

Harbor BioSciences, Inc.
Form 10-Q
November 12, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2010

OR

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: 001-34584

HARBOR BIOSCIENCES, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: Harbor BioSciences, Inc. - Form 10-Q

Delaware
(State or other jurisdiction)

of incorporation)

9171 Towne Centre Drive, Suite 180, San Diego, California
(Address of principal executive offices)

Registrant's telephone number, including area code: (858) 587-9333

13-3697002
(I.R.S. Employer

Identification No.)

92122
(zip code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

As of November 10, 2010 there were 35,465,838 shares of registrant's Common Stock, \$.01 par value, outstanding.

Table of Contents

HARBOR BIOSCIENCES, INC.

Form 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2010

INDEX

	Page
PART I	
<u>Financial Information</u>	
Item 1 <u>Financial Statements (Unaudited)</u>	3
Item 2 <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	9
Item 3 <u>Quantitative and Qualitative Disclosures about Market Risk</u>	11
Item 4 <u>Controls and Procedures</u>	12
PART II	
<u>Other Information</u>	
Item 1 <u>Legal Proceedings</u>	12
Item 1A <u>Risk Factors</u>	13
Item 1B <u>Unresolved Staff Comments</u>	22
Item 2 <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	22
Item 3 <u>Defaults Upon Senior Securities</u>	22
Item 4 <u>Reserved</u>	22
Item 5 <u>Other Information</u>	22
Item 6 <u>Exhibits</u>	22

Table of Contents**Part I. Financial Information****Item 1. Financial Statements
Harbor BioSciences, Inc.****(A Development Stage Company)****Balance Sheets**

All numbers in thousands (except par value)	Sept. 30, 2010 (Unaudited)	Dec. 31, 2009*
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 6,924	\$ 9,738
Prepaid expenses	146	209
Other receivable		81
Deposits	27	48
Total current assets	7,097	10,076
Property and equipment, net of accumulated depreciation of \$291 and \$906, respectively	74	176
Restricted Cash		34
Total assets	\$ 7,171	\$ 10,286
LIABILITIES AND STOCKHOLDERS EQUITY:		
Current liabilities:		
Accounts payable	375	136
Accrued expenses	1,059	1,150
Total current liabilities	1,434	1,286
Commitments and contingencies		
Stockholders equity:		
Preferred stock, \$.01 par value, 10,000 shares authorized; no shares issued or outstanding		
Common stock, \$.01 par value, 100,000 shares authorized; 35,525 and 29,493 shares issued; 35,466 and 29,433 shares outstanding, respectively	355	294
Paid-in capital	263,214	260,884
Cost of treasury stock (59 shares)	(346)	(346)
Deficit accumulated during development stage	(257,486)	(251,832)
Total stockholders equity	5,737	9,000
Total liabilities and stockholders equity	\$ 7,171	\$ 10,286

* Derived from the audited financial statements as of December 31, 2009
The accompanying notes are an integral part of these financial statements.

Table of Contents**Harbor BioSciences, Inc.****(A Development Stage Company)****Statements of Operations****(Unaudited)**

All numbers in thousands, except per share amounts

	Three Months ended Sept. 30,		Nine Months ended Sept. 30,		Period from
	2010	2009	2010	2009	Inception (Aug.15,1994) to Sept. 30, 2010
Revenue:					
Contract R&D revenue	\$	\$	\$	\$	\$ 1,208
Total revenue					1,208
Operating expenses:					
Research and development:					
R&D operating expenses	874	2,411	3,216	8,260	164,360
R&D costs related to common stock, stock option grants including collaborations and technology purchases	60	167	302	469	10,411
Total research and development	934	2,578	3,518	8,729	174,771
General and administrative:					
G&A operating expenses	624	744	1,837	3,740	70,911
G&A costs related to common stock, stock option & warrant grants	39	103	257	605	19,100
Total general and administrative	663	847	2,094	4,345	90,011
Settlement of dispute					3,000
Total operating expenses	1,597	3,425	5,612	13,074	267,782
Other income (expense):					
Loss on disposal of assets	(49)	(12)	(55)	(19)	(272)
Non-cash amortization of deemed discount and deferred issuance costs on convertible debentures					(7,627)
Interest income	4	24	13	135	17,375
Interest expense					(388)
Total other income / (expense), net	(45)	12	(42)	116	9,088
Net loss	\$ (1,642)	\$ (3,413)	\$ (5,654)	\$ (12,958)	\$ (257,486)

Edgar Filing: Harbor BioSciences, Inc. - Form 10-Q

Net loss per share-basic and diluted	\$ (0.05)	\$ (0.12)	\$ (0.18)	\$ (0.44)
Weighted average number of common shares outstanding-basic and diluted	35,459	29,389	31,915	29,288

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

Table of Contents**Harbor BioSciences, Inc. (A Development Stage Company)****Statements of Cash Flows (Unaudited)**

All numbers in thousands

	Nine Months ended September 30,		Period from Inception (Aug. 15, 1994) to Sept. 30, 2010
	2010	2009	
Cash flows from operating activities:			
Net loss	\$ (5,654)	\$ (12,958)	\$ (257,486)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	20	186	2,244
Loss on disposal of assets	55	39	286
Compensation expense related to equity awards	559	1,074	11,217
Amortization of deemed discount on convertible debentures			6,470
Amortization of deferred issuance cost			1,157
Common stock issued for the company 401k plan	44	78	1,550
Common stock and options issued as consideration			
for license fees, milestone payments, interest, note repayment,			
services and amendments to license / finance agreements			2,926
Expense related to warrants issued as consideration to consultants			4,369
Expense related to warrants issued to a director for successful closure of merger			570
Expense related to stock options issued			5,718
Expense related to common stock issued for the purchase of technology			1,848
Common stock issued as consideration for In Process R&D			2,809
Deferred compensation expense related to options issued			1,210
Changes in assets and liabilities:			
Prepaid expenses	63	(135)	(147)
Deposits	21	7	(28)
Other receivables	81	(19)	
Accounts payable	239	(18)	374
Accrued expenses	(91)	(302)	1,706
Net cash used in operating activities	(4,663)	(12,048)	(213,207)
Cash flows provided by (used in) investing activities:			
Proceeds from sale of property and equipment	26		223
Purchase of property and equipment		(5)	(2,827)
Net cash provided by (used in) investing activities	26	(5)	(2,604)
Cash flows from financing activities:			
Contributions from stockholder			104
Restricted cash	34		
Net proceeds from sale of preferred stock			4,000
Net proceeds from sale of common stock	1,789		185,323
Net proceeds from issuance of convertible debentures and warrants			9,214

Edgar Filing: Harbor BioSciences, Inc. - Form 10-Q

Purchase of treasury stock				(346)
Proceeds from issuance of debt				371
Net proceeds from recapitalization				6,271
Net proceeds from warrants and options exercised				17,796
Net cash from financing activities	1,823			222,733
Net increase (decrease) in cash	(2,814)	(12,053)		6,922
Cash and equivalents at beginning of period	9,738	24,152		
Cash and equivalents at end of period	\$ 6,924	\$ 12,099	\$	6,922

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

Table of Contents**Harbor BioSciences, Inc. (A Development Stage Company)****Statements of Cash Flows (Continued)****(Unaudited)**

All numbers in thousands	Nine Months ended Sept. 30,		Period from Inception (Aug. 15, 1994) to Sept. 30, 2010
	2010	2009	
Supplemental Disclosure of Cash Flow Information:			
Interest paid	\$	\$	\$ 388
Supplemental Disclosure of Non-Cash Financing Activities:			
Conversion of debt to equity			10,371
Warrants issued to consultants in lieu of cash, no vesting			559
Warrants issued in lieu of cash, commissions on private placement			733
Warrants issued in connection with convertible debentures			371

Harbor BioSciences, Inc.**(A Development Stage Company)****Notes to Financial Statements****(Unaudited)****1. Basis of Presentation**

The information at September 30, 2010, and for the three-month and nine-month periods ended September 30, 2010 and 2009, and inception to date is unaudited. In the opinion of management, these financial statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. These financial statements should be read in conjunction with the Harbor BioSciences, Inc. (Harbor BioSciences , we or the Company) Annual Report on Form 10-K, for the year ended December 31, 2009, which was filed with the United States Securities and Exchange Commission on March 30, 2010.

Accrued Expenses

Accrued expenses as of September 30, 2010 include approximately \$0.3 million in accrued vacation expense and \$0.8 million in other research and development and general and administrative expenses.

Accrued expenses as of December 31, 2009 include approximately \$0.3 million in accrued vacation expense and \$0.9 million in other research and development and general and administrative expenses.

2. Other Agreements and Commitments*Study Funding Agreement*

The Company had a Study Funding Agreement with Cystic Fibrosis Foundation Therapeutics, Inc. (CFFT). The agreement committed CFFT to provide a total of \$1.7 million to be paid in seven tranches based on the Company s completion of certain agreed-upon events. The agreement

Edgar Filing: Harbor BioSciences, Inc. - Form 10-Q

also contained a provision indicating that upon termination of this agreement by either party, CFPT shall pay the Company for all work performed through the date of termination, plus reasonable costs of bringing the study to an orderly close.

Table of Contents

In return for this funding, the Company has agreed to pay CFFT a minimum royalty on sales of a specified compound over a specified period following regulatory approval in the United States. Additional compensation is due to CFFT if net sales of this compound exceed a specified amount over a period of time.

Revenue was recognized under this agreement on a milestone completion basis for each distinct agreed-upon event. A total of \$1.2 million was paid upon completing agreed upon events.

This agreement expired December 31, 2009.

3. Equity Transactions

In June 2010, the Company raised approximately \$2.06 in gross proceeds from the sale of approximately 5.9 million shares of its common stock and warrants to purchase approximately 3.5 million shares of its common stock. The shares of common stock and warrants to purchase common stock were sold in units, with each unit consisting of one share of common stock and a warrant to purchase 0.6 of a share of common stock. The purchase price per unit is \$0.35. The exercise price of the warrants is \$0.50 per share.

Options to purchase 974,000 shares of common stock were granted in the nine-month period ended September 30, 2010, of which, options for a total of 112,000 shares were to former employees. No options were granted in the three-months ended September 30, 2010. Of these granted options, 543,000 vested immediately and the remaining 404,000 vest over two years. There were no options to purchase shares of common stock exercised in the three-month and nine-month periods ended September 30, 2010. The Company accounts for stock option grants in accordance with ASC Topic 718, Share-Based Payment. Compensation costs related to share-based payments recognized in the Statements of Income were approximately \$0.1 million and \$0.6 million for the three-month and nine-month periods ended September 30, 2010, respectively and \$0.3 million and \$1.1 million for the same periods in 2009. The Company may from time to time extend previous option grants.

4. Fair Value Measurement

We adopted ASC Subtopic 820-10 as of January 1, 2008, for financial instruments measured at fair value on a recurring basis. ASC Topic 820 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP and expands disclosures about fair value measurements.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). These tiers include:

Level 1, defined as observable inputs such as quoted prices for identical instruments in active markets;

Level 2, defined as inputs other than quoted prices in active markets that are directly or indirectly observable such as quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active; and

Table of Contents

Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions, such as valuations derived from valuation techniques in which one or more significant value drivers are observable. We measure certain financial instruments at fair value on a recurring basis. Financial assets measured at fair value on a recurring basis are as follows at September 30, 2010:

	Level 1	Level 2	Level 3	Total
	In Thousands			
Money Market funds included in cash and cash equivalents	\$ 4,403	\$ 0	\$ 0	\$ 4,403
Total	\$ 4,403	\$ 0	\$ 0	\$ 4,403

5. Other Matters

From time to time, we may be involved in litigation relating to claims arising out of our operations in the normal course of business. While it is not possible to predict accurately or to determine the eventual outcome of these matters, as of the date of this report, we do not believe that we are engaged in any legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on our business, financial condition or operating results.

The Company's common stock was delisted from the NASDAQ Stock Market at the opening of business on September 23, 2010. The Company's shares now trade on the OTC Bulletin Board (OTCBB). The Company expects that its common stock will continue to trade on the OTCBB so long as market makers demonstrate an interest in trading the common stock. The Company will continue to file periodic reports with the SEC pursuant to the requirements of Section 12(g) of the Securities Exchange Act of 1934, as amended.

In November 2010, we received notice from the U.S. Internal Revenue Service (IRS) that the company had been awarded approximately \$489,000 in grants under the Qualifying Therapeutic Discovery Project Program. This program was created under the Patient Protection and Affordable Care Act of 2010 to provide tax credits or grants representing up to 50 percent of eligible qualified investments in therapeutic discovery projects during tax years 2009 and 2010.

After a determination by U.S. Department of Health and Human Services that Apoptone and Triolex projects met the definition of a qualifying therapeutic discovery project, the IRS certified the qualifying investment and approved the award amount of approximately \$244,479 per project. The qualified investments represent 2009 research and development expenses; there are no future performance obligations related to these grants.

The Company has evaluated all subsequent events through November 12, 2010, which represents the filing date of this Form 10-Q with the Securities and Exchange Commission, to ensure that this Form 10-Q includes appropriate disclosure of events both recognized in the financial statements as of September 30, 2010 and events which occurred subsequent to September 30, 2010 but were not recognized in the financial statements. As of November 12, 2010, there was one subsequent events that required recognition or disclosure noted above.

Table of Contents

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

The following discussion and analysis should be read in conjunction with the financial statements and notes included elsewhere in this report. The following discussion and analysis contains forward-looking statements that involve risks and uncertainties. This discussion represents our current judgment on the future direction of our business and our actual results may differ materially from those discussed here due to risks and factors including the timing, success and cost of preclinical research and clinical studies, the timing, acceptability and review periods for regulatory filings, the ability to obtain regulatory approval of products, our ability to obtain additional funding and the development of competitive products by others as well as the risks and factors set forth below under the caption Risk Factors. Additional factors that could cause or contribute to such differences can be found in the financial statements and the related Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2009.

Overview

Harbor BioSciences, Inc. (Harbor BioSciences), a clinical-stage pharmaceutical company, is engaged in the discovery and development of products for the treatment of diseases related to aging. Our current development efforts are primarily focused on a series of steroid hormone analogs that are derived from the human adrenal metabolome.

We are currently focused on the development of two clinical drug development candidates APOPTONE® (HE3235), a compound in a Phase I/IIa clinical trial for late-stage prostate cancer and TRIOLEX® (HE3286), a compound which recently completed early Phase II clinical trials for the treatment of type 2 diabetes mellitus.

Drawn from our unique and proprietary platform, our research program has identified additional lead candidates active in preclinical models of cancer, metabolic conditions, autoimmune conditions, lung inflammation, bone degeneration and organ regeneration.

We have been unprofitable since our inception in August 1994. As of September 30, 2010, we had an accumulated deficit of approximately \$257.5 million. We expect to incur substantial additional operating losses and capital expenditures for the foreseeable future on clinical testing and other activities in support of the development of our drug candidates. In addition, in the future, we may have to meet the substantial new challenge of developing the capability to market products if we are successful in obtaining regulatory approval for any of our current or future drug candidates. Accordingly, our activities to date are not as broad in depth or scope as the activities we may undertake in the future, and our historical operations and financial information are not indicative of the future operating results or financial condition or ability to operate profitably as a commercial enterprise when and if we succeed in bringing any drug candidates to market.

Results of Operations

We have devoted substantially all of our resources to the payment of research and development expenses and general and administrative expenses. From inception through September 30, 2010, we have incurred approximately \$174.8 million in research and development expenses, \$90.0 million in general and administrative expenses, and \$3.0 million in the settlement of a dispute. From inception through September 30, 2010, we have generated approximately \$1.2 million in revenues (which resulted from providing research and development services under our Study Funding Agreement with CFFT). We have earned \$9.1 million in net, other income, as our \$17.4 million of interest income has been partly offset by \$7.6 million in deemed discount expense, \$0.4 million in interest expense and \$0.3 million loss on disposal of assets. The combination of these resulted in a net loss of \$257.5 million for the period from inception until September 30, 2010.

Table of Contents

Research and development expenses were \$0.9 million and \$3.5 million for the three-month and nine-month periods ended September 30, 2010, respectively, compared to \$2.6 million and \$8.7 million for the same periods in 2009. The research and development expenses relate primarily to the ongoing development, preclinical testing and clinical trials for our drug candidates. Research and development expenses decreased by \$1.7 million and \$5.2 million for the three-month and nine-month periods ended September 30, 2010, respectively, compared to 2009. The decrease was primarily due to a reduction in personnel, facilities, closure of our laboratories, a substantial reduction in preclinical research and completion of our clinical study of TRIOLEX (HE3286) in inflamed, obese, insulin resistant type 2 diabetic patients.

General and administrative expenses were \$0.7 million and \$2.1 million for the three-month and nine-month periods ended September 30, 2010, respectively, and \$0.8 million and \$4.3 million for the same periods in 2009. General and administrative expenses relate primarily to salaries and benefits, facilities, legal, accounting/auditing, investor relations, consultants, insurance and travel. General and administrative expenses decreased by \$0.1 million for the three-month period and \$2.2 million for the nine-month periods ended September 30, 2010, respectively, compared to the same periods in 2009. The decrease was due mainly to a decrease in salaries expense resulting from reduced personnel, legal expenses, facilities, investor communications and stock option compensation expense.

Other income (loss), net was approximately \$(45,000) and \$(42,000) for the three-month and nine-month periods ended September 30, 2010, respectively, compared to \$12,000 and \$116,000 for the same periods in 2009. The decrease was due to lower interest income due to lower interest rates and cash balances and the loss on disposal of assets.

Please refer to critical accounting policies included in the Form 10-K filed on March 30, 2010.

Liquidity and Capital Resources

A summary of our current contractual obligations as of September 30, 2010 is as follows (in thousands):

Contractual Obligations	Total	Payments Due by Period			
		Less than one year	One to three years	Three to five years	More than five years
Operating Leases	\$ 136	\$ 136	\$	\$	\$

We may also be required to make substantial milestone or royalty payments in cash based on the terms of some of our agreements.

Our operations to date have consumed substantial capital without generating any revenues other than the amount received under the CFFT collaboration. We will continue to require substantial and increasing amounts of funds to conduct necessary research and development and preclinical and clinical testing of our drug candidates, and to market any drug candidates that receive regulatory approval. We do not expect to generate revenue from operations for the foreseeable future, and our ability to meet our cash obligations as they become due and payable may depend for at least the next several years on our ability to sell securities, borrow funds or some combination thereof. Based upon our current plans, we believe that our existing capital resources, together with interest thereon, will be sufficient to meet our operating expenses and capital requirements into the first half of 2011. However, changes in our research and development plans or other events affecting our operating expenses may result in the expenditure of such cash before that time. As of September 30, 2010, our cash and cash equivalents totaled approximately \$6.9 million.

Table of Contents

Our common stock was recently de-listed from the NASDAQ stock market. Our common stock is now traded on the OTC Bulletin Board, an inter-dealer quotation system that provides significantly less liquidity than the NASDAQ stock market or any other national securities exchange, which may make it more difficult to raise capital. In addition, trading in our common stock has historically been extremely limited. Because of the thinness of the market for our stock, the price of our common stock may be subject to manipulation. This limited trading may adversely affect the liquidity of our common stock, not only in terms of the number of shares that can be bought and sold at a given price, but also through delays in the timing of transactions and reduction in security analysts' and the media's coverage of us. As a result, there could be a larger spread between the bid and the ask prices of our common stock and you may not be able to sell shares of our common stock when or at prices you desire.

We expect that it will be very difficult to raise capital to continue our operations and our independent registered public accounting firm has issued an opinion with an explanatory paragraph to the effect that there is substantial doubt about our ability to continue as a going concern. We do not believe that we could succeed in raising additional capital needed to sustain our operations without some strategic transaction, such as a partnership or merger. If we are unable to consummate such a transaction, we expect that we would need to cease all operations and wind down. Although we are currently evaluating our strategic alternatives with respect to all aspects of our business, we cannot assure you that any actions that we take would raise or generate sufficient capital to fully address the uncertainties of our financial position. As a result, we may be unable to realize value from our assets and discharge our liabilities in the normal course of business. If we are unable to settle our obligations to our creditors or if we are unable to consummate a strategic transaction, we would likely need to liquidate the Company in a voluntary dissolution under Delaware law or seek protection under the provisions of the U.S. Bankruptcy Code. In that event, we, or a trustee appointed by the court, may be required to liquidate our assets. In either of these events, we might realize significantly less from our assets than the values at which they are carried on our financial statements. The funds resulting from the liquidation of our assets would be used first to satisfy obligations to creditors before any funds would be available to pay our stockholders, and any shortfall in the proceeds would directly reduce the amounts available for distribution, if any, to our creditors and to our stockholders. In the event we are required to liquidate under Delaware law or the federal bankruptcy laws, it is highly unlikely that stockholders would receive any value for their shares.

Cautionary Statement Regarding Forward-Looking Statements

This quarterly report on Form 10-Q contains forward-looking statements that are based on our management's beliefs and assumptions and on information currently available to our management. Forward-looking statements include information concerning our possible or assumed future results of operations, business strategies, financing plans, competitive position, industry environment, potential growth opportunities, the effects of future regulation and the effects of competition. Forward-looking statements include all statements that are not historical facts and can be identified by terms such as anticipates, believes, could, estimates, expects, intends, may, plans, potential, predicts, projects, or similar expressions.

Forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. We discuss these risks in greater detail in the Risk Factors section below and in our other filings with the Securities and Exchange Commission, including our annual report on Form 10-K for the year ended December 31, 2009. Given these uncertainties, you should not place undue reliance on these forward-looking statements.

Also, forward-looking statements represent our management's beliefs and assumptions only as of the date of this quarterly report on Form 10-Q. Our actual future results may be materially different from what we expect. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes to our investment portfolio from December 31, 2009 to the present. At September 30, 2010, our investment portfolio included only cash and money market accounts and did not contain fixed-income securities. There would be no material impact to our investment portfolio, in the short term, associated with any change in interest rates, and any decline in interest rates over time will reduce our interest income, while increases in interest rates over time will increase our interest income.

Table of Contents

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on the evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)) required by Rule 13a-15(b) of the Exchange Act, James M. Frincke, our chief executive officer, and Robert W. Weber, our chief financial officer, have concluded that, as of September 30, 2010, our disclosure controls and procedures were effective to ensure that the information required in the reports we file under the Exchange Act is gathered, reported-up, analyzed and disclosed with adequate timeliness, accuracy and completeness.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal controls over financial reporting during the period covered by this report, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports we file with or submit to the SEC under the Securities and Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer as appropriate, to allow for timely decisions regarding required disclosure. Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. The size of our company makes full segregation of duties difficult. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Accordingly, our disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the objectives of our disclosure control system are met, and, as set forth above, our chief executive officer and chief financial officer have concluded, based on their evaluation, that our disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance that the objectives of our disclosure control system were met.

PART II Other Information

Item 1. Legal Proceedings

From time to time, we may be involved in litigation relating to claims arising out of our operations in the normal course of business. While it is impossible to predict accurately or to determine the eventual outcome of these matters, as of the date of this report, we do not believe that we are engaged in any legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on our business, financial condition or operating results.

Table of Contents

Item 1A. Risk Factors

In evaluating our business, you should consider the following discussion of risks, in addition to other information contained in this report as well as our other public filings with the Securities and Exchange Commission. The description of risks below includes certain revisions to, and supersedes in its entirety, the description of the risk factors associated with our business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 and our subsequent filings with the Securities and Exchange Commission. Any of the following risks could materially adversely affect our business, financial condition, results of operations and prospects and, as a result, the market price of our common stock could decline, and you may lose all or part of the money you paid to buy our common stock.

We are still a development stage company.

We have never had any revenues from sales of products. None of our drug candidates has been approved for commercial sale and we do not expect that any of our present or future drug candidates will be commercially available for a number of years, if at all. We have incurred losses since our inception and we expect to continue to incur significant additional operating losses for the foreseeable future as we fund clinical trials and other expenses in support of regulatory approval of our drug candidates.

If we do not obtain government regulatory approval for our products, we cannot sell our products and we will not generate revenues.

Our principal development efforts are currently centered around a proprietary class of small compounds that we believe shows promise for the treatment of several diseases and disorders. However, all drug candidates require approval by the U.S. Food and Drug Administration (FDA) before they can be commercialized in the United States as well as approval by various foreign government agencies before they can be commercialized in other countries. These regulations change from time to time and new regulations may be adopted. While limited clinical trials of our drug candidates have been conducted to date, significant additional trials are required, and we may not be able to demonstrate that our drug candidates are safe or effective. In addition, success in early development does not mean that later development will be successful because, for example, drug candidates in later-stage clinical trials may fail to demonstrate sufficient safety and efficacy despite having progressed through initial clinical testing. Our clinical experience with our drug candidates is limited, and to date our drug candidates have been tested in less than the number of patients that will likely need to be studied to gain regulatory approval. The data collected from clinical trials with larger patient populations may not demonstrate sufficient safety and efficacy to support regulatory approval of these drug candidates. In addition, we do not know whether early results from any of our ongoing clinical trials will be predictive of final results of any such trial. If we are unable to demonstrate the safety and effectiveness of a particular drug candidate to the satisfaction of regulatory authorities, the drug candidate will not obtain required government approval and we will experience potentially significant delays in, or be required to abandon, development of the drug candidate. If we do not receive FDA or foreign approvals for our drug candidates, we will not be able to sell products and will not generate revenues. If we receive regulatory approval of one of our drug candidates, such approval may impose limitations on the indicated uses for which we may market the resulting product, which may limit our ability to generate significant revenues. Further, U.S. or foreign regulatory agencies could change existing, or promulgate new, regulations at any time, which may affect our ability to obtain approval of our drug candidates or require significant additional costs to obtain such approvals. In addition, if regulatory authorities determine that we or a partner conducting research and development activities on our behalf have not complied with regulations in the research and development of one of our drug candidates, then they may not approve the drug candidate and we will not be able to market and sell it. If we were unable to market and sell our drug candidates, our business and results of operations would be materially and adversely affected.

Table of Contents

Recent publicity concerning the safety of certain drug products has resulted in heightened scrutiny by the FDA in the process of approving new drugs, which could delay or limit any regulatory approvals we may obtain for our drug candidates.

In light of widely publicized events concerning the safety risk of certain drug products, the FDA, members of Congress, the Government Accountability Office, medical professionals and the general public have raised concerns about potential drug safety issues. These events have resulted in the withdrawal of drug products, revisions to drug labeling that further limit use of the drug products and establishment of risk management programs that may, for instance, restrict distribution of drug products after approval. In addition, the Food and Drug Administration Amendments Act of 2007, or FDAAA, grants significant expanded authority to the FDA, much of which is aimed at improving the safety of drug products before and after approval. In particular, the new law authorizes the FDA to, among other things, require post-approval studies and clinical trials, mandate changes to drug labeling to reflect new safety information and require risk evaluation and mitigation strategies for certain drugs, including certain currently approved drugs. It also significantly expands the federal government's clinical trial registry and results databank, which we expect will result in significantly increased government oversight of clinical trials. Under the FDAAA, companies that violate these and other provisions of the new law are subject to substantial civil monetary penalties, among other regulatory, civil and criminal penalties. The increased attention to drug safety issues may result in a more cautious approach by the FDA in its review of data from our clinical trials. Data from clinical trials may receive greater scrutiny, particularly with respect to safety, which may make the FDA or other regulatory authorities more likely to require additional preclinical studies or clinical trials by drug development companies. As a result, the FDA may require us to conduct additional preclinical studies or clinical trials during the clinical development of one or more of our drug candidates as a condition precedent to approval which could potentially delay our development plans, limit the indications for which our drug candidates are ultimately approved, and otherwise adversely impact us.

If we do not successfully commercialize our products, we may never achieve profitability.

We have experienced significant operating losses to date because of the substantial expenses we have incurred to acquire and fund development of our drug candidates. We have never had significant operating revenues and have never commercially introduced a product. Our accumulated deficit was approximately \$257.5 million as of September 30, 2010. Our net losses for fiscal years 2009, 2008 and 2007 were approximately \$15.6 million, \$21.6 million and \$23.1 million, respectively. Many of our research and development programs are at an early stage. Potential drug candidates are subject to inherent risks of failure. These risks include the possibilities that no drug candidate will be found safe or effective, meet applicable regulatory standards or receive the necessary regulatory clearances. Even if we were ultimately to receive regulatory approval for one or more of our drug candidates, we may be unable to commercialize them successfully for a variety of reasons. These include, for example, the availability of alternative treatments, lack of cost effectiveness, the cost of manufacturing the product on a commercial scale, the effect of competition with other drugs, or because we may have inadequate financial or other resources to pursue one or more of our drug candidates through commercialization. If we are unable to develop safe, commercially viable drugs, we may never achieve profitability. If we become profitable, we may not remain profitable.

As a result of our intensely competitive industry, we may not gain enough market share to be profitable.

The biotechnology and pharmaceutical industries are intensely competitive. We have numerous competitors in the U.S. and elsewhere. Because we are pursuing potentially large markets, our competitors include major multinational pharmaceutical companies, specialized biotechnology firms as well as academic institutions, government agencies and private and public research institutions. Several of these entities have already successfully marketed and commercialized products that will compete with our drug candidates, assuming that our drug candidates gain regulatory approval. A large number of companies including Merck & Company, Inc., GlaxoSmithKline, Takeda Pharmaceuticals, Amylin Pharmaceuticals, Inc., AstraZeneca, Novartis, Novo Nordisk, Pfizer Inc., Sanofi-Aventis and Eli Lilly and Co. are developing and marketing new drugs for the treatment of type 2 diabetes. Similarly, a large number of companies, including Merck & Company, Inc., Pfizer Inc., Johnson & Johnson Inc. and Amgen Inc., are developing and marketing new drugs for the treatment of chronic inflammatory conditions. In addition, there are also a number of other companies with drug candidates in development targeting late-stage prostate cancer, including compounds already in Phase 3 clinical trials. One or more such compounds may be approved before any of our drug candidates could potentially be approved. Many, if not all, of these competing drug development programs are being conducted by pharmaceutical and biotechnology companies with considerably greater financial resources, human resources and experience than ours.

Table of Contents

Many of these competitors have greater financial and other resources, larger research and development staffs and more effective marketing and manufacturing organizations than we do. In addition, academic and government institutions have become increasingly aware of the commercial value of their research findings. These institutions are now more likely to enter into exclusive licensing agreements with commercial enterprises, including our competitors, to develop and market commercial products.

Our competitors may succeed in developing or licensing technologies and drugs that are more effective or less costly than any we are developing. Our competitors may succeed in obtaining FDA or other regulatory approvals for drug candidates before we do. If competing drug candidates prove to be more effective or less costly or better-marketed than our drug candidates, our drug candidates, even if approved for sale, may not be able to compete successfully with our competitors' existing products or new products under development. Similarly, we cannot predict whether any of our drug candidates, if approved, will have sufficient advantages to cause healthcare professionals to adopt our products over competing products. If we are unable to compete successfully, we may never be able to sell enough products at a price sufficient to permit us to generate profits.

We need to raise additional money before we achieve profitability; if we fail to raise additional money, it could be difficult or impossible to continue our business.

As of September 30, 2010, our cash and cash equivalents totaled approximately \$6.9 million. Based on our current plans, we believe these financial resources, and interest earned thereon, will be sufficient to meet our operating expenses and capital requirements into the first half of 2011. However, changes in our research and development plans or other events affecting our operating expenses may result in the expenditure of such cash before that time. We will require substantial additional funds in order to finance our drug discovery and development programs, fund operating expenses, pursue regulatory clearances, develop manufacturing, marketing and sales capabilities, and prosecute and defend our intellectual property rights. We may seek additional funding through public or private financing or through collaborative arrangements with strategic partners.

You should be aware that in the future:

we may not obtain additional financial resources when necessary or on terms favorable to us, if at all; and

any available additional financing may not be adequate.

If we cannot raise additional funds when needed, or on acceptable terms, we will not be able to continue to develop our drug candidates.

Our common stock has a very limited trading market

Our common stock was recently de-listed from the NASDAQ stock market. Our common stock is now traded on the OTC Bulletin Board, an inter-dealer quotation system that provides significantly less liquidity than the NASDAQ stock market or any other national securities exchange. In addition, trading in our common stock has historically been extremely limited. Because of the thinness of the market for our stock, the price of our common stock may be subject to manipulation. This limited trading may adversely affect the liquidity of our common stock, not only in terms of the number of shares that can be bought and sold at a given price, but also through delays in the timing of transactions and reduction in security analysts' and the media's coverage of us. As a result, there could be a larger spread between the bid and the ask prices of our common stock and you may not be able to sell shares of our common stock when or at prices you desire.

Table of Contents

Substantial sales of our stock may impact the market price of our common stock.

As evidenced by the completion of our recent registered direct offering, future sales of substantial amounts of our common stock, including shares that we may issue upon exercise of options and warrants or conversion of convertible securities, could adversely affect the market price of our common stock. Further, if we raise additional funds through the issuance of common stock or securities convertible into or exercisable for common stock, the percentage ownership of our stockholders will be reduced and the price of our common stock may fall.

Issuing preferred stock with rights senior to those of our common stock could adversely affect holders of common stock.

Our charter documents give our board of directors the authority to issue shares of preferred stock without a vote or action by our stockholders. The board also has the authority to determine the terms of preferred stock, including price, preferences and voting rights. The rights granted to holders of preferred stock may adversely affect the rights of holders of our common stock. For example, a series of preferred stock may be granted the right to receive a liquidation preference—a pre-set distribution in the event of a liquidation—that would reduce the amount available for distribution to holders of common stock. In addition, the issuance of preferred stock could make it more difficult for a third party to acquire a majority of our outstanding voting stock. As a result, common stockholders could be prevented from participating in transactions that would offer an optimal price for their shares.

We may need to liquidate the Company in a voluntary dissolution under Delaware law or seek protection under the provisions of the U.S. Bankruptcy Code, and in either event, it is unlikely that stockholders would receive any value for their shares.

We have not generated any revenues from product sales, and have incurred losses in each year since our inception in 1994. We expect that it will be very difficult to raise capital to continue our operations and our independent registered public accounting firm has issued an opinion with an explanatory paragraph to the effect that there is substantial doubt about our ability to continue as a going concern. We do not believe that we could succeed in raising additional capital needed to sustain our operations without some strategic transaction, such as a partnership or merger. If we are unable to consummate such a transaction, we expect that we would need to cease all operations and wind down. Although we are currently evaluating our strategic alternatives with respect to all aspects of our business, we cannot assure you that any actions that we take would raise or generate sufficient capital to fully address the uncertainties of our financial position. As a result, we may be unable to realize value from our assets and discharge our liabilities in the normal course of business. If we are unable to settle our obligations to our creditors or if we are unable to consummate a strategic transaction, we would likely need to liquidate the Company in a voluntary dissolution under Delaware law or seek protection under the provisions of the U.S. Bankruptcy Code. In that event, we, or a trustee appointed by the court, may be required to liquidate our assets. In either of these events, we might realize significantly less from our assets than the values at which they are carried on our financial statements. The funds resulting from the liquidation of our assets would be used first to satisfy obligations to creditors before any funds would be available to pay our stockholders, and any shortfall in the proceeds would directly reduce the amounts available for distribution, if any, to our creditors and to our stockholders. In the event we are required to liquidate under Delaware law or the federal bankruptcy laws, it is highly unlikely that stockholders would receive any value for their shares. See *Liquidity and Capital Resources* in Part II, Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations* and Note 1 to our financial statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

Table of Contents

If we were to lose the services of members of our management team, or fail to attract or retain qualified personnel in the future, our business objectives would be more difficult to implement, adversely affecting our operations.

Our ability to successfully implement our business strategy depends upon the continued services of our management team. If we lose the services of one or more of these individuals, replacement could be difficult and may take an extended period of time and could impede significantly the achievement of our business objectives.

Our results of operations and liquidity needs could be materially negatively affected by market fluctuations and economic downturn.

Our results of operations could be materially negatively affected by economic conditions generally, both in the U.S. and elsewhere around the world. Continuing concerns over inflation, energy costs, geopolitical issues, the availability and cost of credit, the U.S. mortgage market and a declining residential real estate market in the U.S. have contributed to increased volatility and diminished expectations for the economy and the markets going forward. These factors, combined with volatile oil prices, declining business and consumer confidence and increased unemployment, precipitated an economic recession from which the global economy is in stages of recovery. Domestic and international equity markets continue to experience heightened volatility and turmoil. These events and the continuing market upheavals may have an adverse effect on us. In the event of a market downturn, our results of operations could be adversely affected by those factors in many ways, including making it more difficult for us to raise funds if necessary, and our stock price may further decline.

Failure to protect our proprietary technology could impair our competitive position.

We own or have obtained a license to a number of U.S. and foreign patents and patent applications. Our success depends in part on our ability to obtain and defend patent rights and other intellectual property rights that are important to our ability to commercialize our drug candidates, if approved and our ability to operate our business without infringing the proprietary rights of third parties. We place considerable importance on obtaining patent protection for significant new technologies, products and processes. Legal standards relating to the validity of patents covering pharmaceutical and biotechnology inventions and the scope of claims made under such patents are still developing. In some of the countries in which we intend to market our drug candidates, if approved, pharmaceuticals are either not patentable or have only recently become patentable. Past enforcement of intellectual property rights in many of these countries has been limited or non-existent. Future enforcement of patents and proprietary rights in many other countries may be problematic or unpredictable. Moreover, the issuance of a patent in one country does not assure the issuance of a similar patent in another country. Claim interpretation and infringement laws vary by nation, so the extent of any patent protection is uncertain and may vary in different jurisdictions. Our domestic patent position is also highly uncertain and involves complex legal and factual questions. The applicant or inventors of subject matter covered by patent applications or patents owned by or licensed to us may not have been the first to invent or the first to file patent applications for such inventions. Due to uncertainties regarding patent law and the circumstances surrounding our patent applications, the pending or future patent applications we own or have licensed may not result in the issuance of any patents. Existing or future patents owned by or licensed to us may be challenged, infringed upon, invalidated, found to be unenforceable or circumvented by others. Further, any rights we may have under any issued patents may not provide us with sufficient protection against similar competitive products or technologies that do not infringe our patents or otherwise cover commercially valuable products or processes.

Table of Contents

Litigation or other disputes regarding patents and other proprietary rights may be expensive, cause delays in bringing products to market and harm our ability to operate.

The manufacture, use or sale of our drug candidates may infringe on the patent rights of others. If we are unable to avoid infringement of the patent rights of others, we may be required to seek a license, defend an infringement action or challenge the validity of the patents in court. Patent litigation is costly and time consuming and can preclude, delay or suspend commercialization of our drug candidates. We may not have sufficient resources to bring these actions to a successful conclusion. In addition, if we do not obtain a license, develop or obtain non-infringing technology, or fail to successfully defend an infringement action or have the patents we are alleged to infringe declared invalid, we may:

incur substantial money damages;

encounter significant delays in bringing our drug candidates to market;

be precluded from participating in the manufacture, use or sale of our drug candidates or methods of treatment without first obtaining licenses to do so; and/or

not be able to obtain any required license on favorable terms, if at all.

In addition, if another party claims the same subject matter or subject matter overlapping with the subject matter that we have claimed in a U.S. patent application or patent, we may decide or be required to participate in interference proceedings in the U.S. Patent and Trademark Office in order to determine the priority of invention. Loss of such an interference proceeding would deprive us of patent protection sought or previously obtained and could prevent us from commercializing our products. Participation in such proceedings could result in substantial costs, whether or not the eventual outcome is favorable. These additional costs could adversely affect our financial results.

Litigation may be expensive and time consuming and may adversely affect our operations.

From time to time, we may be involved in litigation relating to claims arising out of our operations in the normal course of business. Participation in such proceedings is time consuming and could result in substantial costs, whether or not the eventual outcome is favorable. These additional costs could adversely affect our financial results.

Confidentiality agreements with employees and others may not adequately prevent disclosure of trade secrets and other proprietary information.

In order to protect our proprietary technology and processes, we also rely in part on confidentiality agreements with our employees, consultants, outside scientific collaborators and sponsored researchers and other advisors. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. In addition, others may independently discover trade secrets and proprietary information. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights, and failure to obtain or maintain trade secret protection could adversely affect our competitive business position.

Existing and/or future pricing regulations and reimbursement limitations may limit our potential profits from the sale of our products.

The requirements governing product licensing, pricing and reimbursement vary widely from country to country. Some countries require approval of the sale price of a drug before it can be marketed. In many countries, the pricing review period begins after product-licensing approval is granted. As a result, we may obtain regulatory approval for a drug candidate in a particular country, but then be subject to price regulations that reduce our profits from the sale of the product. In some foreign markets pricing of prescription pharmaceuticals is subject to continuing government control even after initial marketing approval. In addition, certain governments may grant third parties a license to manufacture our product without our permission. Su