

NEOSE TECHNOLOGIES INC
Form 10-Q
August 07, 2008
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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 June 30, 2008.

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: 0-27718

NEOSE TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware

13-3549286

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(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

102 Rock Road
Horsham, Pennsylvania
(Address of principal executive offices)

19044
(Zip Code)

(215) 315-9000

(Registrant's telephone number, including area code)

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 54,468,181 shares of common stock, \$.01 par value, were outstanding as of August 01, 2008.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Neose Technologies, Inc.

Balance Sheets

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(unaudited)

(in thousands, except per share amounts)

	June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	\$ 11,430	\$ 19,282
Accounts receivable, net	1,695	1,758
Prepaid expenses and other current assets	525	1,564
Total current assets	13,650	22,604
Property and equipment, net	12,774	13,564
Other assets	71	71
Total assets	\$ 26,495	\$ 36,239
Liabilities and Stockholders Equity		
Current liabilities:		
Note payable	\$ 237	\$ 658
Current portion of long-term debt and capital lease obligations	158	658
Accounts payable	929	1,309
Accrued compensation	843	872
Accrued expenses	2,076	2,977
Deferred revenue	938	1,517
Total current liabilities	5,181	7,333
Warrant liability	638	4,205
Long-term debt and capital lease obligations	150	182
Deferred revenue	7,772	5,055
Other liabilities	563	548
Total liabilities	14,304	17,323
Stockholders equity:		
Preferred stock, par value \$.01 per share, 5,000 shares authorized, none issued		
Common stock, par value \$.01 per share, 150,000 shares authorized; 54,468 shares issued and outstanding	545	545
Additional paid-in capital	313,440	313,216
Accumulated deficit	(301,794)	(294,845)
Total stockholders equity	12,191	18,916
Total liabilities and stockholders equity	\$ 26,495	\$ 36,239

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

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Neose Technologies, Inc.

Statements of Operations

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(unaudited)

(in thousands, except per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Revenue from collaborative agreements	\$ 1,573	\$ 2,231	\$ 5,685	\$ 3,468
Operating expenses:				
Research and development	3,920	7,742	11,681	17,554
General and administrative	2,091	2,548	5,041	5,513
Total operating expenses	6,011	10,290	16,722	23,067
Operating loss	(4,438)	(8,059)	(11,037)	(19,599)
(Increase) decrease in fair value of warrant liability	(228)	1,920	3,567	(4,430)
Interest income	85	502	247	774
Interest expense	(12)	(48)	(29)	(88)
Loss before income tax benefit	(4,593)	(5,685)	(7,252)	(23,343)
Income tax benefit		533	303	533
Net loss	\$ (4,593)	\$ (5,152)	\$ (6,949)	\$ (22,810)
Basic and diluted net loss per share	\$ (0.08)	\$ (0.09)	\$ (0.13)	\$ (0.50)
Weighted-average shares outstanding used in computing basic and diluted net loss per share	54,468	54,402	54,468	45,995

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

Table of Contents**Neose Technologies, Inc.****Statements of Cash Flows**

(unaudited)

(in thousands)

	Six months ended June 30,	
	2008	2007
Cash flows from operating activities:		
Net loss	\$ (6,949)	\$ (22,810)
Adjustments to reconcile net loss to net cash used in operating activities:		
(Decrease) increase in fair value of warrant liability	(3,567)	4,430
Depreciation and amortization expense	819	1,034
Non-cash compensation expense	224	1,107
Non-cash rent expense		130
Loss on disposition of property and equipment	4	4
Changes in operating assets and liabilities:		
Accounts receivable	63	(3,771)
Prepaid expenses and other current assets	1,039	(208)
Other assets		(16)
Accounts payable	(380)	(702)
Accrued compensation	(29)	(676)
Accrued expenses	(901)	1,463
Deferred revenue	2,138	1,459
Other liabilities	15	19
Net cash used in operating activities	(7,524)	(18,537)
Cash flows from investing activities:		
Purchases of property and equipment	(33)	(3,389)
Net cash used in investing activities	(33)	(3,389)
Cash flows from financing activities:		
Proceeds from issuance of debt	370	367
Repayments of debt	(665)	(856)
Proceeds from issuance of common stock and warrants, net		40,486
Net cash (used in) provided by financing activities	(295)	39,997
Net (decrease) increase in cash and cash equivalents	(7,852)	18,071
Cash and cash equivalents, beginning of period	19,282	16,388
Cash and cash equivalents, end of period	\$ 11,430	\$ 34,459

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

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Neose Technologies, Inc.

Notes to Financial Statements

(unaudited)

(in thousands, except per share amounts)

1. Background

Neose Technologies, Inc. is a clinical-stage biopharmaceutical company focused on the development of next-generation therapeutic proteins, which we believe will be competitive with best-in-class protein drugs currently on the market. We have two therapeutic protein candidates in clinical trials: GlycoPEG-GCSF and GlycoPEG-FVIIa, and two therapeutic protein candidates in the research stage: GlycoPEG-FVIII and GlycoPEG-FIX.

GlycoPEG-GCSF is a long-acting version of granulocyte colony stimulating factor (G-CSF) that we are co-developing with BioGeneriX AG, a company of the ratiopharm Group. G-CSF is prescribed to stimulate production of neutrophils (a type of white blood cell) and is approved for sale in major markets around the world for treatment of neutropenia associated with myelosuppressive chemotherapy. In June 2008, BioGeneriX initiated a Phase II study to evaluate the safety and efficacy of GlycoPEG-GCSF for the treatment of neutropenia associated with myelosuppressive chemotherapy. We expect completion of this Phase II study during the first half of 2009. In November 2007, we reported data from two Phase I clinical trials. That data demonstrated that GlycoPEG-GCSF is a potent stimulator of neutrophils and mobilizer of peripheral blood progenitor cells, and that at comparable doses to Neulasta® (Amgen's marketed, long-acting G-CSF), GlycoPEG-GCSF demonstrated a 60% greater bioavailability, leading to a 30% increase in the generation of neutrophils.

GlycoPEG-FVIIa is a long-acting form of recombinant Factor VIIa that is being developed by our partner, Novo Nordisk A/S, utilizing our GlycoPEGylation technology. Factor VIIa is used in the treatment of bleeding episodes and for the prevention of bleeding during surgery or invasive procedures in patients with congenital hemophilia with inhibitors to coagulation Factors VIII or IX. In June 2008, Novo Nordisk completed an initial Phase I clinical study that assessed the safety and pharmacokinetics of GlycoPEG-FVIIa in healthy volunteers. In the trial, a significant prolongation of the half-life of GlycoPEG-FVIIa was observed. Novo Nordisk is also developing long-acting forms of recombinant Factor VIII and recombinant Factor IX utilizing our GlycoPEGylation technology. Factor VIII products are used in the treatment of Hemophilia A, and Factor IX products are used in the treatment of Hemophilia B.

In January 2008, we announced the discontinuation of further development of GlycoPEG-EPO (NE-180), our product candidate intended for the treatment of anemia in patients with chronic kidney disease and cancer patients receiving chemotherapy. The decision to discontinue development was not due to any safety or efficacy concerns about NE-180, but was based on our evaluation of commercial prospects and the likelihood of entering into a timely collaboration for the compound in the context of increased safety concerns in the erythropoiesis-stimulating agent (ESA) category. In connection with the discontinuation of the NE-180 program, we reduced our workforce by approximately 35% (see Note 14).

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We believe that our enzymatic pegylation technology, GlycoPEGylation, can improve the drug properties of therapeutic proteins by building out, and attaching polyethylene glycol (PEG)

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Neose Technologies, Inc.

Notes to Financial Statements

(unaudited)

(in thousands, except per share amounts)

to, carbohydrate structures at specific sites on the proteins. We are using our technology to develop proprietary versions of protein drugs with proven safety and efficacy and to improve the therapeutic profiles of proteins being developed by our partners. We expect these modified proteins to offer significant advantages, including less frequent dosing and possibly improved efficacy, over the original versions of the drugs now on the market, as well as to meet or exceed the pharmacokinetic profile of next-generation versions of the drugs now on the market. We believe this strategy of targeting drugs with proven safety and efficacy allows us to lower the risk profile of our proprietary development portfolio as compared to *de novo* protein drug development. We intend to continue to focus our research and development resources on therapeutic proteins that we believe have the greatest probability of achieving clinically meaningful therapeutic improvements from our technology and are in commercially attractive categories.

We have incurred losses each year since inception. As of June 30, 2008, we had an accumulated deficit of \$301,794. We expect to spend significant amounts on research and development for our proprietary drug candidates and technology, maintenance of our intellectual property position, and our business development and commercialization efforts. Given our planned level of operating expenses, we expect to continue incurring losses for some time.

We believe that our existing cash and cash equivalents, expected proceeds from collaborations and license arrangements, and interest income should be sufficient to meet our operating and capital requirements at least into the third quarter of 2009, although changes in our collaborative relationships or our business, whether or not initiated by us, may cause us to deplete our cash and cash equivalents sooner than the above estimate. We will require significant amounts of additional capital in the future to fund our operations, and we do not have any assurance that funding will be available when we need it on terms that we find favorable, if at all. If we are unable to raise additional capital when required, we may need to delay, scale back, or eliminate some or all of our research and development programs.

On February 19, 2008, we received notice from The NASDAQ Stock Market LLC ("NASDAQ") stating that for 30 consecutive business days the bid price for our common stock has closed below the minimum \$1.00 per share required for continued listing on the NASDAQ Global Market. As a result, we no longer meet NASDAQ's continued listing criteria and have 180 calendar days, or until August 18, 2008, to regain compliance. Our shares will continue to trade on the NASDAQ Global Market during the 180-day period. We may receive an additional 180-day compliance period if we meet all of the initial listing requirements for the NASDAQ Capital Market, except for the bid price requirement. We currently intend to submit an application to transfer to the NASDAQ Capital Market prior to August 18, 2008. If NASDAQ approves the transfer application, we will be afforded the additional compliance period of 180 calendar days following August 18, 2008, or until February 16, 2009, to regain compliance with the minimum bid price requirement of the NASDAQ Capital Market. If we fail to regain compliance with the minimum bid price requirement prior to February 16, 2009, or if we fail to meet the initial listing requirements for inclusion on the NASDAQ Capital Market on August 18,

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Neose Technologies, Inc.

Notes to Financial Statements

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(in thousands, except per share amounts)

2008, NASDAQ will provide us with written notification that our common stock will be delisted from NASDAQ. At that time, we may appeal the delisting determination to a NASDAQ Listings Qualification Panel pursuant to applicable NASDAQ rules, and our common stock would remain listed until completion of the appeal process. We intend to pursue all available options to regain compliance with the NASDAQ continued listing requirements during the applicable compliance or appeal periods.

We have not yet developed any products or commercialized any products or technologies, and we may never be able to do so. Even if we are successful in developing products that are approved for marketing, we will not be successful unless our products, and products incorporating our technology, gain market acceptance. Our operations are subject to risks and uncertainties in addition to those mentioned above, such as, among others, the uncertainty of product development, including our dependence upon third parties to conduct our clinical trials and to manufacture our product candidates and the materials used to make them, and unexpected delays or unfavorable results in our clinical trials; our limited product development and manufacturing experience; our dependence upon collaborative partners to develop and commercialize products incorporating our technology and the success of collaborative relationships; the uncertainty of intellectual property rights; the possibility of development and commercialization of competitive products by others that are more effective, less costly, or otherwise gain greater market acceptance; and the uncertainty of the impact of government regulation on our operations, including achieving regulatory approvals for our products or products incorporating our technology, and changes in health care reimbursement policies.

2. Interim Financial Information

The accompanying unaudited financial statements have been prepared in accordance with U.S. generally accepted accounting principles for presentation of interim financial statements. Accordingly, the unaudited financial statements do not include all the information and footnotes necessary for a comprehensive presentation of the financial position, results of operations, and cash flows for the periods presented. In our opinion, however, the unaudited financial statements include all the normal recurring adjustments that are necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. You should not base your estimate of our results of operations for 2008 solely on our results of operations for the six months ended June 30, 2008. You should read these unaudited financial statements in combination with the other Notes in this section; the section entitled Management's Discussion and Analysis of Financial Condition and Results of Operations appearing in Item 2 of this Form 10-Q; and the Financial Statements, including the Notes to the Financial Statements, included in our Annual Report on Form 10-K for the year ended December 31, 2007.

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Notes to Financial Statements

(unaudited)

(in thousands, except per share amounts)

3. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and assumptions. Those estimates and assumptions affect the reported amounts of assets and liabilities as of the date of the financial statements, the disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounts Receivable

We record accounts receivable net of an allowance for doubtful accounts. We establish an allowance for doubtful accounts that we believe is adequate to cover anticipated losses on the collection of all outstanding accounts receivable. The adequacy of the allowance for doubtful accounts is based on historical information and management's assessment of our collaborators' ability and intent to pay. We recognize revenue based on proportional performance of research and development work performed on behalf of our collaborators, which recognition may not correspond with how our collaborators are billed. We review the unbilled accounts receivable from our collaborators to determine that such amounts are expected to become billable and collectible. All unbilled receivables are expected to be billed within six months.

Warrant Liability

We follow Emerging Issues Task Force (EITF) No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* (EITF 00-19), which provides guidance for distinguishing among permanent equity, temporary equity and assets and liabilities. EITF 00-19 requires liability classification of warrants that may be settled in cash at the option of warrant holders. Our warrants issued in March 2007 permit net cash settlement in certain change of control circumstances at the option of the warrant holders, and are, therefore, classified as a liability on our Balance Sheets (see Note 10).

We record the warrant liability at its fair value using the Black-Scholes option-pricing model and revalue it at each reporting date until the warrants are exercised or expire. Changes in the fair value of the warrants are reported in our Statements of Operations as non-operating income or expense. The fair value of the warrants is subject to significant fluctuation based on changes in our stock price, expected volatility, remaining contractual life and the risk-free interest rate. The market price for our common stock has been and may continue to be volatile. Consequently, future fluctuations in the price of our common stock may cause significant increases or decreases in the fair value of the warrants.

In connection with the March 2007 equity financing, we were obligated to file a registration statement with the SEC for the registration of the total number of shares sold to the

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Neose Technologies, Inc.

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investors and shares issuable upon exercise of the warrants. We are required under an agreement to use commercially reasonable efforts to cause the registration statement to be declared effective by the SEC, which we accomplished in May 2007, and to remain continuously effective until such time when all of the registered shares are sold. In the event we fail to meet various legal requirements in regards to the registration statement, we will be obligated to pay the investors, as partial liquidated damages and not as a penalty, an amount in cash equal to 1% of the aggregate purchase price paid by investors for each monthly period that the registration statement is not effective, up to 24%. We follow Financial Accounting Standards Board (FASB) Staff Position No. EITF 00-19-2, *Accounting for Registration Payment Arrangements* (EITF 00-19-2), which specifies that registration payment arrangements should play no part in determining the initial classification of, and subsequent accounting for, securities to which the payments relate. Contingent obligations in a registration payment arrangement are separately analyzed under Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies*, and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*. If we determine a registration payment arrangement in connection with the securities issued in March 2007 is probable and can be reasonably estimated, a liability will be recorded. As of June 30, 2008, we concluded the likelihood of having to make any payments under the arrangements was remote, and therefore did not record any related liability.

Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding for the period. Diluted net loss per share is computed by dividing net loss by the sum of the weighted-average number of common shares outstanding for the period and the number of additional shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares are excluded from the calculation of diluted net loss per share if the effect on net loss per share is antidilutive. Our diluted net loss per share is equal to basic net loss per share for all reporting periods presented because giving effect in the computation of diluted net loss per share to the exercise of outstanding stock options and warrants or settlement of restricted stock units (RSUs) would have been antidilutive. See Note 12 for a summary of outstanding options and a description of our RSUs.

Comprehensive Loss

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes certain changes to equity that are not included in net income (loss). Our comprehensive loss for the three and six months ended June 30, 2008 was comprised only of our net loss, and was \$4,593 and \$6,949, respectively. Our comprehensive loss for the three and six months ended June 30, 2007 was comprised only of our net loss, and was \$5,152 and \$22,810, respectively.

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Neose Technologies, Inc.

Notes to Financial Statements

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Fair Value of Financial Instruments

The fair value of financial instruments is the amount for which instruments could be exchanged in a current transaction between willing parties. As of June 30, 2008, the carrying values of cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable, accrued expenses, and accrued compensation equaled or approximated their respective fair values because of the short duration of these instruments. The fair value of our debt and capital lease obligations was estimated by discounting the future cash flows of each instrument at rates recently offered to us for similar debt instruments offered by our lenders. As of June 30, 2008, the fair and carrying values of our debt and capital lease obligations were \$543 and \$545, respectively.

Recent Accounting Pronouncements

In December 2007, the FASB issued EITF 07-01, *Accounting for Collaborative Arrangements* (EITF 07-01). EITF 07-01 provides guidance concerning determining whether an arrangement constitutes a collaborative arrangement, how costs incurred and revenue generated on sales to third parties and payments between participants pursuant to a collaboration agreement should be presented in the results of operations and what participants should disclose in the notes to the financial statements about a collaborative arrangement. EITF 07-01 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact that the adoption of EITF 07-01 will have, if any, on our financial statements and related disclosures.

In June 2007, the FASB issued EITF 07-03, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities*-(EITF 07-03). EITF 07-03 specifies that nonrefundable advance payments for future research and development activities should be deferred and capitalized and should be recognized as an expense as the related goods are delivered or the related services are performed. If, subsequent to an advance payment, an entity no longer expects the goods to be delivered or services to be rendered, the capitalized advance payment should be charged to expense. EITF 07-03 is effective for fiscal years beginning after December 15, 2007. The adoption of EITF 07-03 did not have any impact on our financial statements and related disclosures.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS No. 159), which allows companies to choose, at specific election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Adoption of SFAS No. 159 has had no effect on our financial statements and related disclosure because, as permitted under SFAS No. 159, we have not elected to apply the fair value option to any of our financial assets

and liabilities.

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(unaudited)

(in thousands, except per share amounts)

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Although SFAS No. 157 does not require any new fair value measurements, its application may, for some entities, change current practices related to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* (FSP FAS 157-1) and FASB Staff Position 157-2, *Effective Date of FASB Statement No. 157* (FSP FAS 157-2). FSP FAS 157-1 amends SFAS No. 157 to remove certain leasing transactions from its scope. FSP FAS 157-2 defers the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. We adopted SFAS No. 157, as it applies to our financial instruments, effective January 1, 2008 and the adoption has had no effect on our financial statements and related disclosures.

4. Supplemental Disclosure of Cash Flow Information

The following table contains additional cash flow information for the periods reported:

	Six months ended June 30,	
	2008	2007
Supplemental disclosure of cash flow information:		
Cash paid for interest, net of amounts capitalized	\$ 31	\$ 88
Non-cash investing activities:		
Decrease in accrued property and equipment included in accounts payable and accrued expenses	\$	\$ (1,747)
Assets acquired under capital leases	\$	\$ 373
Non-cash financing activities:		
Initial measurement of warrant liability (see Note 10)	\$	\$ 10,765

Table of Contents**Neose Technologies, Inc.****Notes to Financial Statements****(unaudited)**

(in thousands, except per share amounts)

5. Accounts Receivable

Accounts receivable consisted of the following:

	June 30, 2008	December 31, 2007
Billed receivables	\$ 786	\$ 670
Unbilled receivables	909	1,107
	1,695	1,777
Less allowance for doubtful accounts		(19)
	\$ 1,695	\$ 1,758

6. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consisted of the following:

	June 30, 2008	December 31, 2007
Prepaid insurance	\$ 253	\$ 57
Prepaid maintenance agreements	100	159
Prepaid contract research and development services	16	1,008
Prepaid clinical trials and non-clinical studies		113
Other prepaid expenses	156	227
	\$ 525	\$ 1,564

7. **Property and Equipment**

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Property and equipment consisted of the following:

	June 30, 2008	December 31, 2007
Leasehold improvements	\$ 12,996	\$ 12,984
Laboratory, manufacturing, and office equipment	6,935	6,960
	19,931	19,944
Less accumulated depreciation and amortization	(7,157)	(6,380)
	\$ 12,774	\$ 13,564

As of June 30, 2008 and December 31, 2007, laboratory, manufacturing, and office equipment included \$495 of assets acquired under capital leases. Accumulated depreciation and

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(in thousands, except per share amounts)

amortization as of June 30, 2008 and December 31, 2007 included \$204 and \$148, respectively, related to assets acquired under capital leases. Depreciation expense, which includes amortization of assets acquired under capital leases, was \$819 and \$911 for the six months ended June 30, 2008 and 2007, respectively. During the six months ended June 30, 2008, we disposed of fully depreciated assets that had original acquisition values of \$40. We recorded losses on disposition of property and equipment of \$4 each during the six months ended June 30, 2008 and 2007, for which we did not receive any proceeds from the dispositions. During the six months ended June 30, 2007, we capitalized \$9 of interest expense in connection with our facility improvement projects. We did not capitalize any interest expense incurred during the six months ended June 30, 2008.

8. Debt and Capital Lease Obligations

Debt and capital lease obligations consisted of the following:

	June 30, 2008	December 31, 2007
Notes payable to equipment lender, secured by equipment and facility improvements, interest rates from 9.1% to 9.5%, due 2008	\$ 78	\$ 327
Term loan from landlord (unsecured), annual interest at 13.0%, final payment made June 2008	—	195
Note payable, secured by insurance policies, annual interest at 4.1%, due January 2009	237	—
Subtotal	315	522
Capital lease obligations	230	318
Total debt	545	840
Less note payable, secured by insurance policies	(237)	—
Less current portion	(158)	(658)
Total debt, net of current portion	\$ 150	\$ 182

Note Payable Secured by Insurance Policies

In March 2008, we borrowed \$370 to finance insurance policy premiums due on certain insurance policies. The insurance policy premiums, net of amortization, are included in prepaid expenses and other current assets on our Balance Sheets at June 30, 2008 (see Note 6). We are required to pay \$34 of principal and interest during each of the eleven months beginning on March 15, 2008 and ending on January 15, 2009. To secure

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payment of the amounts financed, we granted the lender a security interest in (a) all unearned premiums or dividends payable under the policies, (b) loss payments which may reduce the unearned premiums, subject to any mortgagee or loss payee interests, and (c) any interest in any state guarantee fund relating to the policies.

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(in thousands, except per share amounts)

9. Accrued Expenses

Accrued expenses consisted of the following:

	June 30, 2008	December 31, 2007
Professional fees	\$ 1,137	\$ 788
Clinical trials and non-clinical studies	\$ 733	1,544
Contract research and development services	206	390
Other expenses	—	255
	\$ 2,076	\$ 2,977

10. Warrant Liability

In March 2007, we sold, through a private placement, 21,415 shares of our common stock and warrants to purchase 9,637 shares of our common stock with an exercise price of \$1.96 (see Note 11). The warrants have a five-year term and are immediately exercisable. The warrant agreement contains a net cash settlement provision, which is available to the warrant holders at their option, in certain change of control circumstances. As of June 30, 2008, the net cash settlement value of the warrants was \$1,887.

As a result of the net cash settlement provision, under EITF 00-19, the warrants are required to be classified as a liability at their current fair value in our Balance Sheets, estimated using the Black-Scholes option-pricing model. Warrants that are classified as a liability are revalued at each reporting date until the warrants are exercised or expire with changes in the fair value reported in our Statements of Operations as non-operating income or expense. Accordingly, we recorded non-operating expense of \$228 during the three months ended June 30, 2008 and non-operating income of \$3,567 during the six months ended June 30, 2008. We recorded non-operating income of \$1,920 during the three months ended June 30, 2007 and non-operating expense of \$4,430 during the six months ended June 30, 2007. The aggregate fair value and the assumptions used for the Black-Scholes option-pricing models as of March 13, 2007, June 30, 2007, December 31, 2007 and June 30, 2008 were as follows:

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	March 13, 2007	June 30, 2007	December 31, 2007	June 30, 2008
Aggregate fair value	\$ 10,765	\$ 15,195	\$ 4,205	\$ 638
Expected volatility	75%	68%	69%	84%
Remaining contractual term (years)	5.0	4.7	4.2	3.7
Risk-free interest rate	4.4%	4.9%	3.3%	3.1%
Expected dividend yield	0%	0%	0%	0%
Common stock price	\$ 1.79	\$ 2.46	\$ 1.07	\$ 0.30

Table of Contents**Neose Technologies, Inc.****Notes to Financial Statements****(unaudited)**

(in thousands, except per share amounts)

11. Stockholders Equity

In March 2007, we sold, through a private placement, 21,415 shares of our common stock and warrants to purchase 9,637 shares of our common stock, including 4,950 shares of our common stock and warrants to purchase 2,228 shares of our common stock to investment funds affiliated with certain members of our board of directors, at a price of \$2.02 per unit, generating net proceeds of \$40,459. Each unit consisted of one share of common stock and a warrant to purchase 0.45 shares of our common stock. The warrants have a five-year term and an exercise price of \$1.96 per share.

12. Equity-based Compensation

The following table summarizes the status of stock options as of June 30, 2008 and changes during the six months then ended:

	Shares	Weighted-average exercise price	Aggregate intrinsic value	Weighted-average remaining contractual life (years)
Outstanding at January 1, 2008	4,568	\$ 8.07		
Granted	942	0.68		
Exercised	—	—		
Forfeited	(318)	2.93		
Expired	(866)	9.78		
Outstanding at June 30, 2008	4,326	\$ 6.50	\$	6.9
Vested at June 30, 2008 and expected to vest	3,489	\$ 7.64	\$	6.5
Exercisable at June 30, 2008	2,752	\$ 9.38	\$	5.8

Fair Value Disclosures

During the three and six months ended June 30, 2008, we recorded \$128 and \$224 of compensation cost for share-based payments, respectively, in our Statements of Operations. During the three and six months ended June 30, 2007, we recorded \$641 and \$1,107 of compensation cost for

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share-based payments in our Statement of Operations. There were no stock options granted during the three months ended June 30, 2008. The weighted-average fair value of stock options granted during the three months ended June 30, 2007 was \$1.54. The weighted-average fair value of stock options granted during the six months ended June 30, 2008 and 2007 was \$0.46 and \$1.63, respectively. There were no stock options exercised during the three months ended June 30, 2008. The total intrinsic values of stock options exercised during the three months ended June 30, 2007 was \$4.

Table of Contents**Neose Technologies, Inc.****Notes to Financial Statements****(unaudited)**

(in thousands, except per share amounts)

The fair value of share-based awards is recognized as expense over the requisite service period, net of estimated forfeitures. We rely primarily on historical experience to estimate expected forfeitures and adjust the annualized forfeiture rate if our historical experience indicates that an adjustment is necessary. During the first quarter of each year, we re-evaluate our forfeiture rate. For the three and six months ended June 30, 2008, based on our historical experience of option pre-vesting cancellations, we have assumed an annualized forfeiture rate of 34% for our stock options granted to individuals not terminated as a result of a restructuring of our operations (see Note 14). For employees terminated as a result of the restructurings in 2008, 2007 and 2006, we have assumed an annualized forfeiture rate of 100%. For the three and six months ended June 30, 2007, we assumed an annualized forfeiture rate of 17% for our stock options granted to individuals not terminated as a result of a restructuring of our operations (see Note 14). Under the provisions of SFAS No. 123R, we will record additional expense if the actual forfeiture rate is lower than we estimated, and will record a recovery of prior expense if the actual forfeiture is higher than we estimated.

As of June 30, 2008, there was \$434 of total unrecognized compensation cost, which includes the impact of expected forfeitures, related to unvested share-based compensation arrangements. That cost is expected to be recognized over a weighted-average period of 1.9 years.

Restricted Stock Units

A summary of the status of RSUs as of June 30, 2008, and changes during the six months then ended, is presented in the following table:

	Shares	Weighted- average grant-date fair value	Aggregate intrinsic value
Outstanding at January 1, 2008	34	\$ 2.44	
Awarded	—	—	
Settled	—	—	
Forfeited	—	—	
Outstanding at June 30, 2008	34	\$ 2.44	\$ 10
Vested at June 30, 2008 and expected to vest	34	\$ 2.44	\$ 10

During the six months ended June 30, 2007, we recorded \$6 of expense for RSUs. All RSUs were vested as of December 31, 2007.

Table of Contents**Neose Technologies, Inc.****Notes to Financial Statements****(unaudited)**

(in thousands, except per share amounts)

13. Collaborative Agreements and Significant Customer Concentration

A summary of revenue recognized under our collaborative agreements during the three and six months ended June 30, 2008 and 2007 is presented in the following table:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Novo Nordisk				
Research and development funding	\$ 809	\$ 1,578	\$ 3,490	\$ 2,134
License fees	212	165	386	313
	1,021	1,743	3,876	2,447
BioGeneriX				
Research and development funding	538	474	1,781	993
License fees	14	14	28	28
	552	488	1,809	1,021
	\$ 1,573	\$ 2,231	\$ 5,685	\$ 3,468

Novo Nordisk A/S Agreements

We have agreements with Novo Nordisk A/S to use our proprietary GlycoPEGylation technology to develop and commercialize next-generation versions of recombinant Factors VIIa, VIII and IX, one of which, Factor VIIa, is currently marketed by Novo Nordisk. Under these agreements, we received a non-refundable, upfront fee of \$4,300, which is being amortized to revenue over the expected performance period. Novo Nordisk is responsible for funding our research and development activities under the agreements, and we may receive up to \$52,200 in milestone payments based on the progress of the programs.

BioGeneriX AG Agreements

We have an agreement with BioGeneriX AG to use our proprietary GlycoPEGylation technology to develop a long-acting version of G-CSF. In connection with the agreement, we received from BioGeneriX a non-refundable, upfront fee, which is being recognized to revenue over the

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expected performance period of 18 years. In October 2006, we entered into an amendment of this agreement. Under the agreement, as amended, we and BioGeneriX shared the expenses of preclinical development, BioGeneriX is responsible for supplying the protein and funding the clinical development program and we are responsible for supplying enzyme reagents and sugar nucleotides. As of January 1, 2007, BioGeneriX became responsible for the cost of reagent supply.

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Neose Technologies, Inc.

Notes to Financial Statements

(unaudited)

(in thousands, except per share amounts)

14. Restructurings and Employee Severance Costs

2008 Restructuring

In January 2008, we announced the discontinuation of further development of NE-180 our product candidate intended for the treatment of anemia in patients with chronic kidney disease and cancer patients receiving chemotherapy. The decision to discontinue development was not due to any safety or efficacy concerns about NE-180, but was based on an evaluation of commercial prospects and the likelihood of entering into a timely collaboration for the compound in the context of increased safety concerns in the ESA category. In connection with the discontinuation of the NE-180 program, we reduced our workforce by approximately 35% (2008 Restructuring). Our net loss for the six months ended June 30, 2008 included \$872 of employee severance costs related to the workforce reduction, of which \$221 was included in research and development expenses and \$651 was included in general and administrative expenses. Of these amounts, \$15 remained unpaid and was included in accrued compensation on our Balance Sheets as of June 30, 2008. The employee severance costs for the 2008 Restructuring were payable pursuant to an employee severance plan established in August 2005 except for one employee whose severance costs were payable pursuant to her change of control agreement.

In connection with the 2008 Restructuring, we committed to pay future cash retention bonuses to certain employees who were not given notice of termination in January 2008, contingent on their not voluntarily terminating their employment prior to November 28, 2008. Our net loss for the three and six months ended June 30, 2008 included \$65 and \$108 of expense related to these cash retention bonuses, respectively, of which \$42 and \$70 was included in research and development expense, respectively, and \$23 and \$38 was included in general and administrative expenses, respectively. We also granted stock options to all employees as part of an employee retention program. These options will vest 50% on August 4, 2008 for all holders who had not voluntarily terminated their employment prior to that date, and will vest 50% on February 4, 2009 for all holders who have not voluntarily terminated their employment prior to that date. The aggregate fair market value of the options was \$247, which is being recognized ratably, net of forfeitures, as compensation expense over the vesting period.

2007 Restructuring

In March 2007, we implemented a restructuring of operations (2007 Restructuring), which included a workforce reduction of approximately 40%. The employee severance costs incurred for the 2007 Restructuring were payable pursuant to an employee severance plan established in August 2005. Our net loss for the six months ended June 30, 2007 included \$644 of employee severance costs related to the 2007 Restructuring, of which \$568 was included in research and development expenses and \$76 was included in general and administrative expenses. All employee severance costs related to the 2007 Restructuring were paid by December 31, 2007.

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Neose Technologies, Inc.

Notes to Financial Statements

(unaudited)

(in thousands, except per share amounts)

In connection with the 2007 Restructuring, we committed to pay future cash retention bonuses to certain employees who were not given notice of termination in March 2007, contingent on their not voluntarily terminating their employment prior to December 31, 2007. Our net loss for the six months ended June 30, 2007 included \$120 of expense related to these cash retention bonuses, of which \$79 was included in research and development expense and \$41 was included in general and administrative expenses. All of these cash retention bonuses were paid by December 31, 2007. We also granted stock options to all employees as part of an employee retention program. These options vested 50% on September 27, 2007 for all holders who had not voluntarily terminated their employment prior to that date, and 50% on March 27, 2008 for all holders who had not voluntarily terminated their employment prior to that date. The aggregate fair market value of the options was \$1,332, which was recognized ratably, net of forfeitures, as compensation expense over the vesting period.

15. Income Tax Benefit

During the six months ended June 30, 2008, we sold Pennsylvania research and development tax credits, resulting in the recognition of \$303 of income tax benefit. During the three months ended June 30, 2007, we sold additional Pennsylvania research and development tax credits, resulting in the recognition of \$533 of income tax benefit.

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

CAUTIONARY STATEMENT PURSUANT TO SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION ACT OF 1995:

This report includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not historical facts and include, but are not limited to, statements about our plans, objectives, representations and contentions that typically may be identified by use of terms such as anticipate, believe, estimate, plan, may, expect, intend, could, potential, and similar expressions, although some forward-looking statements are expressed differently. These forward-looking statements include, among others, statements about our:

- *estimate that our existing cash and cash equivalents, expected proceeds from collaborations and license agreements, and interest income should be sufficient to meet our operating and capital requirements at least into the third quarter of 2009;*

- *expected losses;*

- *expectations for future capital requirements;*

- *expectations regarding net cash utilization and changes in operating expenses;*

- *expectations regarding our stock price and continued listing on NASDAQ;*

- *expectations regarding the scope and expiration of patents;*

- *expectations regarding the timing of non-clinical activities, regulatory meetings and submissions, as well as the progression of clinical trials, for GlycoPEG-GCSF and GlycoPEG-Factor VIIa;*

- *expectations for the development of long-acting versions of G-CSF, Factor VIIa, Factor VIII and Factor IX, and subsequent proprietary drug candidates;*

- *expectations for generating revenue; and*
- *expectations regarding the timing and character of new or expanded collaborations and for the performance of our existing collaboration partners in connection with the development and commercialization of products incorporating our technology.*

You should be aware that the forward-looking statements included in this report represent management's current judgment and expectations, but our actual results, events and performance could differ materially from those in the forward-looking statements. Potential risks and uncertainties that could affect our actual results include the following:

- *our ability to obtain the funds necessary for our operations;*

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- *our ability to meet forecasted timelines due to internal or external causes;*
- *unfavorable non-clinical and clinical results for our product candidates or product categories;*
- *regulatory developments that adversely affect our ability to market our products or obtain government approvals;*
- *our ability to develop commercial-scale manufacturing processes for our products and reagents, either independently or in collaboration with others;*
- *the performance of our contract manufacturers;*
- *our ability to enter into and maintain collaborative arrangements;*
- *our ability to obtain adequate sources of proteins and reagents;*
- *our ability to develop and commercialize products without infringing the patent or intellectual property rights of others;*
- *our ability to expand and protect our intellectual property and to operate without infringing the rights of others;*
- *our ability and our collaborators' ability to develop and commercialize therapeutic proteins and our ability to commercialize our technology;*
- *our ability to attract and retain key personnel;*
- *our ability to satisfy the continued listing requirements of The NASDAQ Stock Market LLC;*

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- *our ability to compete successfully in an intensely competitive field; and*

- *general economic conditions.*

These and other risks and uncertainties that could affect our actual results are discussed in this report and in our other filings with the SEC, particularly in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2007 in the section entitled Risk Factors.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, events, levels of activity, performance, or achievements. We do not assume responsibility for the accuracy and completeness of the forward-looking statements other than as required by applicable law. We do not undertake any duty to update any of the forward-looking statements after the date of this report to conform them to actual results, except as required by the federal securities laws.

You should read this section in combination with the section entitled Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2007, included in our Annual Report on Form 10-K for the year ended December 31, 2007.

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Overview

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We are a clinical-stage biopharmaceutical company focused on the development of next-generation therapeutic proteins, which we believe will be competitive with best-in-class protein drugs currently on the market. We have two therapeutic protein candidates in clinical trials: GlycoPEG-GCSF and GlycoPEG-FVIIa, and two therapeutic protein candidates in the research stage: GlycoPEG-FVIII and GlycoPEG-FIX.

GlycoPEG-GCSF is a long-acting version of G-CSF that we are co-developing with BioGeneriX AG, a company of the ratiopharm Group. G-CSF is prescribed to stimulate production of neutrophils (a type of white blood cell) and is approved for sale in major markets around the world for treatment of neutropenia associated with myelosuppressive chemotherapy. In June 2008, BioGeneriX initiated a Phase II study to evaluate the safety and efficacy of GlycoPEG-GCSF for the treatment of neutropenia associated with myelosuppressive chemotherapy. The study will compare three doses of GlycoPEG-GCSF to the standard, fixed 6 mg dose of Neulasta®. In addition to safety and tolerability, the study will evaluate the duration of severe neutropenia in cycle 1, defined as grade 4 neutropenia ($ANC < 0.5 \times 10^9/L$) and the incidence of febrile neutropenia in cycles 1, 2, 3 and 4 and across all cycles. We expect completion of this Phase II study during the first half of 2009. In November 2007, we reported data from two Phase I clinical trials. That data demonstrated that GlycoPEG-GCSF is a potent stimulator of neutrophils and mobilizer of peripheral blood progenitor cells, and that at comparable doses to Neulasta® (Amgen's marketed, long-acting G-CSF), GlycoPEG-GCSF demonstrated a 60% greater bioavailability, leading to a 30% increase in the generation of neutrophils.

GlycoPEG-FVIIa is a long-acting form of recombinant Factor VIIa that is being developed by our partner, Novo Nordisk, utilizing our GlycoPEGylation technology. Factor VIIa is used in the treatment of bleeding episodes and for the prevention of bleeding during surgery or invasive procedures in patients with congenital hemophilia with inhibitors to coagulation Factors VIII or IX. In June 2008, Novo Nordisk completed an initial Phase I clinical study that assessed the safety and pharmacokinetics of GlycoPEG-FVIIa in healthy volunteers. In the trial a significant prolongation of the half-life of GlycoPEG-FVIIa was observed. Novo Nordisk is also developing long-acting forms of recombinant Factor VIII and recombinant Factor IX utilizing our GlycoPEGylation technology. Factor VIII products are used in the treatment of Hemophilia A, and Factor IX products are used in the treatment of Hemophilia B.

In January 2008, we announced the discontinuation of further development of GlycoPEG-EPO (NE-180), our product candidate intended for the treatment of anemia in patients with chronic kidney disease and cancer patients receiving chemotherapy. The decision to discontinue development was not due to any safety or efficacy concerns about NE-180, but was based on an evaluation of commercial prospects and the likelihood of entering into a timely collaboration for the compound in the context of increased safety concerns in the erythropoiesis-stimulating agent (ESA) category. In connection with the discontinuation of the NE-180 program, we reduced our workforce by approximately 35%. These actions allowed us to significantly reduce our expected cash expenditures and extend our cash runway by approximately one year. We anticipate paying cash severance benefits of approximately \$0.9 million in connection with the workforce

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reduction, all of which was paid out during the six months ended June 30, 2008 except for \$15,000.

We believe that our enzymatic pegylation technology, GlycoPEGylation, can improve the drug properties of therapeutic proteins by building out, and attaching polyethylene glycol (PEG) to, carbohydrate structures at specific sites on the proteins. We are using our technology to develop proprietary versions of protein drugs with proven safety and efficacy and to improve the therapeutic profiles of proteins being developed by our partners. We expect these modified proteins to offer significant advantages, including less frequent dosing and possibly improved efficacy, over the original versions of the drugs now on the market, as well as to meet or exceed the pharmacokinetic profile of next-generation versions of the drugs now on the market. We believe this strategy of targeting drugs with proven safety and efficacy allows us to lower the risk profile of our proprietary development portfolio as compared to *de novo* protein drug development. We intend to continue to focus our research and development resources on therapeutic proteins that we believe have the greatest probability of achieving clinically meaningful therapeutic improvements from our technology and are in commercially attractive categories.

We have incurred operating losses each year since our inception. As of June 30, 2008, we had an accumulated deficit of \$301.8 million. We expect additional losses over the next several years as we continue product research and development efforts and expand our intellectual property portfolio. We have financed our operations through private and public offerings of equity securities, proceeds from debt financings, and revenues from our collaborative agreements.

We believe that our existing cash and cash equivalents, expected proceeds from collaborations and license arrangements, and interest income should be sufficient to meet our operating and capital requirements at least into the third quarter of 2009, although changes in our collaborative relationships or our business, whether or not initiated by us, may cause us to deplete our cash and cash equivalents sooner than the above estimate.

Our common stock is currently listed on the Global Market of The NASDAQ Stock Market LLC. On February 19, 2008, we received a Staff Deficiency Letter from The NASDAQ Stock Market LLC stating that for the last 30 consecutive business days the bid price of our common stock has closed below the minimum \$1.00 per share required for continued inclusion on the NASDAQ Global Market. As a result, we no longer meet NASDAQ's continued listing criteria and have 180 calendar days, or until August 18, 2008, to regain compliance. Our shares will continue to trade on the NASDAQ Global Market during the 180-day period. We may receive an additional 180-day compliance period if we meet all of the initial listing requirements for the NASDAQ Capital Market, except for the bid price requirement. We currently intend to submit an application to transfer to the NASDAQ Capital Market prior to August 18, 2008. If NASDAQ approves the transfer application, we will be afforded the additional compliance period of 180 calendar days following August 18, 2008, or until February 16, 2009, to regain compliance with the minimum bid price requirement of the NASDAQ Capital Market. If we fail to regain compliance with the minimum bid price requirement prior to February 16, 2009, or if we fail to meet the initial listing requirements for inclusion on the NASDAQ Capital Market on August 18, 2008, NASDAQ will provide us with written notification that our common stock will

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be delisted from NASDAQ. At that time, we may appeal the delisting determination to a NASDAQ Listings Qualification Panel pursuant to applicable NASDAQ rules, and our common stock would remain listed until completion of the appeal process. We intend to pursue all available options to regain compliance with the NASDAQ continued listing requirements during the applicable compliance or appeal periods. The delisting of our common stock would significantly affect the ability of investors to trade our securities and would negatively affect the value and liquidity of our common stock.

If delisted from NASDAQ, our common stock will likely be quoted in the over-the-counter market in the so-called pink sheets or quoted in the OTC Bulletin Board. In addition, our common stock would be subject to the rules promulgated under the Securities Exchange Act of 1934 relating to penny stocks. These rules require brokers who sell securities that are subject to the rules, and who sell to persons other than established customers and institutional accredited investors, to complete required documentation, make suitability inquiries of investors and provide investors with information concerning the risks of trading in the security. These requirements could make it more difficult to buy or sell our common stock in the open market. In addition, the delisting of our common stock could materially adversely affect our ability to raise capital on terms acceptable to us or at all. Delisting from NASDAQ could also have other negative results, including the potential loss of confidence by suppliers and employees, the loss of institutional investor interest, fewer business development opportunities, and potential contract claims.

Liquidity and Capital Resources

Overview

We had \$11.4 million in cash and cash equivalents as of June 30, 2008, compared to \$19.3 million as of December 31, 2007. The decrease was due to the continued funding of our operating activities, including the costs associated with the discontinuation of our NE-180 program, and debt repayments. We anticipate the average quarterly spending, net of cash expected to be received for research and development funding reimbursement and milestone payments from our collaborators, for the remainder of 2008 to be approximately \$3.0 million to fund our operating activities, capital expenditures and debt repayments, without giving effect to the impact of entering into any new collaborative agreements.

We had \$11.4 million in cash and cash equivalents as of June 30, 2008, compared to \$19.3 million as of December

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The development of next-generation proprietary protein therapeutics, which we are pursuing both independently and in collaboration with selected partners, will require substantial expenditures by us and our collaborators. We plan to continue financing our operations through private and public offerings of equity securities, proceeds from debt financings, and proceeds from existing and future collaborative agreements. Because our 2008 revenues could be substantially affected by entering into new collaborations and by the financial terms of any new collaborations, we cannot estimate our 2008 revenues. Other than proceeds from our collaborations with Novo Nordisk and BioGeneriX, and any future collaborations with others, we do not expect to generate significant revenues until such time as products using our technology are commercialized, which is not expected during the next several years. We expect an additional several years to elapse before we can expect to generate sufficient cash flow from operations to fund our operating and investing requirements. We believe that our existing cash and cash

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equivalents, expected revenue from collaborations and license arrangements, and interest income should be sufficient to meet our operating and capital requirements at least into the third quarter of 2009. Accordingly, we will need to raise substantial additional funds to continue our business activities and fund our operations until we are generating sufficient cash flow from operations. If we are unable to raise additional capital when required, we may need to delay, scale back, or eliminate some or all of our research and development programs.

Operating Activities

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Net cash used in operating activities was \$7.5 million and \$18.5 million during the six months ended June 30, 2008 and 2007, respectively. Our net loss for the six months ended June 30, 2008 and 2007, was \$6.9 million and \$22.8 million, respectively. Our net loss for the six months ended June 30, 2008 included non-cash income of \$3.6 million relating to a decrease in the fair value of our warrant liability. Our net loss for the six months ended June 30, 2007 included non-cash expense of \$4.4 million from the increase in the fair value of our warrant liability. Revenues were \$2.2 million higher in 2008 compared to 2007 primarily due to the reimbursement of research and development costs under our collaborations with Novo Nordisk and BioGeneriX. During the six months ended June 30, 2008, we received \$3.2 million of milestone payments from one of our collaborators, which also contributed to the reduction of cash used compared to the same period in 2007. Research and development costs decreased by \$5.9 million from 2008 to 2007, due to the discontinuation of our NE-180 program and were partially offset by \$1.1 million increased external costs incurred under our collaborations with Novo Nordisk and BioGeneriX. Fluctuations in operating items vary period-to-period due to, among other factors, the timing of research and development activities, such as the initiation and progress of clinical trials and non-clinical studies.

Investing Activities

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During the six months ended June 30, 2008 and 2007, we invested \$33,000 and \$3.4 million, respectively, in property and equipment. In February 2007, we completed construction of leasehold improvements to a facility that we lease in Horsham, Pennsylvania (Rock Road Facility). We anticipate additional capital expenditures during the remainder of 2008 of approximately \$0.1 million to \$0.2 million. We may finance some or all of these capital expenditures through capital leases or the issuance of new debt or equity. The terms of any new debt could require us to maintain a minimum cash and investments balance, or to transfer cash into an escrow account to collateralize some portion of the debt, or both.

Financing Activities

Equity Financing Activities

In March 2007, we sold, through a private placement, 21.4 million shares of our common stock and warrants to purchase 9.6 million shares of our common stock, including 5.0 million shares of our common stock and warrants to purchase 2.2 million shares of our common stock to investment funds affiliated with certain members of our board of directors, at a price of \$2.02 per unit, generating net proceeds of \$40.5 million. Each unit consisted of one share of our common stock and a warrant to purchase 0.45 shares of our common stock. The warrants have a five-year term and an exercise price of \$1.96 per share.

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Debt Financing Activities

Our total debt decreased to \$0.5 million as of June 30, 2008, compared to \$0.8 million as of December 31, 2007. This decrease primarily resulted from planned debt principal repayments of \$0.7 million and was partially offset by \$0.4 million in proceeds from the issuance of debt to finance insurance policy premiums.

Note Payable Secured by Insurance Policies

In March 2008, we borrowed \$0.4 million to finance insurance policy premiums due on certain insurance policies. The insurance policy premiums, net of amortization, are included in prepaid expenses and other current assets on our Balance Sheets as of June 30, 2008. We are required to pay \$34,000 of principal and interest during each of the eleven months beginning on March 15, 2008 and ending on January 15, 2009. The interest is calculated based on an annual percentage rate of 4.1%. To secure payment of the amounts financed, we granted the lender a security interest in (a) all unearned premiums or dividends payable under the policies, (b) loss payments which may reduce the unearned premiums, subject to any mortgagee or loss payee interests, and (c) any interest in any state guarantee fund relating to the policies.

Equipment Loans

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As of June 30, 2008, we owed \$0.1 million to an equipment lender that financed the purchase of certain equipment and facility improvements, which collateralize the amounts borrowed. Our last payment is scheduled for September 2008, and interest rates applicable to the equipment loans range from 9.1% to 9.5%. During the twelve months ending June 30, 2009, we will make principal and interest payments totaling \$0.1 million under these agreements.

Capital Lease Obligations

The terms of our capital leases require us to make monthly payments through February 2012. As of June 30, 2008, the present value of aggregate minimum lease payments under these agreements was \$0.3 million. Under these agreements, we will be required to make lease payments totaling \$0.1 million during the twelve months ending June 30, 2009.

Operating Leases

We lease laboratory, office, warehouse facilities, and equipment under operating lease agreements. In 2002, we entered into a lease agreement for our Rock Road Facility. The initial term of this lease ends 2022, at which time we have an option to extend the lease for an additional five years, followed by another option to extend the lease for an additional four and one-half years. This lease contains escalation clauses, under which the base rent increases annually by 2%. In January 2007, we entered into a five-year lease agreement for approximately 6,800 square feet of office and warehouse space in Horsham, Pennsylvania.

Summary of Contractual Obligations

A summary of our obligations to make future payments under contracts existing as of December 31, 2007 is included in Item 7, Management's Discussion and Analysis of Financial

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Condition and Results of Operations, of our Annual Report on Form 10-K for the year ended December 31, 2007. The Liquidity and Capital Resources section of this Form 10-Q describes obligations from any material contracts entered into during the six months ended June 30, 2008.

Off-Balance Sheet Arrangements

We are not involved in any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect that is material to investors on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

Critical Accounting Policies and Estimates

A discussion of our critical accounting policies and estimates is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of our Annual Report on Form 10-K for the year ended December 31, 2007. Except as described below, there have not been any changes or additions to our critical accounting policies during the six months ended June 30, 2008.

Stock-based Employee Compensation

The fair value of share-based awards is recognized as expense over the requisite service period, net of estimated forfeitures. We rely primarily on historical experience to estimate expected forfeitures and adjust the annualized forfeiture rate if our historical experience indicates that an adjustment is necessary. During the first quarter of each year, we re-evaluate our forfeiture rate. For the six months ended June 30, 2008, based on our historical experience of option pre-vesting cancellations, we have assumed an annualized forfeiture rate of 34% for our stock options granted to individuals not terminated as a result of a restructuring of our operations. For employees terminated as a result of the restructurings in 2008, 2007 and 2006, we have assumed an annualized forfeiture rate of 100%. For the six months ended June 30, 2007, we assumed an annualized forfeiture rate of 17% for our stock options granted to individuals not terminated as a result of a restructuring of our operations. Under the provisions of SFAS No. 123R, we will record additional expense if the actual forfeiture rate is lower than we estimated, and will record a recovery of prior expense if the actual forfeiture is higher than we estimated.

Results of Operations

We recorded a net loss of \$4.6 million and \$6.9 million during the three and six months ended June 30, 2008, respectively, compared to net losses of \$5.2 million and \$22.8 million for the corresponding periods in 2007. The following sections explain the changes between the reporting periods in each component of net loss.

Revenue from Collaborative Agreements

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Our revenue from collaborative agreements has historically been derived from a few major collaborators. Our collaborative agreements provide for some or all of the following elements: license fees, research and development funding, milestone revenues, and royalties on product sales. A summary of revenue recognized under our collaborative agreements during the

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three and six months ended June 30, 2008 and 2007 is presented in the following table (in thousands):

	Three months ended		Six months ended	
	2008	2007	2008	2007
Novo Nordisk				