expect to invest additional significant resources in their development. We are investigating out-licensing opportunities for VX-765 and pralnacasan, another anti-cytokine in our portfolio. This approach anticipates possible success in bringing to product registration VX-950, VX-702 and a cystic fibrosis compound. However, both VX-950 and VX-702 are in the early stages of clinical testing, and we have not yet advanced a cystic fibrosis compound to clinical development. Any or all of these compounds could fail to progress or advance due to a wide range of adverse experimental outcomes, placing our full investment in them at risk.

We also have a number of compounds being developed in the clinic by collaborators, including VX-385 for the treatment of HIV infection (GlaxoSmithKline), VX-680 for the treatment of cancer (Merck & Co., Inc.), and VX-944 for the treatment of cancer (Avalon Pharmaceuticals Inc.).

The value of each of our assets currently in clinical development will be significantly driven by the information we obtain from clinical trials in upcoming months. Accordingly, the results of these trials have the potential to significantly affect the Company's value.

Collaborative Revenue

Collaborations have been and will continue to be an important component of our business strategy. Based on the value that we believe we have built through research and development investments in certain

of our drug discovery and development programs, and our perception of the level of interest in certain of our programs among some potential collaborators, we believe that we could enter into an additional collaborative agreement or agreements by the end of 2005 that would be material to our business. In future periods, we expect to identify collaborative development and commercialization opportunities for certain of our other drug candidates, in order to continue their clinical advancement as we maintain focus on controlling clinical development of particular drug candidates, such as VX-950 in North America.

Liquidity and Capital Resources

We have incurred operating losses since our inception. Historically we have financed our operations principally through public stock offerings; private placements of our equity and debt securities; strategic collaborative agreements that include research and development funding, development milestones and royalties on the sales of products; proceeds from the disposition of assets of our Discovery Tools and Service business, which we sold in 2003; investment income and proceeds from the issuance of common stock under our employee benefit programs.

At September 30, 2005, we had cash, cash equivalents and available-for-sale securities of $399.2 million, which is an increase of $6.9 million from $392.3 million at December 31, 2004. The increase reflects net proceeds of approximately $165.4 million from our public offering of common stock, which closed in June 2005, offset by cash used in operations of $165.1 million, which includes the net loss of $165.3 million and net cash payments of $18.3 million made against the restructuring accrual. The net loss of $165.3 million includes a $36.3 million non-cash charge relating to the issuance of common stock in exchange for approximately $40.5 million in principal amount of the 2007 Notes plus an amount equal to the accrued interest on those 2007 Notes. Expenditures for property and equipment during the nine months ended September 30, 2005 were $11.8 million. Additionally, we received net proceeds of $16.5 million from the issuance of common stock under our employee benefit plans.

At September 30, 2005, the Company had approximately $232.4 million in principal amount of 2011 Notes and approximately $42.1 million in principal amount of 2007 Notes outstanding. The 2011 Notes are convertible, at the option of the holder, into common stock at a price equal to $14.94 per share, subject to adjustment under certain circumstances. The 2007 Notes are convertible, at the option of the holder, into common stock at a price equal to $92.26 per share, subject to adjustment under certain circumstances.

We expect to continue to make significant investments in our pipeline, particularly in clinical trials for certain of our product candidates, in our ion channel and kinase discovery efforts and in our effort to prepare for potential registration, regulatory approval and commercial launch of our existing and future product candidates. Consequently, we expect to incur losses on a quarterly and annual basis for the foreseeable future.

In the first quarter of 2005, we entered into a commitment to purchase $4.8 million of drug substance to be used for future clinical studies and formulation development. This obligation will be discharged in 2005. Of this obligation, $2.5 million was paid during the third quarter of 2005, and at September 30, 2005, approximately $2.3 million was included in accrued expenses and other current liabilities on our condensed consolidated balance sheets. There have been no other significant changes to our commitments and obligations as reported in our 2004 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 16, 2005.

In 2005 and in future periods, the adequacy of our available funds to meet our future operating and capital requirements, including repayment of the 2007 Notes and the 2011 Notes, will depend on many factors, including the number, breadth and prospects of our discovery and development programs and the costs and timing of obtaining regulatory approvals for any of our product candidates. Collaborations have been and will continue to be an important component of our business strategy. We will continue to rely on cash receipts from our existing research and development collaborations, including research funding,

development reimbursements and potential milestone payments, and from new collaborations, in order to partially fund our research and development efforts.

As part of our strategy for managing our capital structure, we have from time to time adjusted the amount and maturity of our debt obligations through new debt issues, privately negotiated exchange transactions and market purchases, depending on market conditions and our perceived needs at the time. During the remainder of 2005, we expect to continue pursuing a general financial strategy that may lead us to undertake one or more additional capital transactions, which may or may not be similar to transactions in which we have engaged in the past.

To the extent that our current cash and marketable securities, in addition to the above-mentioned sources, are not sufficient to fund our activities, it will be necessary to raise additional funds through public offerings or private placements of our securities or other methods of financing. We will also continue to manage our capital structure and consider all financing opportunities, whenever they may occur, that could strengthen our long-term liquidity profile. There can be no assurance that any such financing opportunities will be available on acceptable terms, if at all.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America. The preparation of these financial statements requires us to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expense during the reported periods. These items are monitored and analyzed by management for changes in facts and circumstances, and material changes in these estimates could occur in the future. Changes in estimates are recorded in the period in which they become known. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from our estimates if past experience or other assumptions do not turn out to be substantially accurate.

We believe that the application of our accounting policies for restructuring expense, revenue recognition, research and development expense and investments, all of which are important to our financial position and results of operations, require significant judgments and estimates on the part of management. Our accounting polices, including the ones discussed below, are more fully described in Note B, “Accounting Policies”, to our consolidated financial statements included in our Annual Report on Form 10-K that was filed with the Securities and Exchange Commission on March 16, 2005.

Restructuring Expense

We record liabilities associated with restructuring activities based on estimates of fair value in the period the liabilities are incurred, in accordance with SFAS 146. As prescribed by SFAS 146, we use a probability-weighted discounted cash-flow analysis to calculate the amount of the liability. The probability-weighted discounted cash-flow analysis is based on management’s assumptions and estimates of our ongoing lease obligations, including contractual rental and build-out commitments and income from sublease rentals, including estimates of sublease timing and sublease rental terms. We applied a discount rate of approximately 10% to estimated cash flows. These estimates are reviewed and may be adjusted in subsequent periods. Adjustments are based, among other things, on management’s assessment of changes in factors underlying the estimates. Because our estimate of the liability includes the application of a discount rate to reflect the time-value of money, the estimate will increase simply as a result of the passage of time, even if all other factors remain unchanged.

Our estimates of this liability have changed in the past, and it is possible that our estimates and assumptions will change in the future, resulting in additional adjustments to the amount of the estimated liability, and the effect of any adjustments could be material. For example, we currently have subleases and sublease commitments for portions of the Kendall Square Facility with terms ranging from six to seven years, and we have made certain estimates and assumptions relating to future sublease terms following the expiration of the current subleases and sublease commitments. As a result, we may be exposed to market variability in the future. We will review our assumptions and judgments related to the lease restructuring on at least a quarterly basis until the Kendall Square Lease is terminated, and make whatever modifications we believe are necessary, based on our best judgment, to reflect any changed circumstances.

The accrual for restructuing expense of $39.3 million at September 30, 2005 is related to the portion of the Kendall Square Facility that we do not intend to occupy. This estimate represents our best judgment of the assumptions and estimates most appropriate in measuring the ongoing obligation.

Revenue Recognition

Our revenue recognition policies are in accordance with the SEC’s Staff Accounting Bulletin No. 101, “Revenue Recognition in Financial Statements” (“SAB 101”) as amended by SEC Staff Accounting Bulletin No. 104, “Revenue Recognition” (“SAB 104”) and for revenue arrangements entered into after June 30, 2003, Emerging Issues Task Force Issue No. 00-21, “Revenue Arrangements with Multiple Deliverables” (“EITF 00-21”).

Our collaborative research and development revenue is generated primarily through collaborative research and development agreements with strategic collaborators. The terms of these agreements typically include payment to us of non-refundable up-front license fees, funding for research and development efforts, payments to us based upon achievement of certain milestones, and royalties payable on product sales.

We recognize revenue from non-refundable, up-front license fees and milestones that are not specifically tied to a separate earnings process, ratably over the contracted or estimated period of performance. Changes in estimates could materially affect revenue in the remainder of the performance period. For example, if

our estimate of the period of performance shortens or lengthens, the amount of revenue we recognize from non-refundable, up-front license fees and milestones could increase or decrease beginning in the period the change in estimate becomes known. Future related revenues would be adjusted accordingly. To date, changes to our estimates have not had a material impact on our financial position or results of operations. Research funding is recognized ratably over the period of effort, as earned. Milestones that are based on designated achievement points and that are considered at-risk and substantive at the inception of the collaboration agreement are recognized as earned when management considers the corresponding payment to be reasonably assured. We evaluate whether milestones are at-risk and substantive based on the contingent nature of the milestone, specifically reviewing factors such as the technological and commercial risk that must be overcome and the level of investment required.

Under EITF 00-21, in multiple-element arrangements, license payments are recognized together with any up-front payment and the research and development funding as a single unit of accounting, unless the delivered technology has stand-alone value to the customer and we have objective and reliable evidence of fair value of the undelivered elements in the arrangement. License payments received during the course of a collaboration that do not meet the separation criteria above are recognized, ratably over the period of performance. Payments received after performance obligations are complete are recognized when earned.

Royalty revenue is recognized based upon actual and estimated net sales of licensed products in licensed territories, as provided by our collaborator GlaxoSmithKline, and is recognized in the period the sales occur. Differences between actual royalty revenues and estimated royalty revenues, which have not historically been significant, are reconciled and adjusted for in the quarter in which they become known.

Research and Development Costs

All research and development costs, including amounts funded by research and development collaborations, are expensed as incurred. Research and development expenses are comprised of costs incurred in performing research and development activities, including salaries and benefits; laboratory supplies; contract services, including clinical trial costs; and infrastructure costs, including facilities cost and depreciation. Accounting for clinical trial, contract services and other outside costs requires that we make estimates of the costs incurred in a given accounting period and record accruals at period-end, because the third party service periods and billing terms do not always coincide with our period-end. We base our estimates on our knowledge of the research and development programs, services performed for the period, past history for related activities and the expected duration of the third party service contract, where applicable.

Altus Investment

We assess our investment in Altus Pharmaceuticals, Inc., for which we account using the cost method, on a quarterly basis to determine if there has been any estimated decrease in the fair value of the asset below its $18.9 million carrying value that might require us to write down the cost basis of the asset. If any adjustment to the fair value of an investment reflects a decline in the value of that investment below its cost, we consider the evidence available to us, including the duration and extent to which the decline is other than temporary. If the decline is considered other than temporary, the cost basis of the investment is written down to fair value as a new cost basis and the amount of the write-down is included in the consolidated statement of operations. We have not identified facts or circumstances which would cause us to determine that the investment basis of our investment in Altus should be changed.

Results of Operations

Three Months Ended September 30, 2005 Compared with Three Months Ended September 30, 2004

Our net loss for the three months ended September 30, 2005 was $79,578,000, or $0.84 per basic and diluted common share, compared to net loss of $38,771,000, or $0.49 per basic and diluted common share, for the three months ended September 30, 2004. Included in the net loss for the quarter ended September 30, 2005 is restructuring expense of $1,565,000 and a charge for the issuance of common stock in exchange for a portion of our 2007 Notes of $36,324,000. Our loss for the quarter ended September 30, 2004 includes net restructuring expense of $1,561,000 and a charge for retirement of a portion of our 2007 Notes of $993,000. Although revenue increased during the three months ended September 30, 2005, it was offset by increased development expense related to our proprietary drug candidates.

Revenues

Total revenues increased $9,379,000 to $36,207,000 for the three months ended September 30, 2005, compared to $26,828,000 for the three months ended September 30, 2004. In the third quarter of 2005, revenue was comprised of $9,466,000 in royalties and $26,741,000 in collaborative research and development revenue, as compared with $4,403,000 in royalties and $22,425,000 in collaborative research and development revenue in the third quarter of 2004.

Royalties consist of Lexiva®/Telzir® (fosamprenavir calcium) and Agenerase® royalty revenue. Fosamprenavir calcium is marketed under the trade name Lexiva in the United States and Telzir in the European Union. Royalty revenue is based on actual and estimated worldwide net sales of Lexiva/Telzir and Agenerase. We began earning royalties on sales of Lexiva in the United States in November 2003 and on Telzir in the European Union in November 2004. The increase in royalty revenue is due to the increase in Lexiva/Telzir sales. In 2005, Lexiva/Telzir largely replaced Agenerase in worldwide markets. As a result,

we expect that royalty revenue in the foreseeable future will consist primarily of Lexiva/Telzir royalty revenue. We pay a royalty to a third party on sales of Agenerase and Lexiva/Telzir.

Collaborative research and development revenue increased $4,316,000, or 19%, for the three months ended September 30, 2005, as compared with the same period in 2004. The increase in collaborative research and development revenue is primarily due to the execution of new collaboration agreements in mid-2004 and early 2005. The revenue recognized under the new collaborations was $9,776,000 in the third quarter of 2005, compared with $6,892,000 for the same period in 2004. Additionally, we recorded increased revenue from our collaboration with Kissei Pharmaceuticals Co. Ltd. (“Kissei”) relating to reimbursement of a portion of our development costs for VX-702 and a $2,500,000 million milestone payment for the completion of regulatory filings in preparation for Phase I clinical development of VX-702 in Japan. The increase in collaborative research and development revenue was offset by a decrease in revenue from our collaboration with Serono S.A., which terminated on September 30, 2004. We recorded $2,280,000 of revenue related to the Serono collaboration during the third quarter of 2004.

Costs and Expenses

Research and development expenses increased $14,800,000, or 30%, to $63,590,000 for the three months ended September 30, 2005 from $48,790,000 for the same period in 2004. The increase in research and development expenses was driven primarily by investment in our clinical development programs for VX-950 and VX-702. Development expenses accounted for 91%, or $13,501,000, of the aggregate increase in research and development expenses. During the third quarter of

2005, we incurred costs from Phase II-enabling activities for VX-950, we completed enrollment in a 315-patient Phase II clinical trial of VX-702 for the treatment of rheumatoid arthritis, and we continued a Phase IIb clinical study (called the "METRO" study) of merimepodib in combination with peginterferon and ribavirin for the treatment of HCV infection.

Research and development expenses consist primarily of salary and benefits, laboratory supplies, contractual services and infrastructure costs, including facilities costs and depreciation. Set forth below is a summary that reconciles our total research and development expenses for the three months ended September 30, 2005 and 2004 (in thousands):

	Three Months Ended September 30,			
	2005	2004	$ Change	% Change
Research Expenses:				
Salary and benefits	$ 10,354	$ 8,939	$ 1,415	16%
Laboratory supplies and other direct expenses	5,135	5,156	(21)	0%
Contractual services	1,320	2,509	(1,189)	(47)%
Infrastructure costs	12,855	11,761	1,094	9%
Total research expenses	$ 29,664	$ 28,365		
Development Expenses:				
Salary and benefits	$ 7,181	$ 5,224	$ 1,957	37%
Laboratory supplies and other direct expenses	3,176	2,043	1,133	55%
Contractual services	17,009	7,705	9,304	121%
Infrastructure costs	6,560	5,453	1,107	20%
Total development expenses	$ 33,926	$ 20,425		
Total Research and Development Expenses:				
Salary and benefits	$ 17,535	$ 14,163	$ 3,372	24%
Laboratory supplies and other direct expenses	8,311	7,199	1,112	15%
Contractual services	18,329	10,214	8,115	79%
Infrastructure costs	19,415	17,214	2,201	13%
Total research and development expenses	$ 63,590	$ 48,790		

Our collaborators have agreed to fund portions of our research and development programs related to specific drug candidates. The following table details our collaborator-and Company-sponsored research and development expenses for the three months ended September 30, 2005 and 2004 (in thousands):

	For the Three Months Ended September 30, 2005			For the Three Months Ended September 30, 2004		
	Research	Development	Total	Research	Development	Total
Collaborator-sponsored	$ 16,777	$ 20,106	$ 36,883	$ 14,249	$ 3,915	$ 18,164
Company-sponsored	12,887	13,820	26,707	14,116	16,510	30,626
Total	$ 29,664	$ 33,926	$ 63,590	$ 28,365	$ 20,425	$ 48,790

The increase in the collaborator-sponsored expenses to $36,883,000 for the three months ended September 30, 2005 from $18,164,000 for the same period in 2004 is primarily due to the performance under collaboration agreements with Merck & Co. Inc., Mitsubishi Pharma Corporation and The Cystic Fibrosis Foundation Therapeutics Incorporated ("CFFT").

Sales, general and administrative expenses increased slightly to $10,738,000 for the three months ended September 30, 2005, compared to $10,600,000 for the same period in 2004.

Restructuring expense for the three months ended September 30, 2005 was $1,565,000 compared to a restructuring expense for the three months ended September 30, 2004 of $1,561,000. The charge in both periods resulted primarily from an imputed interest cost related to the restructuring accrual.

The activity related to the restructuring accrual and related expense for the three months ended September 30, 2005 is as follows (in thousands):

	Accrual as of June 30, 2005	Cash Payment, third quarter 2005	Cash received from sublease, third quarter 2005	Charge, third quarter 2005	Accrual as of September 30, 2005
Lease restructuring expense	$ 43,813	$ (6,645)	$ 591	$ 1,565	$ 39,324

The activity related to the restructuring accrual and related expense for the three months ended September 30, 2004 is as follows (in thousands):

	Accrual as of June 30, 2004	Cash payments, third quarter 2004	Charge, third quarter 2004	Accrual as of September 30, 2004
Lease restructuring expense	$ 56,701	$ (8,139)	$ 1,561	$ 50,123

Interest income increased $1,288,000, or 53%, to $3,733,000 for the three months ended September 30, 2005 from $2,445,000 for the three months ended September 30, 2004. The increase is a result of a higher portfolio yields.

As a result of the issuance of common stock in exchange for 2007 Notes in September 2005, we recorded a non-cash charge of $36,324,000. This charge is related to the incremental shares issued in the transaction over the number that would have been issued upon conversion of the notes under their original terms, at a conversion price of $92.26 per share.

Nine months ended September 30, 2005 Compared with Nine months ended September 30, 2004

Net Loss

Our net loss for the nine months ended September 30, 2005 was $165,286,000, or $1.93 per basic and diluted common share, compared to net loss of $123,478,000, or $1.57 per basic and diluted common share, for the nine months ended September 30, 2004. Included in the net loss for the nine months ended September 30, 2005 is net restructuring expense of $1,736,000 and a charge for the issuance of common stock in exchange for 2007 Notes of $36,324,000. Our net loss for the nine months ended September 30, 2004 includes restructuring expense of $5,216,000, and a charge for retirement of 2007 Notes of $3,446,000.

Revenues

Total revenues increased by $34,252,000 to $97,134,000 for the nine months ended September 30, 2005, compared to $62,882,000 for the nine months ended September 30, 2004. In the first nine months of 2005, revenue was comprised of $23,086,000 in royalties and $74,048,000 in collaborative research and development revenue, as compared with $10,996,000 in royalties and $51,886,000 in collaborative research and development revenue in the first nine months of 2004.

Collaborative research and development revenue increased $22,162,000, or 43%, for the nine months ended September 30, 2005 as compared with the same period in 2004. The increase in collaborative research and development revenue is primarily due to the execution of new collaboration agreements in mid-2004 and early 2005. The revenue recognized under the new collaborations was $28,971,000 for the nine months ended September 30, 2005 and $8,052,000 for the nine months ended September 30, 2004. The increase in collaborative research and development revenue was offset by a decrease in revenue related to our collaboration with Serono S.A., which terminated on September 30, 2004. For the nine months ended September 30, 2004 we recorded $5,241,000 of revenue related to this collaboration.

Costs and Expenses

Research and development expenses increased $42,467,000, or 31%, to $180,382,000 for the nine months ended September 30, 2005 from $137,915,000 for the same period in 2004. Development expenses accounted for 84%, or $35,766,000, of the total increase in research and development expenses.

Set forth below is a summary that reconciles our total research and development expenses for the nine months ended September 30, 2005 and 2004 (in thousands):

	Nine Months ended September 30,			
	2005	2004	$ Change	% Change
Research Expenses:				
Salary and benefits	$ 30,497	$ 27,515	$ 2,982	11%
Laboratory supplies and other direct expenses	16,147	13,121	3,026	23%
Contractual services	4,831	6,118	(1,287)	(21)%
Infrastructure costs	38,003	36,023	1,980	5%
Total research expenses	$ 89,478	$ 82,777		
Development Expenses:				
Salary and benefits	$ 19,770	$ 14,626	$ 5,144	35%
Laboratory supplies and other direct expenses	8,005	5,195	2,810	54%
Contractual services	43,752	19,054	24,698	130%
Infrastructure costs	19,377	16,263	3,114	19%
Total development expenses	$ 90,904	$ 55,138		
Total Research and Development Expenses:				
Salary and benefits	$ 50,267	$ 42,141	$ 8,126	19%
Laboratory supplies and other direct expenses	24,152	18,316	5,836	32%
Contractual services	48,583	25,172	23,411	93%
Infrastructure costs	57,380	52,286	5,094	10%
Total research and development expenses	$ 180,382	$ 137,915		

The following table details our collaborator-and Company-sponsored research and development expenses for 2005 and 2004 (in thousands):

	For the Nine Months Ended September 30, 2005			For the Nine Months Ended September 30, 2004		
	Research	Development	Total	Research	Development	Total
Collaborator-sponsored	$ 50,204	$ 46,537	$ 96,741	$ 43,913	$ 10,754	$ 54,667
Company-sponsored	39,274	$ 44,367	83,641	38,864	44,384	83,248
Total	$ 89,478	$ 90,904	$ 180,382	$ 82,777	$ 55,138	$ 137,915

The increase in the collaborator-sponsored expenses to $96,741,000 for the nine months ended September 30, 2005 from $54,667,000 for the same period in 2004 is primarily due to the performance under collaboration agreements with Merck, Mitsubishi, and CFFT.

Sales, general and administrative expenses increased slightly to $31,179,000 for the nine months ended September 30, 2005, from $30,482,000 for the same period in 2004.

Net restructuring expense for the nine months ended September 30, 2005 was $1,736,000, compared to $5,216,000 for the nine months ended September 30, 2004.

The activity related to the restructuring accrual and related expense for the nine months ended September 30, 2005 is as follows (in thousands):

	Credit for

	Accrual as of December 31, 2004	Cash Payments, nine months ended Sept. 30, 2005	Cash received from sublease, nine months ended Sept. 30, 2005	portion of facility Vertex expects to occupy, nine months ended Sept. 30, 2005	Charge. nine months ended Sept. 30, 2005	Accrual as of Sept. 30, 2005
Lease restructuring expense	$ 55,843	$ (19,662)	$ 1,407	$ (10,018)	$ 11,754	$ 39,324

The activity related to the restructuring accrual and related expense for the nine months ended September 30, 2004 is as follows (in thousands):

	Accrual as of December 31, 2003	Cash payments, nine months ended Sept. 30, 2004	Charge, nine months ended Sept. 30, 2004	Accrual as of Sept. 30, 2004
Lease restructuring expense and other operating lease expense	$ 69,526	$ (24,619)	$ 5,216	$ 50,123

Interest income increased 318,000, or 4%, to $8,299,000 for the nine months ended September 30, 2005 from $7,981,000 for the nine months ended September 30, 2004. The increase is a result of a higher average balance of funds invested and higher portfolio yields.

New Accounting Pronouncements

In December 2004, the Financial Accouting Standards Board (“FASB”) issued FASB Statement No. 123(R), “Share-Based Payments” (“FASB 123(R)”). FASB 123(R) revises FASB Statement No. 123, “Accounting for Stock-Based Compensation,” supersedes APB Opinion No. 25, “Accounting for Stock Issued to Employees,” and amends FASB Statement No. 95, “Statement of Cash Flows.” FASB 123(R) requires companies to expense the fair value of employee stock options and other forms of stock-based compensation over the employees’ service periods. Compensation cost is measured at the fair value of the award at the grant date and is adjusted to reflect actual forfeitures and the outcome of certain conditions. The fair value of an award is not re-measured after its initial estimation on the grant date. FASB has determined that the effective date of FASB 123(R) should be the first interim or annual reporting period that begins after June 15, 2005. Therefore, we are required to comply with FASB 123(R) beginning January 1, 2006. The impact of adopting FASB 123(R) cannot be accurately estimated at this time, as it will depend on the market value and the amount of share-based awards granted in future periods. However, had we adopted FASB 123(R) in prior periods, the impact of the standard would have approximated the impact of SFAS 123 as described in “Stock Based Compensation” under Note 2 of our Condensed Consolidated Financial Statements. We are currently evaluating the transition methods and option valuation methods for accounting for and reporting stock options in preparation for the adoption of FASB 123(R).

Forward-Looking Statements

This report contains forward-looking statements about our business, including our expectation that:

- we expect to incur a substantial loss for the year ending December 31, 2005 and on a quarterly and annual basis for the forseeable future;
- we will occupy approximately 120,000 square feet of the Kendall Square Facility beginning in 2006;
- we will focus our efforts both on programs that we expect to control throughout the development and commercialization process in North America, as well as on programs that we anticipate will be controlled principally by a collaborator;
- we will continue pursuit of a general financing strategy that may lead us to undertake one or more additional capital transactions;
- we will continue to make significant investments in our pipeline;
- we will continue to rely on cash receipts from our existing research and development collaborations, including research funding, development reimbursements and potential milestone payments, and from new collaborations, in order to help fund our research and development efforts;
- the fair value of our guarantees and indemnification obligation discussed in Footnote 7 to our condensed consolidated financial statements included in this Quarterly Report on 10-Q will be immaterial;
- we will increase our investment in 2006 in VX-950 and VX-702;
- we will advance a compound for the treatment of cystic fibrosis into clinical development in 2006;
- we will initiate a Phase II clinical trial in the United States to evaluate VX-950 in combination with pegylated interferon and ribavirin by the end of 2005;
- we will not invest significant additional resources in the development of merimepodib and VX-765;
- we will complete our clinical trials of merimepodib and VX-765;
- we could enter into an additional collaborative agreement or agreements by the end of 2005 that would be material to our business;
- our royalty revenue will consist of principally royalties on the sale of Lexiva/Telzir for the forseeable future;
- we will identify collaborative development and commercialization opportunities for certain of our drug candidates in order to continue their clinical advancement, as we maintain focus on controlling clinical development of particular drug candidates; and
- our net liability under the Kendall Square Lease will be as we have estimated.

While management makes its best efforts to be accurate in making forward-looking statements, such statements are subject to risks and uncertainties that could cause our actual results to vary materially. These risks and uncertainties include, among other things, the possibility of delays in the commencement or completion of clinical trials; the risk that clinical trials may not result in marketable products; the risk that we may be unable to successfully finance and secure regulatory approval of and market our drug candidates; our dependence upon existing and new collaborations; the levels and timing of payments under our collaborative agreements; uncertainties about our ability to obtain new corporate collaborations on satisfactory terms, if at all; our ability to protect our proprietary technologies; patent-infringement claims; risks of new scientific discoveries and methods of treatment for disease targets that may reduce demand for

our drug products and drug candidates; and the risk that there may be changing and new regulations in the U.S. and internationally that could adversely affect the process of regulatory approval for our drug candidates or our ability to successfully market or sell any approved drugs on favorable terms. Please see the "Risk Factors" appearing in Item 1 of our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 16, 2005, for more details regarding these and other risks. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As part of our investment portfolio, we own financial instruments that are sensitive to market risks. The investment portfolio is used to preserve our capital until it is required to fund operations, including our research and development activities. None of these market risk sensitive instruments are held for trading purposes. We do not have derivative financial instruments in our investment portfolio.

Interest Rate Risk

We invest our cash in a variety of financial instruments, principally securities issued by the U.S. government and its agencies, investment grade corporate bonds and notes and money market instruments. These investments are denominated in U.S. dollars. All of our interest-bearing securities are subject to interest rate risk, and could decline in value if interest rates fluctuate. Substantially all of our investment portfolio consists of marketable securities with active secondary or resale markets to help ensure portfolio liquidity, and we have implemented guidelines limiting the term to maturity of its investment instruments. Due to the conservative nature of these instruments, we do not believe that we have a material exposure to interest rate risk.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's chief executive officer and chief financial officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13(a)-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q, have concluded that, based on such evaluation, as of September 30, 2005 the Company's disclosure controls and procedures were effective and designed to provide reasonable assurance that the information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. In designing and evaluating the disclosure controls and procedures, the Company's management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Controls Over Financial Reporting

No change in the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) occurred during the third quarter of 2005 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II. Other Information

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On September 9, 2005, the Company issued 2,452,000 shares of its common stock to certain holders of the Company's 5% Convertible Subordinated Notes due 2007 in exchange for $40,450,000 principal amount of those notes, plus accrued interest. The exchanges were exempt from registration under Section 3(a)(9) of the Securities Act of 1933, as each of the transactions were solely among the Company and its security holders and no commission or other remuneration was paid or given directly or indirectly for soliciting the exchanges.

Item 6. Exhibits

Exhibit No.	Description
10.1	Exchange Agreement, dated September 8, 2005, between Vertex Pharmaceuticals Incorporated and Akanthos Arbitrage Master Fund, L.P..
10.2	Exchange Agreement, dated September 8, 2005, between Vertex Pharmaceuticals Incorporated and Alexandra Global Master Fund Ltd.
10.3	Exchange Agreement, dated September 8, 2005, between Vertex Pharmaceuticals Incorporated and Quattro Fund, Ltd., Quattro Multi-Strategy Master Fund, L.P., Partners Group Alternative Strategies PCC Limited, Red Delta Cell and Institutional Benchmark Series (Master Feeder) Limited in Respect of Electra Series.
10.4	Exchange Agreement, dated September 8, 2005, between Vertex Pharmaceuticals Incorporated and Radcliffe SPC, Ltd..
31.1	Certification of the Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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.

November 9, 2005 VERTEX PHARMACEUTICALS INCORPORATED

By: /s/ IAN F. SMITH

Ian F. Smith
Senior Vice President and Chief Financial Officer
(principal financial officer and duly authorized officer)

Exhibit Index

Exhibit No.	Description
10.1	Exchange Agreement, dated September 8, 2005, between Vertex Pharmaceuticals Incorporated and Akanthos Arbitrage Master Fund, L.P.
10.2	Exchange Agreement, dated September 8, 2005, between Vertex Pharmaceuticals Incorporated and Alexandra Global Master Fund Ltd.
10.3	Exchange Agreement, dated September 8, 2005, between Vertex Pharmaceuticals Incorporated and Quattro Fund, Ltd., Quattro Multi-Strategy Master Fund, L.P., Partners Group Alternative Strategies PCC Limited, Red Delta Cell and Institutional Benchmark Series (Master Feeder) Limited in Respect of Electra Series.
10.4	Exchange Agreement, dated September 8, 2005, between Vertex Pharmaceuticals Incorporated and Radcliffe SPC, Ltd.
31.1	Certification of the Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

EXCHANGE AGREEMENT

This Exchange Agreement (this "Agreement") is made as of the later of the dates set forth opposite the parties' signatures (the "Agreement Date") by and between Vertex Pharmaceuticals Incorporated, a Massachusetts corporation (the "Company"), and Akanthos Arbitrage Master Fund, L.P., a Cayman Islands exempted limited partnership (the "Investor").

WHEREAS: The Company originally issued $345,000,000 in aggregate principal amount of 5% Convertible Subordinated Notes due 2007 (the "Notes");

WHEREAS: The Investor is the holder of the Notes described in Section 2(b) (the "Exchange Notes"); and

WHEREAS: The Investor has indicated to the Company its desire to exchange the Exchange Notes for Common Stock of the Company (the "Common Stock") and, after negotiation between the parties hereto, such parties have agreed to affect such exchange on the terms and conditions hereinafter set forth.

NOW, THEREFORE, in consideration of the premises, the mutual covenants and agreements herein contained and other valuable consideration, the receipt and adequacy whereof is hereby acknowledged, the parties hereto agree as follows:

Section 1. Agreement to Exchange Securities

(a) Exchange of Securities. On the terms and subject to the conditions set forth herein, the Investor agrees to transfer, or cause to be transferred, to the Company all of its right, title and interest in and to the Exchange Notes on the following basis: in exchange for the Exchange Notes, a number of shares of freely tradable Common Stock (the "Exchanged Shares") equal to (i) 99% of the principal amount of the Exchange Notes plus 100% of the accrued and unpaid interest on the Exchange Notes, divided by (ii) the Determination Price.

(b) Determination Price. The Determination Price shall be equal to 93% of the lesser of (i) the arithmetic average of the closing bid prices of the Common Stock on the Agreement Date and for the 9 consecutive trading days immediately preceding the Agreement Date, and (ii) the closing bid price of the Common Stock on the Agreement Date.

(c) Fractional Shares. In lieu of issuing fractional shares, the Company shall issue the highest whole number of Exchanged Shares according to the formula set forth in Section 1.1(a) plus cash in an amount equal to the fraction of an Exchanged Share to which the Investor would otherwise be entitled multiplied by the Determination Price.

(d) Closing. The completion of the transactions contemplated by this Agreement (the "Closing") shall take place as soon as practical and, in any event, no later than September 9, 2005, or such other date as is agreed upon by the parties (the "Closing Date"), as follows:

(i) The Investor shall deliver or cause to be delivered the Exchange Notes to the Company or the Company's agent in such manner as shall be acceptable to the Company and effective to convey all right, title and interest of the Investor in the Exchange Notes

---

to the Company against delivery of the Exchanged Shares by the Company through the Depositary Trust Company to Morgan Stanley & Co, DTC # 050, FFC: Akanthos Arbitrage Fund, Acct: 38C5591.

(ii) The Company shall pay the Investor by wire transfer of immediately available funds an amount equal to the cash value of any fractional Exchanged Share, determined in accordance with the provisions of Section 1(c).

Section 2. Representations and Warranties

(a) Mutual Representations and Warranties. Each party hereto hereby makes the following representations and warranties to the other party hereto as follows:

(i) It is a corporation or other entity duly organized, validly existing and in good standing under the laws of its jurisdiction of organization.

(ii) (x) It has full power and authority to enter into this Agreement and to consummate the transactions contemplated hereby, and (y) the person who has executed this Agreement is duly authorized to do so and thereby bind the party on whose behalf he or she is purporting to sign.

(iii) This Agreement is its valid and binding agreement, enforceable against it in accordance with its terms, subject to bankruptcy and similar laws and to equitable principles.

(iv) Neither the execution and delivery of this Agreement, nor the consummation of the transactions contemplated hereby, will violate, result in a breach of any of the terms or provisions of, constitute a default under, accelerate any obligations under, or conflict with (x) its certificate of incorporation or bylaws (or other organizational documents) or any agreement, indenture or other instrument to which it is a party or by which it or its properties are bound, (y) any judgment, decree, order or award of any court, governmental body or arbitrator to which it is subject, or (z) any law, rule or regulation applicable to it.

(v) It has not, directly or indirectly, paid any commission or other remuneration to any person for soliciting the exchange of the Exchange Notes for Exchanged Shares as contemplated by this Agreement.

(b) Representations and Warranties of the Investor. The Investor hereby represents and warrants to the Company that it

(i) is the sole legal and beneficial owner of the Exchange Notes, and, upon the Closing, the Company will acquire the Exchange Notes free and clear of any liens, encumbrances, pledges, security interests or other restrictions or claims of third parties, other than any of the foregoing created by the Company;

(ii) is not an affiliate of the Company;

(iii) holds the following Exchange Notes that were acquired before September 1, 2005 in the public market and are free of restrictive legend: $11,518,000 principal amount of Notes (CUSIP: 92532F AD 2);

(iv) has had such opportunity as it has deemed adequate to obtain from representatives of the Company such information as is necessary to permit it to evaluate the merits and risks of an investment in the Exchanged Shares;

(v) has sufficient experience in business, financial and investment matters to be able to evaluate the risks involved in the acquisition of the Exchanged Shares issued in respect of the Exchange Notes and to make an informed investment decision with respect to such acquisition; and

(vi) on September 8, 2005, it (a) did not and will not, directly or indirectly, issue, offer, sell, agree to issue, offer or sell, solicit offers to purchase, grant any call option, warrant or other right to purchase, purchase any put option or other right to sell, pledge, borrow, assign or otherwise dispose of any Relevant Security (as defined below), and (b) did not and will not, directly or indirectly, establish or increase any "put equivalent position" or liquidate or decrease any "call equivalent position" with respect to any Relevant Security (in each case within the meaning of Section 16 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the rules and regulations promulgated thereunder) with respect to any Relevant Security, or otherwise enter into any swap, derivative or other transaction or arrangement that transfers to another, in whole or in part, any economic consequence of ownership of a Relevant Security, whether or not such transaction is to be settled by delivery of Relevant Securities, other securities, cash or other consideration. As used herein, the term "Relevant Security" means the Common Stock, any other equity security of the Company and any security convertible into, or exercisable or exchangeable for, the Common Stock or any other such equity security.

(c) Representations and Warranties of the Company. The Company hereby represents and warrants to the Investor that upon issuance, the Exchanged Shares will be duly and validly authorized and issued, fully paid and nonassessable, and that the Investor will acquire such Common Stock free and clear of any liens, encumbrances, pledges, security interests or other restrictions or claims of third parties, other than any of the foregoing created by the Investor. The Company represents and warrants to the Investor that the Exchanged Shares to be issued in exchange for the Exchange Notes shall be issued pursuant to a valid exemption from registration under Section 3(a)(9) of the Securities Act of 1933, as amended, in order to make them freely salable into the public market in the hands of the Investor.

(d) Survival of Representations and Warranties. All representations, warranties and agreements of each party hereto shall survive the Closing.

Section 3. Miscellaneous

(a) Further Assurances. Each party hereto shall properly execute and deliver such further agreements and instruments, and take such further actions, as the other party may reasonably request in order to carry out the purposes and intent of this Agreement.

(b) Exclusivity. The Company hereby agrees that concurrently with the Closing and for a 90 day period beginning on the Closing Date, the Company will not engage in any transaction or transactions that would result in the exchange of Notes with an aggregate principal amount in excess of $40,450,000 (including the transactions contemplated by this Agreement, which shall not exceed such amount).

(c) Confidentiality. The parties hereto agree to keep confidential and to not disclose the terms, provisions, or existence of this Agreement, except as the parties reasonably believe such disclosure is required by applicable law, provided, however, that the Company shall be entitled, without the prior approval of the Investor, to make any press release or other public disclosure with respect to such transactions as is required by applicable law and regulations, including the Exchange Act and the rules

and regulations promulgated thereunder, including the public filing of this Agreement (although the Investor shall be consulted by the Company in connection with any such press release or other public disclosure prior to its release and shall be provided with a copy thereof).

(d) Notices. All notices, requests, demands and other communications hereunder shall be in writing and shall be deemed given if delivered personally, by facsimile transmission (with subsequent letter confirmation by mail), by overnight courier or two days after being mailed by certified or registered mail, postage prepaid, return receipt requested, to the parties, their successors in interest or their assignees at the following addresses, or at such other addresses as the parties may designate by written notice in the manner aforesaid:

If to the Investor: Akanthos Arbitrage Master Fund, L.P.
c/o Akanthos Capital Management, LLC
21700 Oxnard Street, Suite 1520
Woodland Hills, California 91367
Facsimile: 818-883-8271

If to the Company: Vertex Pharmaceuticals Incorporated
130 Waverly Street
Cambridge, Massachusetts 02139
Attention: The Office of General Counsel
Facsimile: 617-444-6483

(e) Assignability and Parties in Interest. This Agreement shall not be assignable by any of the parties hereto without the consent of the other party hereto. This Agreement shall inure to the benefit of and be binding upon the parties and their respective permitted successors and assigns.

(f) Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the internal substantive law, and not the law pertaining to conflicts of law, of the State of New York.

(g) Counterparts. This Agreement may be executed in several counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

(h) Complete Agreement. This Agreement is an integrated agreement containing the entire agreement between the parties hereto with respect to the subject matter hereof and shall supersede all previous and all contemporaneous oral or written negotiations, commitments or understandings.

(i) Modifications, Amendments and Waiver. This Agreement may be modified, amended otherwise supplemented or terminated only by a writing signed by the party against whom it is sought to be enforced. No waiver of any right or power hereunder shall be deemed effective unless and until a writing waiving such right or power is executed by the party waiving such right or power.

(j) No Third Party Beneficiaries. There are no third party beneficiaries under this Agreement or intended by any party hereto.

(k) Expenses. Each party hereto shall bear its own costs and expenses, including, without limitation, attorneys' fees, incurred in connection with this Agreement and the transactions contemplated hereby.

(l) Contract Interpretation and Construction of Agreement. This Agreement is the joint drafting product of the Company and the Investor, and each provision has been subject to negotiation and agreement with the advice of counsel and shall not be construed for or against either party as the drafter thereof.

IN WITNESS WHEREOF, each of the Company and the Investor have caused this Agreement to be signed by their respective duly authorized officers as of the date first written above.

Vertex Pharmaceuticals Incorporated

Date: September 8, 2005

By: /s/ JOSHUA S. BOGER
Joshua S. Boger, Chief Executive Officer

Akanthos Arbitrage Master Fund, L.P.

By: Akanthos Capital Management, LLC,
its general partner

Date: September 8, 2005

By: /s/ MICHAEL KAO
Name: Michael Kao
Title: Managing Member

EXCHANGE AGREEMENT

This Exchange Agreement (this "Agreement") is made as of the later of the dates set forth opposite the parties' signatures (the "Agreement Date") by and between Vertex Pharmaceuticals Incorporated, a Massachusetts corporation (the "Company"), and Alexandra Global Master Fund Ltd., a British Virgin Islands international business company (the "Investor").

WHEREAS: The Company originally issued $345,000,000 in aggregate principal amount of 5% Convertible Subordinated Notes due 2007 (the "Notes");

WHEREAS: The Investor is the holder of the Notes described in Section 2(b) (the "Exchange Notes"); and

WHEREAS: The Investor has indicated to the Company its desire to exchange the Exchange Notes for Common Stock of the Company (the "Common Stock") and, after negotiation between the parties hereto, such parties have agreed to affect such exchange on the terms and conditions hereinafter set forth.

NOW, THEREFORE, in consideration of the premises, the mutual covenants and agreements herein contained and other valuable consideration, the receipt and adequacy whereof is hereby acknowledged, the parties hereto agree as follows:

Section 1. Agreement to Exchange Securities

(a) Exchange of Securities. On the terms and subject to the conditions set forth herein, the Investor agrees to transfer, or cause to be transferred, to the Company all of its right, title and interest in and to the Exchange Notes on the following basis: in exchange for the Exchange Notes, a number of shares of freely tradable Common Stock (the "Exchanged Shares") equal to (i) 99% of the principal amount of the Exchange Notes plus 100% of the accrued and unpaid interest on the Exchange Notes, divided by (ii) the Determination Price.

(b) Determination Price. The Determination Price shall be equal to 93% of the lesser of (i) the arithmetic average of the closing bid prices of the Common Stock for the 10 consecutive trading days ending on and including the Agreement Date, and (ii) the closing bid price of the Common Stock on the Agreement Date.

(c) Fractional Shares. In lieu of issuing fractional shares, the Company shall issue the highest whole number of Exchanged Shares according to the formula set forth in Section 1.1(a) plus cash in an amount equal to the fraction of an Exchanged Share to which the Investor would otherwise be entitled multiplied by the Determination Price.

(d) Closing. The completion of the transactions contemplated by this Agreement (the "Closing") shall take place as soon as practical and, in any event, no later than September 9, 2005, or such other date as is agreed upon by the parties (the "Closing Date"), as follows:

(i) The Investor shall deliver or cause to be delivered the Exchange Notes to the Company or the Company's agent in such manner as shall be acceptable to the Company and effective to convey all right, title and interest of the Investor in the Exchange Notes

---

to the Company against delivery of the Exchanged Shares by the Company through the Depositary Trust Company to Deutsche Bank Securities, DTC# 0573, FFC: Alexandra Global Master Fund Ltd., Acct: 106-95455.

(ii) The Company shall pay the Investor by wire transfer of immediately available funds an amount equal to the cash value of any fractional Exchange Share, determined in accordance with the provisions of Section 1(c).

Section 2. Representations and Warranties

(a) Mutual Representations and Warranties. Each party hereto hereby makes the following representations and warranties to the other party hereto as follows:

(i) It is a corporation or other entity duly organized, validly existing and in good standing under the laws of its jurisdiction of organization.

(ii) (x) It has full power and authority to enter into this Agreement and to consummate the transactions contemplated hereby, and (y) the person who has executed this Agreement is duly authorized to do so and thereby bind the party on whose behalf he or she is purporting to sign.

(iii) This Agreement is its valid and binding agreement, enforceable against it in accordance with its terms, subject to bankruptcy and similar laws and to equitable principles.

(iv) Neither the execution and delivery of this Agreement, nor the consummation of the transactions contemplated hereby, will violate, result in a breach of any of the terms or provisions of, constitute a default under, accelerate any obligations under, or conflict with (x) its certificate of incorporation or bylaws (or other organizational documents) or any agreement, indenture or other instrument to which it is a party or by which it or its properties are bound, (y) any judgment, decree, order or award of any court, governmental body or arbitrator to which it is subject, or (z) any law, rule or regulation applicable to it.

(v) It has not, directly or indirectly, paid any commission or other remuneration to any person for soliciting the exchange of the Exchange Notes for Exchanged Shares as contemplated by this Agreement.

(b) Representations and Warranties of the Investor. The Investor hereby represents and warrants to the Company that it

(i) is the sole legal and beneficial owner of the Exchange Notes, and, upon the Closing, the Company will acquire the Exchange Notes free and clear of any liens, encumbrances, pledges, security interests or other restrictions or claims of third parties, other than any of the foregoing created by the Company;

(ii) is not an affiliate of the Company;

(iii) holds the following Exchange Notes that were acquired before September 1, 2005 in the public market and are free of restrictive legend: $17,029,000 principal amount of Notes (CUSIP: 92532F AD 2):

(iv) has had such opportunity as it has deemed adequate to obtain from representatives of the Company such information as is necessary to permit it to evaluate the merits and risks of an investment in the Exchanged Shares; and

(v) has sufficient experience in business, financial and investment matters to be able to evaluate the risks involved in the acquisition of the Exchanged Shares issued in respect of the Exchange Notes and to make an informed investment decision with respect to such acquisition.

(vi) on September 8, 2005, it (a) did not and will not, directly or indirectly, issue, offer, sell, agree to issue, offer or sell, solicit offers to purchase, grant any call option, warrant or other right to purchase, purchase any put option or other right to sell, pledge, borrow, assign or otherwise dispose of any Relevant Security (as defined below), and (b) did not and will not, directly or indirectly, establish or increase any "put equivalent position" or liquidate or decrease any "call equivalent position" with respect to any Relevant Security (in each case within the meaning of Section 16 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the rules and regulations promulgated thereunder) with respect to any Relevant Security, or otherwise enter into any swap, derivative or other transaction or arrangement that transfers to another, in whole or in part, any economic consequence of ownership of a Relevant Security, whether or not such transaction is to be settled by delivery of Relevant Securities, other securities, cash or other consideration. As used herein, the term "Relevant Security" means the Common Stock, any other equity security of the Company and any security convertible into, or exercisable or exchangeable for, the Common Stock or any other such equity security.

(c) Representations and Warranties of the Company. The Company hereby represents and warrants to the Investor that upon issuance, the Exchanged Shares will be duly and validly authorized and issued, fully paid and nonassessable, and that the Investor will acquire such Common Stock free and clear of any liens, encumbrances, pledges, security interests or other restrictions or claims of third parties, other than any of the foregoing created by the Investor. The Company represents and warrants to the Investor that the Exchanged Shares to be issued in exchange for the Exchange Notes shall be issued pursuant to a valid exemption from registration under Section 3(a)(9) of the Securities Act of 1933, as amended, in order to make them freely salable into the public market in the hands of the Investor. If required by the rules of Nasdaq, the Company will, prior to the Closing Date, file an application for the listing of the Exchanged Shares on Nasdaq.

(d) Survival of Representations and Warranties. All representations, warranties and agreements of each party hereto shall survive the Closing.

Section 3. Miscellaneous

(a) Further Assurances. Each party hereto shall properly execute and deliver such further agreements and instruments, and take such further actions, as the other party may reasonably request in order to carry out the purposes and intent of this Agreement.

(b) Exclusivity. The Company hereby agrees that concurrently with the Closing and for a 90 day period beginning on the Closing Date, the Company will not engage in any transaction or transactions that would result in the exchange of Notes with an aggregate principal amount in excess of $40,050,000 (including the transactions contemplated by this Agreement, which shall not exceed such amount).

(c) Confidentiality. The parties hereto agree to keep confidential and to not disclose the terms, provisions, or existence of this Agreement, except as the parties reasonably believe such disclosure

is required by applicable law, provided, however, that the Company shall be entitled, without the prior approval of the Investor, to make any press release or other public disclosure with respect to such transactions as is required by applicable law and regulations, including the Exchange Act and the rules and regulations promulgated thereunder, including the public filing of this Agreement (although the Investor shall be consulted by the Company in connection with any such press release or other public disclosure prior to its release and shall be provided with a copy thereof). The restrictions contained in the foregoing sentence shall expire upon the Company's issuance of a press release describing the transactions.

(d) Notices. All notices, requests, demands and other communications hereunder shall be in writing and shall be deemed given if delivered personally, by facsimile transmission (with subsequent letter confirmation by mail), by overnight courier or two days after being mailed by certified or registered mail, postage prepaid, return receipt requested, to the parties, their successors in interest or their assignees at the following addresses, or at such other addresses as the parties may designate by written notice in the manner aforesaid:

If to the Investor:
Alexandra Global Master Fund Ltd.
c/o Alexandra Investment Management, LLC
767 Third Avenue
39th Floor
New York, New York 10017
Facsimile: (212) 301-1810

If to the Company:
Vertex Pharmaceuticals Incorporated
130 Waverly Street
Cambridge, Massachusetts 02139
Attention: The Office of General Counsel
Facsimile: 617-444-6483

(e) Assignability and Parties in Interest. This Agreement shall not be assignable by any of the parties hereto without the consent of the other party hereto. This Agreement shall inure to the benefit of and be binding upon the parties and their respective permitted successors and assigns.

(f) Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the internal substantive law, and not the law pertaining to conflicts of law, of the State of New York.

(g) Counterparts. This Agreement may be executed in several counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

(h) Complete Agreement. This Agreement is an integrated agreement containing the entire agreement between the parties hereto with respect to the subject matter hereof and shall supersede all previous and all contemporaneous oral or written negotiations, commitments or understandings.

(i) Modifications, Amendments and Waiver. This Agreement may be modified, amended otherwise supplemented or terminated only by a writing signed by the party against whom it is sought to be enforced. No waiver of any right or power hereunder shall be deemed effective unless and until a writing waiving such right or power is executed by the party waiving such right or power.

(j) No Third Party Beneficiaries. There are no third party beneficiaries under this Agreement or intended by any party hereto.

(k) Expenses. Each party hereto shall bear its own costs and expenses, including, without limitation, attorneys' fees, incurred in connection with this Agreement and the transactions contemplated hereby.

(l) Contract Interpretation and Construction of Agreement. This Agreement is the joint drafting product of the Company and the Investor, and each provision has been subject to negotiation and agreement with the advice of counsel and shall not be construed for or against either party as the drafter thereof.

IN WITNESS WHEREOF, each of the Company and the Investor have caused this Agreement to be signed by their respective duly authorized officers as of the date first written above.

Vertex Pharmaceuticals Incorporated

Date: September 8, 2005

By: /s/ JOSHUA S. BOGER
Joshua S. Boger, Chief Executive Officer

ALEXANDRA GLOBAL MASTER FUND LTD.

By: ALEXANDRA INVESTMENT MANAGEMENT, LLC, as Investment Advisor

Date: September 8, 2005

By: /s/ MIKHAIL FILIMONOV
Mikhail Filimonov
Chairman and Chief Executive Officer

Exchange Agreement

This Exchange Agreement (this "Agreement"), dated as of September 8, 2005, is entered into between Vertex Pharmaceuticals Incorporated (the "**Company**") and Quattro Fund, Ltd., Quattro Multi-Strategy Master Fund, LP, Partners Group Alternative Strategies PCC Limited, Red Delta Cell and Institutional Benchmark Series (Master Feeder) Limited in Respect of Electra Series (collectively, "**Quattro**").

Recitals: 1. Quattro wishes to exchange a total of $5,311,000 par value of 5% Convertible Subordinated Notes due 2007 (the "**Notes**") issued by the Company. **2.** Quattro and the Company have agreed that it is in their mutual interest to exchange the Notes for shares of the common stock of the Company (the **"Stock"). 3.** In consideration of the premises and the agreements and representations contained herein, the parties hereto agree as follows:

A. Agreement to Exchange Securities

(1) Exchange of Securities. On the terms and subject to the conditions set forth herein, the Quattro agrees to transfer, or cause to be transferred, to the Company all of its right, title and interest in and to the Notes described in Section C(8) (the "**Exchange Notes**") in exchange for a number of shares of Stock (the "**Shares**") equal to (i) 99% of the principal amount of the Exchange Notes plus 100% of the accrued and unpaid interest on the Exchange Notes through and including the date hereof, divided by (ii) the Determination Price.

(2) Determination Price. The Determination Price shall be equal to 93% of the lesser of (i) the arithmetic average of the closing bid prices of the Common Stock for the 10 consecutive trading days ending on and including the date hereof, and (ii) the closing bid price of the Common Stock on the date hereof. "Trading day" shall mean any day on which the Common Stock is traded for any period on the Nasdaq National Market.

(3) Fractional Shares. In lieu of issuing fractional shares, the Company shall issue the highest whole number of Shares according to the formula set forth in Section 1.1(a) plus cash in an amount equal to the fraction of a Share to which the Quattro would otherwise be entitled multiplied by the Determination Price.

(4) Closing. The completion of the transactions contemplated by this Agreement (the "**Closing**") shall take place as soon as practical and, in any event, no later than September 9, 2005, or such other date as is agreed upon by the parties (the "**Closing Date**"), as follows:

(i) The Quattro shall deliver or cause to be delivered the Exchange Notes to the Company or the Company's agent in such manner as shall be acceptable to the Company and effective to convey all right, title and interest of the Quattro in the Exchange Notes to the Company against delivery of the Shares by the Company through the Depositary Trust Company to the broker accounts listed on Exhibit A. The Shares shall be issued to the Quattro entities pro rata based on the par value of the Notes exchanged by each such entity.

(ii) the Company shall pay the Quattro by wire transfer of immediately available funds an amount equal to the cash value of any fractional Share, determined in accordance with the provisions of Section A(3).

(5) the Company shall be entitled to deduct and withhold from this consideration such amount as may be required to be deducted and withheld with respect to the making of such payment under the Internal Revenue Code of 1986, as amended, or under any provision of state, local or foreign law.

B. Company Representations and Warranties.

The Company represents and warrants to Quattro that:

(1) upon issuance, the Shares are validly issued, fully paid, nonassessable and free and clear of any liens, encumbrances, pledges, security interests or other restrictions or claims of third parties, other than any of the foregoing created by Quattro;

(2) the Shares will not be registered at the time of their issuance under the Securities Act for the reason that the sale provided for in this Agreement is exempt pursuant to Section 3(a)(9) of the Securities Act (as defined below) and that the reliance of the Company on such exemption is predicated in part on Quattro's representations set forth herein;

(3) the issuance and delivery of the Shares to Quattro does not violate: (a) the Company's charter documents; (b) any agreement to which the Company is a party, including any indenture; or (c) any federal or state statute, rule or regulation applicable to it;

(4) the Company is duly organized and validly existing under the laws of the jurisdiction of its formation and has the requisite corporate power and authority to execute, deliver and perform its obligations under this Agreement;

(5) this Agreement has been duly executed and delivered by the Company and constitutes a valid and legally binding obligation, enforceable against it in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, fraudulent conveyance or transfer, moratorium or similar laws and court decisions affecting the enforcement of creditors' right generally or by equitable principles relating to enforceability (regardless of whether considered in a proceeding at law or in equity) and

(6) no representation or warranty contained herein or information appearing in any writing furnished to Quattro contains any untrue statement of a material fact or omits to state a material fact necessary to make the statements herein or therein not misleading.

C. Quattro Representations and Warranties.

Quattro, on behalf of each of the Quattro entities, represents and warrants:

(1) Each of the Quattro entities (a) is a limited partnership, corporation, partnership or limited liability company duly organized and validly existing under the laws of the jurisdiction of its formation and (b) has the requisite partnership corporate or limited liability company, as the case may be, power and authority to execute, deliver and perform its obligations under this Agreement.

(2) The execution, delivery and performance by it of this Agreement and the transactions contemplated hereby (a) have been duly authorized by all necessary partnership, corporate or limited liability company, as the case may be, action, of each Quattro entity, (b) do not contravene the terms of each of such entities

organizational documents, or any amendment thereof, and (c) do not violate, conflict with or result in any breach or contravention of, or the creation of any lien under any agreement to which any of the Quattro entities is a party; or (c) any federal or state statute, rule or regulation applicable to any of the Quattro entities.

(3) This Agreement has been duly executed and delivered by it and constitutes its valid and legally binding obligation, enforceable against each of the Quattro entities in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, fraudulent conveyance or transfer, moratorium or similar laws and court decisions affecting the enforcement of creditors' rights generally or by equitable principles relating to enforceability (regardless of whether considered in a proceeding at law or in equity).

(4) Each of the Quattro entities understands that the Shares will not be registered at the time of their issuance under the Securities Act for the reason that the sale provided for in this Agreement is exempt pursuant to Section 3(a)(9) of the Securities Act and that the reliance of the Company on such exemption is predicated in part on its representations set forth herein.

(5) Each of the Quattro entities believes that it has received all the information it considers necessary or appropriate for deciding whether to make an investment in the Shares. It has reviewed all of the Company's registration statements, proxy statement, periodic filings and other reports filed with the Securities and Exchange Commission, including the Company's Annual Report to Stockholder on Form 10-K for the year ended December 31, 2004, and the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2005.

(6) Each of the Quattro entities owns all right, title and interest in and to its Notes, free and clear of any liens, encumbrances, charges or other security interests and when transferred to the Company pursuant to the terms of this Agreement, the Company shall have valid title to the Notes free and clear of any liens, encumbrances, pledges, security interests or other restrictions or claims of third parties, other than any of the foregoing created by the Company. None of the Quattro entities used a broker, finder or financial advisor in connection with the transactions contemplated by this Agreement.

(7) Each of the Quattro entities, individually or collectively, is not an "affiliate" of the Company as defined in Rule 12b-2 under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

(8) The Quattro entities collectively hold the following Exchange Notes that were acquired before September 1, 2005 in the public market and are free of restrictive legend: $5,311,000 principal amount of Notes (CUSIP: 92532F AD 2).

(9) Each of the Quattro entities has had such opportunity as it has deemed adequate to obtain from representatives of the Company such information as is necessary to permit it to evaluate the merits and risks of an investment in the Shares.

(10) Each of the Quattro entities has sufficient experience in business, financial and investment matters to be able to evaluate the risks involved in the acquisition of the Shares issued in respect of the Exchange Notes and to make an informed investment decision with respect to such acquisition.

(11) On September 8, 2005, none of the Quattro entities (a) did or will, directly or indirectly, issue, offer, sell, agree to issue, offer or sell, solicit offers to purchase, grant any call option, warrant or other right to purchase, purchase any put option or other right to sell, pledge, borrow, assign or otherwise dispose of any Relevant Security (as defined below), and (b) did or will, directly or indirectly, establish or increase any "put equivalent position" or liquidate or decrease any "call equivalent position" with respect to any Relevant Security (in each case within the meaning of Section 16 of the Exchange Act, and the rules and regulations promulgated thereunder) with respect to any Relevant Security, or otherwise enter into any swap, derivative or other transaction or arrangement that transfers to another, in whole or in part, any economic consequence of ownership of a Relevant Security, whether or not such transaction is to be settled by delivery of Relevant Securities, other securities, cash or other consideration. As used herein, the term "Relevant Security" means the Stock, any other equity security of the Company and any security convertible into, or exercisable or exchangeable for, the Stock or any other such equity security.

D. Miscellaneous

(1) Exclusivity. For a period beginning on the Closing Date and extending for 30 days following the closing of the transaction, the Company shall not engage in any transaction or transactions that would result in the exchange of the Notes with an aggregate principal amount in excess of $40,450,000 (including the transaction set forth herein).

(2) Governing Law. This Agreement shall be governed by the laws of the State of New York without giving effect to the conflict of law rules contained therein.

(3) Further Assurances. Each party hereto shall properly execute and deliver such further agreements and instruments, and take such further actions, as the other party may reasonably request in order to carry out the purposes and intent of this Agreement.

(4) Notices. All notices, requests, demands and other communications hereunder shall be in writing and shall be deemed given if delivered personally, by facsimile transmission (with subsequent letter confirmation by mail), by overnight courier or two days after being mailed by certified or registered mail, postage prepaid, return receipt requested, to the parties, their successors in interest or their assignees at the following addresses, or at such other addresses as the parties may designate by written notice in the manner aforesaid:

If to Quattro:

Facsimile:

If to the Company:
Vertex Pharmaceuticals Incorporated
130 Waverly Street
Cambridge, Massachusetts 02139
Attention: The Office of General Counsel
Facsimile: 617-444-6483

(5) Assignability and Parties in Interest. This Agreement shall not be assignable by any of the parties hereto without the consent of the other party hereto. This Agreement shall inure to the benefit of and be binding upon the parties and their respective permitted successors and assigns.

(6) Counterparts. This Agreement may be executed in several counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

(7) Complete Agreement. This Agreement is an integrated agreement containing the entire agreement between the parties hereto with respect to the subject matter hereof and shall supersede all previous and all contemporaneous oral or written negotiations, commitments or understandings.

(8) Modifications, Amendments and Waiver. This Agreement may be modified, amended otherwise supplemented or terminated only by a writing signed by the party against whom it is sought to be enforced. No waiver of any right or power hereunder shall be deemed effective unless and until a writing waiving such right or power is executed by the party waiving such right or power.

(9) No Third Party Beneficiaries. There are no third party beneficiaries under this Agreement or intended by any party hereto.

(10) Expenses. Each party hereto shall bear its own costs and expenses, including, without limitation, attorneys' fees, incurred in connection with this Agreement and the transactions contemplated hereby.

(11) Contract Interpretation and Construction of Agreement. This Agreement is the joint drafting product of the Company and Quattro, and each provision has been subject to negotiation and agreement with the advice of counsel and shall not be construed for or against either party as the drafter thereof.

IN WITNESS WHEREOF, the parties have caused this Agreement to be duly executed as of the date hereof.

Quattro Fund Ltd. Quattro Multi Strategy Master Fund LP Partners Group Alternative Strategies, PCC Limited, Red Delta Cell Institutional Benchmark Services (Master Feeder) Limited in Respect of Electra Series)	Vertex Pharmaceuticals Incorporated
By: /s/ GREGG RIINA	By: /s/ JOSHUA S. BOGER
Name: Gregg Riina	Name: Joshua S. Boger
Title: Authorized Person	Title: Chief Executive Officer

Exhibit 10.4

September 8, 2005

Radcliffe SPC, Ltd. — Class A
Convertible Crossover Segregated Portfolio
c/o RG Capital Management, L.P.
3 Bala Plaza — East, Suite 501
Bala Cynwyd, PA 19004
Attention: Gerald Stahlecker, Managing Director

Re: Exchange of 5% Convertible Subordinated Notes of Vertex Pharmaceuticals, Incorporated.

Dear Steve:

The purpose of this letter agreement (this "Agreement") is to confirm the agreement of Vertex Pharmaceuticals Incorporated ("VRTX") and Radcliffe SPC, Ltd. for and on behalf of its Class A Convertible Crossover Segregated Portfolio (the "Fund") as follows:

1. Exchange of 5% Convertible Subordinated Notes.

(a) Exchange of Securities. On the terms and subject to the conditions set forth herein, the Fund agrees to transfer, or cause to be transferred, to VRTX all of its right, title and interest in and to the 5% Convertible Subordinated Notes due 2007 (the "Notes") described in Section 2(l) (the "Exchange Notes") in exchange for a number of shares (the "Exchanged Shares") of freely tradable VRTX Common Stock (the "Common Stock") equal to (i) 99% of the principal amount of the Exchange Notes plus 100% of the accrued and unpaid interest on the Exchange Notes through and including the date hereof, divided by (ii) the Determination Price.

(b) Determination Price. The Determination Price shall be equal to 93% of the lesser of (i) the arithmetic average of the closing bid prices of the Common Stock for the 10 consecutive trading days ending on and including the date hereof, and (ii) the closing bid price of the Common Stock on the date hereof. "Trading day" shall mean any day on which the Common Stock is traded for any period on the Nasdaq National Market.

(c) Fractional Shares. In lieu of issuing fractional shares, VRTX shall issue the highest whole number of Exchanged Shares according to the formula set forth in Section 1.1(a) plus cash in an amount equal to the fraction of an Exchanged Share to which the Fund would otherwise be entitled multiplied by the Determination Price.

(d) Closing. The completion of the transactions contemplated by this Agreement (the "Closing") shall take place as soon as practical and, in any event, no later than September 9, 2005, or such other date as is agreed upon by the parties (the "Closing Date"), as follows:

(i) The Fund shall deliver or cause to be delivered the Exchange Notes to VRTX or VRTX's agent in such manner as shall be acceptable to VRTX and effective to convey all right, title and interest of the Fund in the Exchange Notes to VRTX against delivery of

---

the Exchanged Shares by VRTX through the Depositary Trust Company to: Morgan Stanley & Co., DTC number: #050, FCC: RADCLIFFE SPC, LTD. for and on behalf of The Class A Convertible Crossover Segregated Portfolio, account number 038C6240.

(ii) VRTX shall pay the Fund by wire transfer of immediately available funds an amount equal to the cash value of any fractional Exchanged Share, determined in accordance with the provisions of Section 1(c).

2. Representations. As applicable, VRTX and the Fund hereby represent, warrant and agree as follows:

(a) Each of VRTX and the Fund acknowledges that the transaction contemplated hereby is intended to be exempt from registration by virtue of Section 3(a)(9) of the Securities Act of 1933, as amended (the "Securities Act"). Neither VRTX nor the Fund knows of any reason why such exemption is not available.

(b) The Fund has had such opportunity as it has deemed adequate to obtain from representatives of VRTX such information as is necessary to permit the Fund to evaluate the merits and risks of the transaction contemplated hereby.

(c) The Fund has sufficient experience in business, financial and investment matters to be able to evaluate the risks involved in the acquisition of the Common Stock issued in respect of the Exchange Notes and to make an informed investment decision with respect to such acquisition.

(d) The Fund is not in possession of any material, non-public information regarding VRTX. .

(e) The Fund has not acted on behalf of VRTX, nor has the Fund received any commission or remuneration from VRTX, nor was the Fund solicited by VRTX to effect this transaction, nor has the Fund solicited any other holder of the Notes to participate in this transaction.

(f) Each of VRTX and the Fund has obtained all regulatory approvals, if any, in connection with the transactions contemplated hereby.

(g) The Exchanged Shares will not be "restricted securities" within the meaning of Rule 144 under the Securities Act. The certificate(s) representing the shares of Common Stock will not bear a restrictive legend under the Securities Act.

(h) Each of VRTX and the Fund has full power and authority to enter into this Agreement and to consummate the transactions contemplated hereby, and the person who has executed this Agreement is duly authorized to do so and thereby bind the party on whose behalf he or she is purporting to sign.

(i) This Agreement is its valid and binding agreement, enforceable against each of VRTX and the Fund in accordance with its terms, subject to bankruptcy and similar laws and to equitable principles.

(j) The Fund is the sole legal and beneficial owner of the Exchange Notes, and, upon the Closing, VRTX will acquire the Exchange Notes free and clear of any liens, encumbrances, pledges, security interests or other restrictions or claims of third parties.

(k) The Fund is not an affiliate of VRTX.

(l) The Fund holds the following Exchange Notes that it is exchanging pursuant to this Agreement, which Exchanging Notes were acquired before September 1, 2005 in the public market and are free of restrictive legend: $6,592,000 principal amount of Notes (CUSIP: 92532F AD 2).

(m) On September 8, 2005 and prior to the publication of the press release describe in (n) below, if any, the Fund (a) did not and will not, directly or indirectly, issue, offer, sell, agree to issue, offer or sell, solicit offers to purchase, grant any call option, warrant or other right to purchase, purchase any put option or other right to sell, pledge, borrow, assign or otherwise dispose of any Relevant Security (as defined below), and (b) did not and will not, directly or indirectly, establish or increase any "put equivalent position" or liquidate or decrease any "call equivalent position" with respect to any Relevant Security (in each case within the meaning of Section 16 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the rules and regulations promulgated thereunder) with respect to any Relevant Security, or otherwise enter into any swap, derivative or other transaction or arrangement that transfers to another, in whole or in part, any economic consequence of ownership of a Relevant Security, whether or not such transaction is to be settled by delivery of Relevant Securities, other securities, cash or other consideration. As used herein, the term "Relevant Security" means the Common Stock, any other equity security of VRTX and any security convertible into, or exercisable or exchangeable for, the Common Stock or any other such equity security.

(n) To the extent VRTX considers the execution of this Agreement and the consummation of the transaction contemplated hereby shall constitute material, non-public information regarding VRTX, VRTX agrees to disseminate a press release to inform the public of the material aspects of this transaction by 9:30 am EST of the Closing Date.

3. Entire Agreement. This Agreement represents the entire understanding and agreement between the parties hereto with respect to the subject matter hereof and supersedes all prior oral and written and all contemporaneous oral negotiations, commitments and understandings between such parties. The parties may amend or modify this Agreement, in such manner as may be agreed upon, only by a written instrument executed by the parties hereto.

4. Expenses. Each party shall pay its own expenses in connection with this Agreement and the transactions contemplated hereby.

5. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of New York.

6. Severability. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement.

7. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, but all of which shall be one and the same document.

8. Further Assurances. Each party hereto shall properly execute and deliver such further agreements and instruments, and take such further actions, as the other party may reasonably request in order to carry out the purposes and intent of this Agreement.

9. Confidentiality. The parties hereto agree to keep confidential and to not disclose the terms, provisions, or existence of this Agreement, except as the parties reasonably believe such disclosure is required by applicable law, provided, however, that VRTX shall be entitled, without the prior approval of the Fund, to make any press release or other public disclosure with respect to such transactions as is

required by applicable law and regulations, including the Exchange Act and the rules and regulations promulgated thereunder, including the public filing of this Agreement (provided the Fund shall be consulted by VRTX in connection with any such press release or other public disclosure prior to its release and shall be provided with a copy thereof and provided further that VRTX shall not disclose the name of the Fund in any such press release without the prior written consent of the Fund).

10. Assignability and Parties in Interest. This Agreement shall not be assignable by any of the parties hereto without the consent of the other party hereto. This Agreement shall inure to the benefit of and be binding upon the parties and their respective permitted successors and assigns.

11. Notices. All notices, requests, demands and other communications hereunder shall be in writing and shall be deemed given if delivered personally, by facsimile transmission (with subsequent letter confirmation by mail), by overnight courier or two days after being mailed by certified or registered mail, postage prepaid, return receipt requested, to the parties, their successors in interest or their assignees at the following addresses, or at such other addresses as the parties may designate by written notice in the manner aforesaid:

If to the Fund:
Radcliffe SPC, Ltd. — Class A
Convertible Crossover Segregated Portfolio
c/o RG Capital Management, L.P.
3 Bala Plaza — East, Suite 501
Bala Cynwyd, PA 19004
Attention: Gerald Stahlecker, Managing Director

Facsimile: 610-617-0580

If to VRTX:
Vertex Pharmaceuticals Incorporated
130 Waverly Street
Cambridge, Massachusetts 02139
Attention: The Office of General Counsel
Facsimile: 617-444-6483

Please confirm your agreement by signing in the space indicated below.

Vertex Pharmaceuticas Incorporated

By: /s/ JOSHUA S. BOGER
Name: Joshua S. Boger
Title: Chief Executive Officer

Accepted and Agreed as of this 8th day
of September, 2005:

RADCLIFFE SPC, LTD. for and on behalf of The Class A
Convertible Crossover Segregated Portfolio

By: RG Capital Management, L.P., Investment Manager
By: RGC Management Company, LLC, its general partner

By: /s/ GERALD STAHLECKER
Name: Gerald Stahlecker
Title: Managing Director

Exhibit 31.1

Certification
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Joshua S. Boger, certify that:

1. I have reviewed this quarterly report of Vertex Pharmaceuticals 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 (the registrant's fourth fiscal quarter in the case of an annual report) 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 (or persons performing the equivalent functions):
   (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.

November 9, 2005

By: /s/ JOSHUA S. BOGER
Joshua S. Boger
Chairman, President and Chief Executive Officer

Exhibit 31.2

Certification
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Ian F. Smith, certify that:

1. I have reviewed this quarterly report of Vertex Pharmaceuticals 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 (the registrant's fourth fiscal quarter in the case of an annual report) 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 (or persons performing the equivalent functions):
   (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.

November 9, 2005

By: /s/ IAN F. SMITH
Ian F. Smith
Senior Vice President and Chief Financial Officer

Exhibit 32.1

Certification
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(Subsections (a) and (b) of Section 1350,
Chapter 63 of Title 18, United States Code)

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), each of the undersigned officers of Vertex Pharmaceuticals Incorporated, a Massachusetts corporation (the "Company"), does hereby certify, to such officer's knowledge, that the Quarterly Report on Form 10-Q for the quarter ended September 30, 2005 (the "Form 10-Q") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 9, 2005

/s/ JOSHUA S. BOGER
Joshua S. Boger
Chairman, President and Chief Executive Officer
(principal executive officer)

Dated: November 9, 2005

/s/ IAN F. SMITH
Ian F. Smith
Senior Vice President and Chief Financial Officer
(principal financial officer)