

PRO PHARMACEUTICALS INC  
Form 10-Q  
May 13, 2011  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended March 31, 2011

**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 000-32877

**PRO-PHARMACEUTICALS, INC.**

Edgar Filing: PRO PHARMACEUTICALS INC - Form 10-Q

<b>Nevada</b> (State or other jurisdiction of incorporation)	<b>04-3562325</b> (I.R.S. Employer Identification No.)
<b>7 Wells Avenue, Newton, Massachusetts</b> (Address of Principal Executive Offices)	<b>02459</b> (Zip Code)
<b>(617) 559-0033</b> (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 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 (§232.05 of this chapter) 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

The number of shares outstanding of the registrant's common stock as of May 10, 2011 was 69,606,394.

**Table of Contents**

**PRO-PHARMACEUTICALS, INC.**

**INDEX TO FORM 10-Q**

**FOR THE QUARTER ENDED MARCH 31, 2011**

	<b>PAGE</b>
<b>PART I FINANCIAL INFORMATION</b>	
ITEM 1.	
<u>Unaudited Condensed Consolidated Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets as of March 31, 2011 and December 31, 2010 (unaudited)</u>	3
<u>Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2011 and 2010, and for the Cumulative Period From Inception (July 10, 2000) to March 31, 2011 (unaudited)</u>	4
<u>Condensed Consolidated Statement of Changes in Redeemable Convertible Preferred Stock and Stockholders' Deficit for the Three Months Ended March 31, 2011 (unaudited)</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2011 and 2010, and for the Cumulative Period From Inception (July 10, 2000) to March 31, 2011 (unaudited)</u>	6
<u>Notes to Unaudited Condensed Consolidated Financial Statements (unaudited)</u>	7
ITEM 2.	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
ITEM 3.	
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	19
ITEM 4.	
<u>Controls and Procedures</u>	19
<b>PART II OTHER INFORMATION</b>	
ITEM 1.	
<u>Legal Proceedings</u>	19
ITEM 1A.	
<u>Risk Factors</u>	19
ITEM 2.	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	19
ITEM 5.	
<u>Other Information</u>	19
ITEM 6.	
<u>Exhibits</u>	19
<u>SIGNATURES</u>	22

**Table of Contents****PRO-PHARMACEUTICALS, INC.**

(A Development-Stage Company)

**CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

	March 31,	December 31,
	2011	2010
	(in thousands)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 6,948	\$ 5,891
Grant receivable	-	234
Prepaid expenses and other current assets	73	70
Total current assets	7,021	6,195
Property and equipment, net	5	7
Restricted cash	59	59
Intangible assets, net	39	39
Total assets	\$ 7,124	\$ 6,300
<b>LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS DEFICIT</b>		
Current liabilities:		
Accounts payable	\$ 182	\$ 125
Accrued expenses	182	537
Accrued dividends payable	-	48
Deferred revenue	200	200
Warrant liabilities	294	861
Total current liabilities	858	1,771
Other long-term liabilities	7	12
Total liabilities	865	1,783
Commitments and contingencies (Note 9)		
Series B-1 12% redeemable convertible preferred stock; 900,000 shares authorized, issued and outstanding at March 31, 2011 and December 31, 2010, redemption value: \$1,800,000, liquidation value: \$1,800,000 at March 31, 2011	1,669	1,664
Series B-2 12% redeemable convertible preferred stock; 2,100,000 shares authorized at March 31, 2011 and December 31, 2010, 2,100,000 issued and outstanding at March 31, 2011 and December 31, redemption value: \$4,200,000, liquidation value of \$4,200,000 at March 31, 2011	2,527	2,474
Series C super dividend convertible preferred stock; 1,000 shares authorized, 225 and 212 issued and outstanding at March 31, 2011 and December 31, 2010, respectively, redemption value: \$4,500,000, liquidation value: \$2,250,000 at March 31, 2011	2,203	2,073
Stockholders deficit:		

## Edgar Filing: PRO PHARMACEUTICALS INC - Form 10-Q

Undesignated stock, \$0.01 par value; 20,000,000 shares authorized at March 31, 2011 and December 31, 2010, 8,001,000 designated at March 31, 2011 and December 31, 2010		
Series A 12% convertible preferred stock; 5,000,000 shares authorized, 1,592,500 issued and outstanding at March 31, 2011 and December 31, 2010	644	644
Common stock, \$0.001 par value; 300,000,000 shares authorized at March 31, 2011 and December 31, 2010, 68,537,072 and 63,909,155 issued and outstanding at March 31, 2011 and December 31, 2010, respectively	69	64
Additional paid-in capital	58,293	54,022
Deficit accumulated during the development stage	(59,146)	(56,424)
<b>Total stockholders' deficit</b>	<b>(140)</b>	<b>(1,694)</b>
Total liabilities, redeemable convertible preferred stock and stockholders' deficit	\$ 7,124	\$ 6,300

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****PRO-PHARMACEUTICALS, INC.****(A Development-Stage Company)****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**

	<b>Three Months Ended March 31,</b>		<b>Cumulative Period from Inception (July 10, 2000) to March 31, 2011</b>
	<b>2011</b>	<b>2010</b>	
	<b>(in thousands except per share data)</b>		
<b>Operating expenses:</b>			
Research and development	\$ 744	\$ 129	\$ 20,275
General and administrative	1,269	903	36,076
Total operating expenses	2,013	1,032	56,351
Total operating loss	(2,013)	(1,032)	(56,351)
<b>Other income (expense):</b>			
Interest income	5	-	781
Interest expense	-	-	(4,451)
Change in fair value of convertible debt instrument	-	-	(3,426)
Change in fair value of warrant liabilities	(384)	(1,106)	9,162
Other income	-	-	491
Total other income (expense)	(379)	(1,106)	2,557
Net loss	\$ (2,392)	\$ (2,138)	\$ (53,794)
Preferred stock dividends	(272)	(198)	(1,963)
Preferred stock accretion	(58)	(481)	(3,643)
Net loss applicable to common stockholders	\$ (2,722)	\$ (2,817)	\$ (59,400)
Net loss per common share basic and diluted	\$ (0.04)	\$ (0.06)	
Weighted average common shares outstanding basic and diluted	66,932	49,899	

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****PRO-PHARMACEUTICALS, INC.**

(A Development-Stage Company)

**CONSOLIDATED STATEMENT OF CHANGES IN REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' DEFICIT****THREE MONTHS ENDED March 31, 2011 (UNAUDITED)**

(in thousands except share data)

	Series B-1 12% Redeemable Convertible Preferred Stock		Series B-2 12% Redeemable Convertible Preferred Stock		Series C Super Dividend Convertible Preferred Stock		Series A 12% Convertible Preferred Stock		Stockholders' Common Stock		Deficit		
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Additional Paid-In Capital	Deficit Accumulated During the Development Stage	Total Stockholders' Deficit
<b>Balance at December 31, 2010</b>	<b>900,000</b>	<b>\$ 1,664</b>	<b>2,100,000</b>	<b>\$ 2,474</b>	<b>212</b>	<b>\$ 2,073</b>	<b>1,592,500</b>	<b>\$ 644</b>	<b>63,909,155</b>	<b>\$ 64</b>	<b>\$ 54,022</b>	<b>\$ (56,424)</b>	<b>\$ (1,694)</b>
Accretion of Series B redeemable convertible preferred stock		5		40								(45)	(45)
Accretion of beneficial conversion feature for Series B-2				13								(13)	(13)
Issuance of Series C super dividend convertible preferred stock					13	130							
Series A 12% convertible preferred stock dividend									88,096		96	(48)	48
Series B-1 12% redeemable convertible preferred stock dividend									114,143		57	(57)	
									266,332		133	(133)	

Edgar Filing: PRO PHARMACEUTICALS INC - Form 10-Q

Series B-2 12% redeemable convertible preferred stock dividend														
Series C super dividend convertible preferred stock dividend								31,874		34		(34)		
Issuance of common stock upon exercise of warrants								3,507,472	4	3,106				3,110
Issuance of common stock upon exercise of options								620,000	1	134				135
Stock-based compensation expense										711				711
Net loss												(2,392)		(2,392)
<b>Balance at March 31, 2011</b>	<b>900,000</b>	<b>\$ 1,669</b>	<b>2,100,000</b>	<b>\$ 2,527</b>	<b>225</b>	<b>\$ 2,203</b>	<b>1,592,500</b>	<b>\$ 644</b>	<b>68,537,072</b>	<b>\$ 69</b>	<b>\$ 58,293</b>	<b>\$ (59,146)</b>	<b>\$ (140)</b>	

See notes to unaudited condensed consolidated financial statements



**Table of Contents****PRO-PHARMACEUTICALS, INC.****(A Development-Stage Company)****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

	Three Months Ended March 31,		Cumulative Period from Inception (July 10, 2000) to March 31, 2011
	2011	2010	(in thousands)
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net loss	\$ (2,392)	\$ (2,138)	\$ (53,794)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	2	4	539
Stock-based compensation expense	711	303	7,048
Non-cash interest expense	-	-	4,279
Change in fair value of convertible debt instrument	-	-	3,426
Change in fair value of warrant liabilities	384	1,106	(9,162)
Write off of intangible assets	-	-	351
Changes in operating assets and liabilities:			
Grant receivable	234	-	-
Prepaid expenses and other current assets	(3)	(4)	(70)
Accounts payable and accrued expenses	(298)	251	632
Other long-term liabilities	(5)	(283)	7
<b>Net cash used in operating activities</b>	<b>(1,367)</b>	<b>(761)</b>	<b>(46,744)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of property and equipment	-	-	(421)
Change in restricted cash	-	-	(59)
Increase in patents costs and other assets	-	-	(404)
<b>Net cash used in investing activities</b>	<b>-</b>	<b>-</b>	<b>(884)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Net proceeds from issuance of common stock and warrants	-	-	28,690
Net proceeds from issuance of Series A preferred stock and related warrants	-	-	1,691
Net proceeds from issuance of Series B-1 preferred stock and related warrants	-	-	1,548
Net proceeds from issuance of Series B-2 preferred stock and related warrants	-	630	3,935
Net proceeds from issuance of Series C preferred stock	130	-	2,203
Net proceeds from issuance of convertible debt instruments	-	-	10,621
Repayment of convertible debt instruments	-	-	(1,641)
Proceeds from exercise of common stock warrants and options	2,294	-	7,520
Proceeds from shareholder advances	-	-	9
<b>Net cash provided by financing activities</b>	<b>2,424</b>	<b>630</b>	<b>54,576</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>1,057</b>	<b>(131)</b>	<b>6,948</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>5,891</b>	<b>251</b>	<b>-</b>

Edgar Filing: PRO PHARMACEUTICALS INC - Form 10-Q

CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 6,948	\$ 120	\$ 6,948
SUPPLEMENTAL DISCLOSURE Cash paid for interest	\$ -	\$ -	\$ 114
NONCASH FINANCING ACTIVITIES:			
Issuance of equity warrants in connection with equity offerings	\$ -	\$ 423	\$ 5,037
Conversion of accrued expenses into common stock	-	-	303
Cashless exercise of stock options	-	-	98
Conversion and redemption of convertible notes and accrued interest into common stock	-	-	12,243
Conversion of extension costs related to convertible notes into common stock			171
Payment of preferred stock dividends in common stock	320	251	2,011
Dividends payable on preferred stock	-	-	-
Issuance of warrants to induce conversion of notes payable	-	-	503
Issuance of stock to acquire Pro-Pharmaceuticals-NV	-	-	107

See notes to unaudited condensed consolidated financial statements.

---

**Table of Contents**

**PRO-PHARMACEUTICALS, INC.**

**(A DEVELOPMENT-STAGE COMPANY)**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Basis of Presentation**

The unaudited condensed consolidated financial statements as reported in this Quarterly Report on Form 10-Q reflect all adjustments which are, in the opinion of management, necessary to present fairly the financial position of Pro-Pharmaceuticals, Inc. (the Company) as of March 31, 2011 and the results of its operations for the three months ended March 31, 2011 and 2010 and the cumulative period from inception (July 10, 2000) through March 31, 2011 and its cash flows for the three months ended March 31, 2011 and 2010, and for the cumulative period from inception (July 10, 2000) to March 31, 2011. All adjustments made to the interim financial statements include all those of a normal and recurring nature. The Company considers events or transactions that occur after the balance sheet date but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. Subsequent events have been evaluated through the date these financial statements are available to be issued. The results for interim periods are not necessarily indicative of results which may be expected for any other interim period or for the full year.

The unaudited condensed consolidated financial statements of the Company should be read in conjunction with its Annual Report on Form 10-K for the year ended December 31, 2010.

As shown in the unaudited condensed consolidated financial statements, the Company incurred cumulative net losses applicable to common stockholders of approximately \$59.4 million for the cumulative period from inception (July 10, 2000) through March 31, 2011. The Company's net losses have resulted principally from costs associated with (i) research and development expenses, including clinical trial costs, (ii) general and administrative activities and (iii) the Company's financing transactions including interest and the costs related to fair value accounting for the Company's convertible debt instrument and warrant liabilities. As a result of planned expenditures for future research, discovery, development and commercialization activities and potential legal cost to protect its intellectual property, the Company expects to incur additional losses and use additional cash in its operations for the foreseeable future. From inception (July 10, 2000) through March 31, 2011, the Company has raised a net total of approximately \$54.6 million in capital through sale and issuance of common stock, common stock warrants, convertible preferred stock, redeemable convertible preferred stock, convertible debt securities in public and private offerings and the exercise of common stock options and warrants. From inception (July 10, 2000) through March 31, 2011, the Company has used approximately \$46.7 million of cash in its operations.

At March 31, 2011, the Company had \$6,948,000 of unrestricted cash and cash equivalents available to fund future operations. Subsequent to March 31, 2011, the Company issued 1,039,322 shares of common stock for the exercise of common stock warrants and options, resulting in cash proceeds of \$614,000. The Company believes that with the funds on hand at March 31, 2011 and cash received subsequent to quarter end, there is sufficient cash to fund operations through 2012. The Company is actively seeking to raise additional capital. If the Company is unsuccessful in raising additional capital before the end of 2012, the Company may be required to cease operations or seek bankruptcy protection.

The Company is subject to a number of risks similar to those of other development-stage companies, including dependence on key individuals, uncertainty of product development and generation of revenues, dependence on outside sources of capital, risks associated with clinical trials of products, dependence on third-party collaborators for research operations, need for regulatory approval of products, risks associated with protection of intellectual property, and competition with larger, better-capitalized companies. Successful completion of the Company's development program and, ultimately, the attainment of profitable operations is dependent upon future events, including obtaining adequate financing to fulfill its development activities and achieving a level of revenues adequate to support the Company's cost structure. There are no assurances that the Company will be able to obtain additional financing on favorable terms, or at all, or successfully market its products.

**2. Agreement with PROCAPS S.A. and Research Grants**

*Agreement with PROCAPS S.A.*

## Edgar Filing: PRO PHARMACEUTICALS INC - Form 10-Q

On March 25, 2010, the Company granted PROCAPS S.A. ( PROCAPS ) exclusive rights to market and sell DAVANAT<sup>®</sup> to treat cancer in Colombia, South America. PROCAPS is a large, international, privately held pharmaceutical company based in Barranquilla, Colombia. Under terms of the agreement, PROCAPS is responsible for obtaining regulatory and pricing approval in Colombia, South America. PROCAPS also will be responsible for the vial filling, packaging, marketing and distribution of DAVANAT<sup>®</sup> in the region.

**Table of Contents**

Once approved for sale by regulators, the Company will receive a transfer payment for each dose of DAVANAT<sup>®</sup> shipped to PROCAPS, in addition to a royalty above a minimum annual sales threshold. In October 2010, the Company received a payment of \$200,000 and shipped DAVANAT<sup>®</sup> to PROCAPS to be used by PROCAPS to qualify its vial filling process and to replicate the Company's stability study. The Company retains all intellectual property rights and is the owner of the regulatory approval of DAVANAT<sup>®</sup> in the region. PROCAPS has first negotiation rights to other countries in South and Central America and the Caribbean. Should we gain approval in Colombia, PROCAPS may then obtain the marketing authorization in more than 10 countries in Latin America.

The Company recorded the \$200,000 payment from PROCAPS as deferred revenue on the consolidated balance sheets as of March 31, 2011 and December 31, 2010 and will recognize the revenue when the remaining deliverables of the collaboration agreement have been completed.

*Qualifying Therapeutic Discovery Project*

In October 2010, the Company was notified that it was awarded \$489,000 total in two federal grants under the Qualifying Therapeutic Discovery Project ( QTDP ) Program for its DAVANAT<sup>®</sup> anti-cancer compound and for its GR/GM-Series of anti-fibrotic, cirrhosis compounds for work performed during 2010 and 2009. The Company recognized this grant in other income in the statement of operations for the year ended December 31, 2010. The Company received \$255,000 of the grant in 2010 and the remaining \$234,000 was received in 2011 and is included in grants receivable on the consolidated balance sheet at December 31, 2010.

**3. Stock-Based Compensation**

Stock-based compensation expense related to stock options, restricted stock and warrants totaled \$711,000 and \$303,000 for the three months ended March 31, 2011 and 2010, respectively.

*Stock Options*

The following table summarizes the stock option activity in the Company's equity incentive plans from December 31, 2010 through March 31, 2011:

	Shares	Weighted Average Exercise Price
Outstanding, December 31, 2010	11,794,250	\$ 1.07
Granted	5,500,000	1.15
Exercised	(620,000)	0.22
Options forfeited/cancelled	(1,409,000)	1.08
<b>Outstanding, March 31, 2011</b>	<b>15,265,250</b>	<b>\$ 1.13</b>

As of March 31, 2011, there was \$3,685,000 of unrecognized compensation related to 4,750,000 unvested options which is expected to be recognized over a weighted average period of approximately 3.3 years. The weighted-average grant date fair value for options granted during the three months ended March 31, 2011 and March 31, 2010, was \$0.82 and \$0.26, respectively.

Of the 5,500,000 options granted during the three months ended March 31, 2011, 1,000,000 vest only upon the achievement of certain market conditions (500,000 and 500,000 upon the Company achieving a market capitalization of \$5 billion and \$10 billion, respectively).

The fair value of the options granted is determined using the Black-Scholes option-pricing model. The following weighted average assumptions were used:

**Table of Contents**

	Three Months Ended March 31,		Cumulative Period from Inception (July 10, 2000) to March 31, 2011
	2011	2010	2011
Risk-free interest rate	2.19%	2.38%	2.37%
Expected life of the options	5 years	5 years	5 years
Expected volatility of the underlying stock	115%	126%	113%
Expected dividend rate	0%	0%	0%

*Restricted Stock.*

During the year ended December 31, 2009, the Company granted 2,500,000 shares of restricted common stock to members of its Board of Directors. These shares are restricted and any unvested shares are subject to forfeiture upon termination and would revert back to the Company. Of the 2,500,000 shares, 2,343,750 were vested as of December 31, 2010 and the remaining 156,250 vested during the three months ended March 31, 2011. The restricted shares were valued at \$450,000 (\$0.18 per share) at the date of grant, which was recognized over the vesting period.

**4. Accrued Expenses**

Accrued expenses consist of the following:

	March 31, 2011	December 31, 2010
	(in thousands)	
Legal and accounting fees	\$ 39	\$ 94
Accrued compensation	79	87
Severance agreement (Note 9)	-	293
Other	64	63
<b>Total</b>	<b>\$ 182</b>	<b>\$ 537</b>

**5. Common Stock Warrants**

The following table summarizes the stock warrant activity from December 31, 2010 through March 31, 2011:

	Shares	Weighted Average Exercise Price
Outstanding, December 31, 2010	51,515,194	\$ 0.63
Granted	-	0.00
Exercised	(3,507,472)	0.62
Forfeited/cancelled	-	0.00
<b>Outstanding, March 31, 2011</b>	<b>48,007,722</b>	<b>\$ 0.63</b>

*Consultant Warrants*

In April 2009, the Company entered into agreements with consultants that provided for the grant of warrants for 330,000 shares of common stock at an exercise price of \$0.50 per share. Of the 330,000 warrants, 200,000 remained vested as of March 31, 2011. When it became probable

## Edgar Filing: PRO PHARMACEUTICALS INC - Form 10-Q

that the remaining 200,000 warrants would vest, the Company valued the warrants at \$142,000 as of March 31, 2011 using the following assumptions: expected life of 2.04 years, volatility of 97%, risk free interest rates of 0.8% and zero dividends. The Company recognized expense related to the 200,000 warrants of \$8,000 and \$32,000 for the three months ended March 31, 2011 and March 31, 2010, respectively.

**Table of Contents**

In May 2010, the Company entered into an agreement with a consultant that provided for the grant of warrants for 72,000 shares of common stock at an exercise price of \$2.50 per share. The warrants vest at a rate of 3,000 per month and the unvested warrants will be revalued as they vest. The following assumptions were used to value the warrants for the three months ended March 31, 2011: an expected life of 3.15 to 3.32 years, volatility of 128% to 130%, risk free interest rate of 0.98% to 1.29% and zero dividends. At March 31, 2011, 39,000 warrants were vested. The company recognized an expense of \$7,000 related to these warrants during the three months ended March 31, 2011.

In May 2010, the Company entered into an agreement with a consultant that provided for the grant of warrants for 500,000 shares of common stock at an exercise price of \$0.75 per share and which vest upon the achievement of certain milestones. At March 31, 2011, all 500,000 warrants were unvested. The Company will value and recognize the expense related to these warrants as they vest. The Company did not recognize any expense related to these warrants during the three months ended March 31, 2011, as the Company determined that it was not yet probable that the milestones will be achieved.

In June 2010, the Company entered into an agreement with a consultant, who was also a board member, which provided for the grant of warrants for 600,000 shares of common stock at an exercise price of \$0.71 per share. Of the 600,000 warrants, 150,000 vested immediately on signing of the agreement, 150,000 vest at the end of one year and the remaining 300,000 warrants vest based on the achievement of certain milestones. The following assumptions were used to value the warrants on March 7, 2011 at the date the consultant effectively became an employee of the Company: an expected life of 4.28 years, volatility of 135%, risk free interest rate of 1.705% and zero dividends. The Company recognized an expense of \$127,000 related to these warrants during the three months ended March 31, 2011.

**6. Fair Value of Financial Instruments**

In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs utilize data points that are observable, such as quoted prices, interest rates and yield curves. Fair values determined by Level 3 inputs utilize unobservable data points for the asset or liability. The Company's financial liabilities have been classified as Level 2. These Level 2 liabilities consist of warrant liabilities and have been valued using the Black-Scholes pricing model.

The Company uses the Black-Scholes pricing model to calculate fair value of its warrant liabilities. Key assumptions used to apply these models are as follows:

	Warrant Liabilities	
	March 31, 2011	December 31, 2010
Risk free interest rate	0.09%	0.19%
Expected life	0.37 years	0.62 years
Expected volatility of common share price	76%	70%
Common share price	\$ 1.04	\$ 0.90

Below is a summary of our fair value measurements at March 31, 2011 and December 31, 2010:

	Value at Period End	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(in thousands)			
<b>March 31, 2011:</b>				
Warrant liabilities	\$ 294	\$ -	\$ 294	\$ -
<b>December 31, 2010:</b>				
Warrant liabilities	\$ 861	\$ -	\$ 861	\$ -

The Company's financial instruments consist of cash equivalents, accounts payable and accrued expenses. The estimated fair value of these financial instruments approximates their carrying value due to their short-term nature.



**7. Preferred Stock**  
*Series B Preferred Stock*

## Table of Contents

Through a series of closings from February 2009 through May 2010, the Company issued and sold a total of (i) 900,000 shares of Series B-1 convertible preferred stock ( Series B-1 redeemable convertible preferred stock or Series B-1 ) and related common stock warrants for 10,800,000 shares of common stock and (ii) 2,100,000 shares of Series B-2 convertible preferred stock ( Series B-2 redeemable convertible preferred stock or Series B-2 ) and together with the Series B-1, the Series B ) and related warrants for 25,200,000 shares of common stock. During the three months ended March 31, 2010, the Company issued 330,000 shares of Series B-2 and related warrants for net proceeds of \$630,000. Pursuant to an agreement with the holder of all shares of Series B, on January 26, 2011, the Company amended and restated the Certificate of Designation of Preferences, Rights and Limitations for the Series B-1 Convertible Preferred Stock and Series B-2 Convertible Preferred Stock, as previously amended, to (i) delete Section 5(c) (entitled Mandatory Conversion ) in order to remove the Company's right to compel conversion of the Series B Preferred Stock to shares of its Common Stock, (ii) amend the definitions in Section 1 (entitled Definitions ) of the terms Series B-1 Redemption Date and the Series B-2 Redemption Date in order to extend such redemption dates to be the earlier of February 12, 2019, or the date of a promissory note issued to David Platt, Ph.D. pursuant to a separation agreement between him and the Company, (iii) amend Section 3 (entitled Dividends ) such that dividends are payable in cash or shares of Common Stock valued at 100% of the volume weighted average price of the Common Stock for the 20 consecutive trading days prior to the dividend payment date on and after September 30, 2011, and (iv) insert new Section 5(d) (entitled Automatic Conversion Upon Transfer ) to require that any request for transfer of shares of Series B Preferred Stock to another holder shall result in an automatic conversion to shares of Common Stock.

### *Series C 6% Super Dividend Convertible Preferred Stock*

On December 29, 2010, the Company designated and authorized the sale and issuance of up to 1,000 shares of Series C Super Dividend Convertible Preferred Stock ( Series C ) with a par value of \$0.01 and a stated value equal to \$10,000 (the Stated Value ).

On December 30, 2010, the Company sold and issued 212 shares of Series C at a price of \$10,000 per share for gross proceeds of \$2,120,000. The Company incurred \$47,000 of cash transaction costs resulting in net cash proceeds of \$2,073,000. In addition, the Company issued 3,000 warrants exercisable at \$1.20 to a placement agent which had a de minimis value.

During January 2011, the Company sold and issued 13 shares of Series C at a price of \$10,000 per share for gross proceeds of \$130,000.

The terms of the Series C are as follows:

*Conversion Rights.* Each holder of Series C may convert all, but not less than all, of his Series C shares plus accrued and unpaid dividends into Common Stock at the price of \$1.00 per share of Common Stock ( Conversion Price ), such that 10,000 shares of Common Stock will be issued per each converted share of Series C (accrued and unpaid dividends will be issued as additional shares).

Subject to the continuing obligation to pay post conversion dividends, the Company may convert all, but not less than all, of the Series C (plus all accrued and unpaid dividends) into Common Stock, at the Conversion Price, upon such time that the closing price of the Common Stock is no less than \$3.00 per share for 15 consecutive trading days.

*Dividends.* Holders of Series C shall be entitled to receive cumulative non-compounding dividends at the rate per share of Series C equal to the greater of (i) 6% per annum of the Stated Value (also defined as the Floor ) or (ii) 2.5% of net sales until the total dividends paid is equal to the initial investment and 1.25% of net sales thereafter. The maximum amount each Series C shareholder will receive in dividend payments is equal to \$100,000 (the Maximum Payout ). For purposes of this dividend calculation, net sales shall mean gross revenues actually received by the Company, from the sale or licensing of the product DANA V A T<sup>®</sup>, less chargebacks, returns, expenses attributable to product recalls, duties, customs, sales tax, freight, insurance, shipping expenses, allowances and other customary deductions.

The dividend shall be payable in arrears semi annually on March 31 and September 30, beginning with the first such date after the original issue date; provided, however, that all dividends and all other distributions shall cease, and no further dividends or other distributions shall be paid, in respect of each share of Series C from and after such time that the Maximum Payout has been paid in respect of such share of Series C. Such dividends shall be payable at the Company's option either in cash or in duly authorized, fully paid and non-assessable shares of Common Stock valued at the higher of (i) \$0.50 per share or (ii) the average of the Common Stock trading price for the ten (10) consecutive trading days ending on the trading day that is immediately prior to the dividend payment date.

*Series C Post Conversion Dividend Right.* In the event that any share of Series C is converted into Common Stock before the Maximum Payout is paid in respect of such converted share of Series C, then the holder shall have the right to continue to receive dividends in respect of such converted share of Series C equal to the remaining payout (the Series C Preferred Stock Post Conversion Dividend Right ) which shall be equal to the Maximum Payout less the cumulative dividends received through the conversion date. One share of Series C Preferred Stock Post Conversion Dividend Right shall be issued for each such converted share of Series C. The holder of each Series C Preferred Stock Post

Conversion Dividend Right shall receive the remaining payout on an equal basis and in conjunction with the then outstanding shares of Series C

**Table of Contents**

and all the other then outstanding Series C Post Conversion Dividend Rights, in the same manner and subject to the same terms and conditions as applicable to the payment of dividends on each share of Series C, except that for purposes of calculating the dividend the Floor shall not apply. The Series C Preferred Stock Post Conversion Dividend Right shall have no stated value, liquidation preference or right to any dividends or distributions other than the remaining payout. The Series C Preferred Stock Post Conversion Right is subject to redemption in the same manner as outstanding Series C shares.

At the date of issuance, the Series C have an embedded dividend right to continue to receive dividend payments after conversion to common stock (the Series C Post Conversion Dividend Right) which requires bifurcation. The value of this post conversion dividend right on the date of issuance was determined to be de minimis due to the payment of a dividend stream other than the 6% dividend and conversion of Series C prior to the Company achieving sales of DANAVAT<sup>®</sup> was deemed improbable at that time. Upon a conversion of the Series C, the Company will be required to record a liability and the related expense during the period of conversion. The Company will continue to evaluate and assess the Series C Post Conversion Dividend Right for each reporting period.

*Liquidation Rights.* In the event of any liquidation, dissolution or winding up of the Company, either voluntarily or involuntarily, the holders of Series C will receive \$10,000 per share plus accrued and unpaid dividends, payable prior and in preference to any distributions to the holders of Common Stock but after and subordinate to the Series A 12% Convertible Preferred Stock ( Series A ), Series B-1 and Series B-2, subject to the Maximum Payout.

*Redemption.* Upon a sale of the Company, the Company shall redeem all of the then outstanding shares of Series C and Series C Preferred Stock Post Conversion Rights within thirty (30) days after the transaction constituting the sale of the Company is closed and such closing is fully funded. The price to redeem a share of Series C and each redeemed Series C Preferred Stock Post Conversion Redemption Right shall be equal to (i) (A) the applicable return on investment ( ROI ) percentage, multiplied by (B) \$10,000, minus (ii) the cumulative dividends received through the redemption date. The redemption price shall be payable at our option either in cash or in shares of common stock valued at the higher of (i) \$0.50 per share or (ii) the average market price for the ten consecutive trading days ending immediately prior to the date of redemption. The ROI Percentage shall mean the percentage that applies as of the redemption date, as follows:

ROI Percentage	
200%	before the second anniversary of the date of issuance;
250%	on or after the second anniversary of the date of issuance, but before the third anniversary of the date of issuance;
300%	on or after the third anniversary of the date of issuance, but before the fourth anniversary of the date of issuance;
350%	on or after the fourth anniversary of the date of issuance, but before the fifth anniversary of the date of issuance;
400%	on or after the fifth anniversary of the date of issuance, but before the sixth anniversary of the date of issuance;
450%	on or after the sixth anniversary of the date of issuance, but before the seventh anniversary of the date of issuance;
500%	on or after the seventh anniversary of the date of issuance, but before the eighth anniversary of the date of issuance; and
550%	on or after the eighth anniversary of the date of issuance, but before the ninth anniversary of the date of issuance.

Due to the redemption feature, the Company has presented the Series C outside of permanent equity, in the mezzanine of the consolidated balance sheet at March 31, 2011 and December 31, 2010.

*Voting Rights.* The Series C shares have no voting rights.

**8. Loss Per Share**

Basic loss per share is based on the weighted-average number of common shares outstanding during each period. Diluted loss per share is based on basic shares as determined above plus the incremental shares that would be issued upon the assumed exercise of in-the-money stock options and warrants using the treasury stock method. The computation of diluted net loss per share does not assume the issuance of common shares that have an anti-dilutive effect on net loss per share. For the three month periods ended March 31, 2011 and 2010, all stock options, warrants and potential shares related to conversion of the Series A, the Series B and the Series C were excluded from the computation of diluted net loss per share. Dilutive shares which could exist pursuant to the exercise of outstanding stock instruments and which were not included in the calculation because their affect would have been anti-dilutive are as follows:



**Table of Contents**

	March 31, 2011 (Shares)	March 31, 2010 (Shares)
Warrants to purchase shares of common stock	48,007,722	54,597,255
Options to purchase shares of common stock	15,265,250	12,383,250
Restricted shares subject to vesting	-	1,250,000
Shares of common stock issuable upon conversion of preferred stock	15,842,500	11,857,500
	79,115,472	80,088,005

**9. Commitments and Contingencies***Separation Agreement Former Chief Executive Officer and Chairman of the Board of Directors*

In February 2009, the Company entered into a Separation Agreement in connection with the resignation of David Platt, Ph.D., the Company's former Chief Executive Officer and Chairman of the Board of Directors. The Separation Agreement provides that the Company shall continue to pay Dr. Platt his current salary at a monthly rate of \$21,667 for 24 months and that it may defer payment of a portion of such salary amounts greater than \$10,000 per month (so long as Dr. Platt does not receive payments of less than the salary payments being made to the Company's Chief Executive Officer). However, all deferred amounts will continue to accrue and will be payable on the earlier of (i) the Company receiving a minimum of \$4.0 million of funding after February 12, 2009, or (ii) February 12, 2011. The Company also agreed to continue to (i) provide health and dental insurance benefits to Dr. Platt, until the first to occur of February 12, 2011 or the date Dr. Platt and his family become eligible to receive health and dental insurance benefits under the plans of a subsequent employer and (ii) make the current monthly lease payments on his automobile until February 12, 2011. The Company recognized the full amount of the salary, health insurance and automobile during the first quarter of 2009. The remaining liability related to this severance is reflected in accrued expenses (\$293,000) on the condensed consolidated balance sheet at December 31, 2010 and was paid to Dr. Platt on February 12, 2011.

The Separation Agreement also provides for the deferral of a \$1.0 million severance payment due to Dr. Platt under his employment agreement until the occurrence of any of the following milestone events: (i) the approval by the Food and Drug Administration for a new drug application (NDA) for any drug candidate or drug delivery candidate based on the DAVANĀ Technology (whether or not such technology is patented). We also will grant Dr. Platt fully vested cashless stock option with identical terms to purchase at least 500,000 shares of common stock; (ii) consummation of a transaction with a pharmaceutical company expected to result in at least \$10.0 million of equity investment or \$50 million of royalty revenue to the Company. The Company also will grant Dr. Platt fully vested cashless-exercise stock options exercisable to purchase at least 300,000 shares of common stock for ten (10) years at an exercise price not less than the fair market value of the Common Stock determined as of the date of the grant; or (iii) the renewed listing of our securities on a national securities exchange. Payment upon the events (i) and (iii) may be deferred up to nine months, and if the Company has insufficient cash at the time of any of such events, it may issue Dr. Platt a secured promissory note for such amount. If the Company file a voluntary or involuntary petition for bankruptcy, whether or not a milestone event has occurred, such event shall trigger our obligation to pay the \$1.0 million with the result that Dr. Platt may assert a claim for such obligation against the bankruptcy estate. Due to the uncertainties regarding the achievement of any of the milestones as described, the Company has not accrued for the \$1.0 million severance nor has it recognized the value of the unissued stock options as of December 31, 2010. When it is deemed probable that one or more of the milestone events will be achieved, the Company will then recognize the \$1.0 million severance and the expense related to the issuance of the stock option at that time based on the then current fair value.

*Legal Proceedings*

The Company records accruals for such contingencies to the extent that the Company concludes that their occurrence is probable and the related damages are estimable. There has been no change in the matters reported in our Annual Report on Form 10-K for the year ended December 31, 2010.

**10. Subsequent Events**

The Company has evaluated all events or transactions that occurred through the date on which the financial statements were issued, noting the following:

Edgar Filing: PRO PHARMACEUTICALS INC - Form 10-Q

Subsequent to March 31, 2011, the Company issued 1,039,322 shares of common stock for the exercise of common stock warrants, resulting in cash proceeds of \$614,000.

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

In addition to historical information, the following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements as defined under federal securities laws and is subject to the safe harbor created therein for forward-looking statements. Such statements include, but are not limited to, statements concerning our anticipated operating results, research and development, clinical trials, regulatory proceedings, legal proceedings, and financial resources, and can be identified by use of words such as, for example, anticipate, estimate, expect, project, intend, plan, believe and would, should, could or may. Forward-looking statements are based on our expectations, estimates and projections about the industry and markets in which Pro-Pharmaceuticals operates, and management's beliefs and assumptions. These statements are not guarantees of future performance and involve certain known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed or implied by such statements. Such risks and uncertainties are related to, without limitation, our early stage of development, our dependence on outside capital, uncertainties of our technology and clinical trials, uncertainties of regulatory approval requirements for our products, competition and stock price volatility in the biotechnology industry, limited trading volume for our stock, concentration of ownership of our stock, and other risks detailed herein and from time to time in our SEC reports. The following discussion should be read in conjunction with the accompanying consolidated financial statements and notes thereto of Pro-Pharmaceuticals appearing elsewhere herein.

**Overview**

We are a development-stage company engaged in the discovery and development of therapeutic compounds that target Galectin proteins that we believe enhance existing cancer treatments. We believe our therapeutics could also be used in the treatment of liver, microbial and inflammatory diseases. All of our products are presently in development, including pre-clinical and clinical trials.

Since our inception on July 10, 2000, our primary focus has been the development of a new generation of anti-cancer treatments using polysaccharide polymers which are designed to increase survival and improve the quality of life for cancer patients. Our lead product candidate, DAVANAT<sup>®</sup>, is a patented, new chemical entity that we believe, when administered in combination with chemotherapies or biologics, or vaccines increases efficacy while reducing serious adverse effects. We hold the patent on DAVANAT<sup>®</sup>, without any licensing or royalty obligations.

At March 31, 2011, we had \$6,948,000 of unrestricted cash to fund our operations. Subsequent to year end, we received \$614,000 from the exercise of warrants and options for 1,039,322 shares of our common stock. We believe that with the cash received subsequent to year end and the cash on hand at March 31, 2011, there is sufficient cash to fund operations through 2012. We will require more cash to fund our operations and believe we will be able to obtain additional financing. However, there can be no assurance that we will be successful in obtaining such new financing or, if available, that such financing will be on terms favorable to us.

*Development of DAVANAT<sup>®</sup> Technology*

In 2002, the Food and Drug Administration (FDA) granted an Investigational New Drug (IND) application for us to administer DAVANAT<sup>®</sup> in combination with 5-FU to treat late-stage cancer patients with solid tumors. 5-FU is FDA-approved, and one of the most widely used chemotherapies for treatment of various types of cancer, including colorectal, breast and gastrointestinal. We believe that using DAVANAT<sup>®</sup> in combination with 5-FU enables greater absorption of the chemotherapy in cancer cells while reducing its toxic side effects.

The FDA also has granted us an IND for DAVANAT<sup>®</sup> to be administered with Avastin<sup>®</sup>, 5-FU and leucovorin in a combination therapy to treat early-stage colorectal cancer patients and an IND for DAVANAT<sup>®</sup> to be administered with 5-FU to treat early stage bile duct cancer patients. In addition, the FDA also has granted us, on a case-by-case basis, the ability to treat patients with breast cancer in response to physicians' requests for so-called compassionate use.

To date, DAVANAT<sup>®</sup> has been administered to approximately 100 cancer patients. Data from a Phase II trial for end-stage colorectal cancer patients showed that DAVANAT<sup>®</sup> in combination with 5-FU extended median survival to 6.7 months with significantly reduced side effects, as compared to 4.6 months for best standard of care as determined by the patients' physicians. These clinical trials also showed that patients experienced fewer adverse side effects of the chemotherapy and required less hospitalization.

Our pre-clinical and clinical trial data also show that DAVANAT<sup>®</sup> is well tolerated, safe and non-toxic.

We believe, based on the outcome of our clinical trials to date, that DAVANAT<sup>®</sup>, when co-administered with 5-FU or other chemotherapies or biologics is superior to the current standard of care. We plan to file NDAs for DAVANAT<sup>®</sup> in combination with other chemotherapies, biologics and vaccines.



## Edgar Filing: PRO PHARMACEUTICALS INC - Form 10-Q

According to its published guidance, the FDA initially determines whether a New Drug Application ( NDA ) filing is complete for purposes of allowing a review, and, if allowed, then determines whether to approve the NDA, a process that takes six or ten months. Upon approval, an

## **Table of Contents**

applicant may commence commercial marketing and distribution of the approved products.

In May 2008, we submitted a Drug Master File ( DMF ) for DAVANAT<sup>®</sup> to the FDA. This is an important step toward the filing of our DAVANAT<sup>®</sup> NDA because a DMF contains confidential detailed information in support of the NDA about facilities, processes or articles used in the chemistry, manufacturing, controls, processing, packaging, and storing or stability of drugs. We believe the DMF represents a significant milestone in our eventual commercialization of DAVANAT<sup>®</sup> because it demonstrates our ability to produce commercial quantities of pharmaceutical-grade DAVANAT<sup>®</sup> under current Good Manufacturing Process ( cGMP ) standards. A DMF can be cross-referenced by potential partners to use in combination with other therapies to expedite clinical studies and submission of NDAs.

In September 2008, we submitted a clinical and pre-clinical package to the FDA in support of our DAVANAT<sup>®</sup> NDA. The FDA reported to us in its minutes for the December 2008 meeting that we will be required to conduct a Phase III trial to demonstrate superiority to the best standard of care for late stage colorectal cancer patients.

On December 17, 2010, we met with officials from the FDA to present our Phase III clinical development program for DAVANAT<sup>®</sup>. Agreement was reached on the design of pivotal, randomized, controlled, and blinded Phase III clinical trials of DAVANAT<sup>®</sup> co-administered with standard chemotherapy for second line treatment of patients with metastatic colorectal cancer.

On March 9th, 2011 we announced that our Board of Directors named Peter G. Traber, M.D., President and Chief Executive Officer, effective March 17, 2011. Prior to being named President and Chief Executive Officer, Dr. Traber had been our interim Chief Medical Officer and has been a member of our Board of Directors since February 2009. Dr. Traber was President Emeritus and former Chief Executive Officer of Baylor School of Medicine. His previous positions include Senior Vice President of Clinical Development and Medical Affairs and Chief Medical Officer of GlaxoSmithKline, and Chief Executive Officer of the University of Pennsylvania Health System.

### *Development of GM and GR Series of Anti-Fibrosis Compounds*

We are also developing therapeutic compounds for treatment of other serious disease, such as liver fibrosis. The GM and GR series of compounds are first-in-class, novel carbohydrate compounds that significantly reduced collagen expression and reversed fibrosis in animal models.

Uncontrolled collagen expression is a pathological process that occurs during the fibrotic process, affecting various organs leading to scar tissue. Chemical toxicity, viral infection or physical injury cause liver, renal and other types of fibrosis. According to the American Liver Foundation, more than 25 million Americans are or have been afflicted with liver and biliary diseases. The disease is even more of a problem outside the U.S. because of the prevalence of chronic hepatitis B and C that often results in fibrosis, and ultimately cirrhosis, of the liver. The area of anti-fibrotics is generating great interest based on their potential to impact chronic liver disease. The need for an effective therapeutic solution for liver fibrosis is acute, and this innovative project would significantly advance treatment in this critical area. The only current treatment for late stage fibrosis or cirrhosis is a liver transplant. Therefore, carbohydrate polymers were created and screened to inhibit collagen production in in-vivo and in-vitro fibrosis models.

In December 2010, we announced that we had entered into an extension of our research collaboration with Mount Sinai School of Medicine which began in 2006 to evaluate, in pre-clinical models, the anti-fibrotic effects of several of the Company's novel, Galectin-targeting compounds. Mount Sinai has one of the world's largest, most productive and well-respected liver disease investigation programs.

Dr. Scott Friedman, Chief of Liver Diseases, Division of Medicine at Mount Sinai, has performed pioneering research into the underlying causes of scarring, or fibrosis associated with chronic liver disease, which affects millions worldwide. Dr. Friedman was among the first to isolate and characterize the hepatic stellate cell, which is the key cell type responsible for scar production in liver.

In initial experiments in Dr. Friedman's laboratory, our polysaccharide compounds that target Galectin receptors markedly reduced the markers of fibrosis in cultured stellate cells and reversed the formation of fibrotic tissue in diseased rat livers. In the extension of our research collaboration, he and his team will be testing several of our galactomannans and rhamnogalacturonans as Galectin blockers in liver anti-fibrotic therapies. Specifically Dr. Friedman will complete the in vitro and in vivo analysis of several of our compounds for anti-fibrotic efficacy and mechanism of action using state-of-the-art molecular methods to assess fibrosis, fibrogenic gene expression and liver function. This work will lead to an IND to begin clinical investigations.

### *Agreement with PROCAPS S.A.*

## Edgar Filing: PRO PHARMACEUTICALS INC - Form 10-Q

On March 25, 2010, the Company granted PROCAPS S.A. ( PROCAPS ) exclusive rights to market and sell DAVANAT<sup>®</sup> to treat cancer in Colombia, South America. PROCAPS is a large, international, privately held pharmaceutical company based in Barranquilla, Colombia. Under terms of the agreement, PROCAPS is responsible for obtaining regulatory and pricing approval in Colombia, South America. PROCAPS also will be responsible for the vial filling, packaging, marketing and distribution of DAVANAT<sup>®</sup> in the region.

**Table of Contents**

Once approved for sale by regulators, the Company will receive a transfer payment for each dose of DAVANAT<sup>®</sup> shipped to PROCAPS, in addition to a royalty above a minimum annual sales threshold. In October 2010, the Company received a payment of \$200,000 and shipped DAVANAT<sup>®</sup> to PROCAPS to be used by PROCAPS to qualify its vial filling process and to replicate the Company's stability study. The Company retains all intellectual property rights and is the owner of the regulatory approval of DAVANAT<sup>®</sup> in the region. PROCAPS has first negotiation rights to other countries in South and Central America and the Caribbean. Should we gain approval in Colombia, PROCAPS may then obtain the marketing authorization in more than 10 countries in Latin America.

The Company recorded the \$200,000 payment from PROCAPS as deferred revenue on the consolidated balance sheets as of March 31, 2011 and December 31, 2010 and will recognize the revenue when the remaining deliverables of the collaboration agreement have been completed.

*Qualifying Therapeutic Discovery Project*

In October 2010, the Company was notified that it was awarded \$489,000 total in two federal grants under the Qualifying Therapeutic Discovery Project ( QTDP ) Program for its DAVANAT anti-cancer compound and for its GR/GM-Series of anti-fibrotic, cirrhosis compounds for work performed during 2010 and 2009. The Company recognized this grant in other income in the statement of operations for the year ended December 31, 2010. The Company received \$255,000 of the grant in 2010 and the remaining \$234,000 was received in 2011 and is included in grants receivable on the consolidated balance sheet at December 31, 2010.

**Results of Operations****Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010**

*Research and Development Expense.* During the three-months ended March 31, 2011, research and development expenses increased \$615,000, or 477%, to \$744,000, as compared to \$129,000 incurred during the same period in 2010. We generally categorize research and development expenses as either direct external expenses, comprised of amounts paid to third party vendors for services, or all other research and development expenses, comprised of employee payroll and general overhead allocable to research and development. We subdivide external expenses between clinical programs and pre-clinical activities. We consider a clinical program to have begun upon acceptance by the FDA, or similar agency outside of the United States, to commence a clinical trial in humans, at which time we begin tracking expenditures by the product candidate. We have one product candidate DAVANAT<sup>®</sup> in clinical trials at this time. Clinical program expenses comprise payments to vendors related to preparation for, and conduct of, all phases of the clinical trial, including costs for drug manufacture, patient dosing and monitoring, data collection and management, oversight of the trials and reports of results. Pre-clinical expenses comprise all research and development amounts incurred before human trials begin, including payments to vendors for services related to product experiments and discovery, toxicology, pharmacology, metabolism and efficacy studies, as well as manufacturing process development for a drug candidate.

Our research and development expenses for the three months ended March 31, 2011, as compared to the three months ended March 31, 2010, were as follows:

	<u>Three Months</u>	
	<u>Ended</u>	
	<u>March 31,</u>	
	2011	2010
	(in thousands)	
Direct external expenses:		
Clinical programs	\$ 89	\$ 8
Pre-clinical activities	16	11
All other research and development expenses	639	110
	<b>\$ 744</b>	<b>\$ 129</b>

Clinical program and pre-clinical expenses for the three months ended March 31, 2011, increased compared to the same period in 2010, due primarily to overall increased clinical program activity related to DAVANAT<sup>®</sup>. Other research and development expense increased primarily

## Edgar Filing: PRO PHARMACEUTICALS INC - Form 10-Q

due to increased stock-based compensation (\$515,000) and payroll expenses (\$14,000). We plan to initiate a Phase III trial as soon as we are able to raise sufficient additional funds which will serve to increase our research and development expense.

Both the time required and costs we may incur in order to commercialize a drug candidate that would result in material net cash inflow are subject to numerous variables, and therefore we are unable at this stage of our development to forecast useful estimates. Variables that make

**Table of Contents**

estimates difficult include the number of clinical trials we may undertake, the number of patients needed to participate in the clinical trial, patient recruitment uncertainties, trial results as to the safety and efficacy of our product, and uncertainties as to the regulatory agency response to our trial data prior to receipt of marketing approval. Moreover, the FDA or other regulatory agencies may suspend clinical trials if we or an agency believes patients in the trial are subject to unacceptable risks, or find deficiencies in the conduct of the clinical trial. Delays or rejections may also occur if governmental regulation or policy changes during our clinical trials or in the course of review of our clinical data. Due to these uncertainties, accurate and meaningful estimates of the ultimate cost to bring a product to market, the timing of costs and completion of our program and the period during which material net cash inflows will commence are unavailable at this time.

*General and Administrative Expense.* During the three-months ended March 31, 2011, general and administrative expenses increased \$366,000, or 41%, to \$1,269,000, as compared to \$903,000 incurred during the same period in 2010. General and administrative expenses consist primarily of salaries including stock based compensation, legal and accounting fees, insurance, investor relations, business development and other office related expenses. The primary reason for the increase for the three-months ended March 31, 2011 as compared to the same period in 2010 is due to increased payroll (\$91,000) as employee salaries returned to more normal levels from the reductions during the prior period, increased business development costs (\$36,000) as we increased our marketing efforts in South America and increased legal and accounting costs (\$265,000), offset by decreased stock-based compensation costs (\$38,000).

*Other Income and Expense.* Other income and expense for the three months ended March 31, 2011 and 2010 was a loss of \$379,000 and \$1,106,000, respectively related primarily to the change in fair value of warrant liabilities.

**Liquidity and Capital Resources**

As described above in the Overview and elsewhere in this Quarterly Report on Form 10-Q, we are in the development stage and have not generated any revenues. Since our inception on July 10, 2000, we have financed our operations from proceeds of public and private offerings of debt and equity. As of March 31, 2011, we raised a net total of \$54.6 million from these offerings. At March 31, 2011, we had \$6,948,000 of unrestricted cash and cash equivalents available to fund future operations.

Subsequent to the quarter ended March 31, 2011, we received \$614,000 upon exercise of warrants and options for 1,039,322 shares of our common stock. We believe that with the funds from the subsequent cash received from the exercise of warrants and the cash on hand at March 31, 2011, there is sufficient cash to fund operations through 2012. We will require more cash to fund our operations and believe we will be able to obtain additional financing. However, there can be no assurance that we will be successful in obtaining such new financing or, if available, that such financing will be on terms favorable to us. If we are unsuccessful in raising additional capital before the end of 2012, we may be required to cease operations or seek bankruptcy protection.

Net cash used in operations increased by \$606,000 to \$1,367,000 for the three months ended March 31, 2011, as compared to \$761,000 for the three months ended March 31, 2010. Cash operating expenses increased principally due to increased research and development activities and increased general and administrative expenses.

No cash was provided by or used in investing activities during the three-months ended March 31, 2011, unchanged from the same period in 2010.

Net cash provided by financing activities was \$2,424,000 during the three-months ended March 31, 2011 as compared to \$630,000 during the three-months ended March 31, 2010, due primarily to the transactions described below.

During January 2011, we issued and sold 13 shares of Series C for net proceeds of \$130,000.

During the three months ended March 31, 2011, we issued 3,507,472 shares of common stock for the exercise of common stock warrants and 620,000 shares of common stock for the exercise of common stock options, resulting in net proceeds of \$2,159,000 and \$135,000, respectively.

**Payments Due Under Contractual Obligations**

The following table summarizes the payments due under our contractual obligations at March 31, 2011, and the effect such obligations are expected to have on liquidity and cash flow in future periods:



**Table of Contents**

Contractual Obligations	Total	Payments due by period (in thousands)			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating leases	\$ 99	\$ 99	\$	\$	\$
Total payments due under contractual obligations	\$ 99	\$ 99	\$	\$	\$

*Operating leases.* On May 1, 2006, we entered into an operating lease for office space. The lease commenced on August 11, 2006, and extends for five years and terminates on September 30, 2011. The lease provides for annual base rental payments of \$235,000 in the first year, increasing in each subsequent lease year to \$244,000, \$253,000, \$263,000 and \$273,000, respectively. In addition to base rental payments included in the contractual obligations table above, we are responsible for our pro-rata share of increases in the operating expenses for the building after calendar year 2006 and taxes for the building after fiscal year 2007. We have the option to extend the term of the lease for an additional five year period at the prevailing market rate at the time of exercise. In connection with this lease, a commercial bank has issued a letter of credit collateralized by cash we have on deposit with the bank of \$59,000.

*Separation agreement.* In February 2009, the Company entered into a Separation Agreement in connection with the resignation of David Platt, Ph.D., the Company's former Chief Executive Officer and Chairman of the Board of Directors. The Separation Agreement provides that the Company shall continue to pay Dr. Platt his current salary at a monthly rate of \$21,667 for 24 months and that it may defer payment of a portion of such salary amounts greater than \$10,000 per month (so long as Dr. Platt does not receive payments of less than the salary payments being made to the Company's Chief Executive Officer). However, all deferred amounts will continue to accrue and will be payable on the earlier of (i) the Company receiving a minimum of \$4.0 million of funding after February 12, 2009, or (ii) February 12, 2011. The Company also agreed to continue to (i) provide health and dental insurance benefits to Dr. Platt, until the first to occur of February 12, 2011 or the date Dr. Platt and his family become eligible to receive health and dental insurance benefits under the plans of a subsequent employer and (ii) make the current monthly lease payments on his automobile until February 12, 2011. The Company recognized the full amount of the salary, health insurance and automobile during the first quarter of 2009. The remaining liability related to this severance is reflected in accrued expenses (\$293,000) on the condensed consolidated balance sheet at December 31, 2010 and was paid to Dr. Platt on February 12, 2011.

The Separation Agreement also provides for the deferral of a \$1.0 million severance payment due to Dr. Platt under his employment agreement until the occurrence of any of the following milestone events: (i) the approval by the Food and Drug Administration for a new drug application ( NDA ) for any drug candidate or drug delivery candidate based on the DAVAN<sup>®</sup>Technology (whether or not such technology is patented). We also will grant Dr. Platt fully vested cashless stock option with identical terms to purchase at least 500,000 shares of common stock; (ii) consummation of a transaction with a pharmaceutical company expected to result in at least \$10.0 million of equity investment or \$50 million of royalty revenue to the Company. The Company also will grant Dr. Platt fully vested cashless-exercise stock options exercisable to purchase at least 300,000 shares of common stock for ten (10) years at an exercise price not less than the fair market value of the Common Stock determined as of the date of the grant; or (iii) the renewed listing of our securities on a national securities exchange. Payment upon the events (i) and (iii) may be deferred up to nine months, and if the Company has insufficient cash at the time of any of such events, it may issue Dr. Platt a secured promissory note for such amount. If the Company file a voluntary or involuntary petition for bankruptcy, whether or not a milestone event has occurred, such event shall trigger our obligation to pay the \$1.0 million with the result that Dr. Platt may assert a claim for such obligation against the bankruptcy estate. Due to the uncertainties regarding the achievement of any of the milestones as described, the Company has not accrued for the \$1.0 million severance nor has it recognized the value of the unissued stock options as of March 31, 2011. When it is deemed probable that one or more of the milestone events will be achieved, the Company will then recognize the \$1.0 million severance and the expense related to the issuance of the stock option at that time based on the then current fair value.

*Other.* We have engaged outside vendors for certain services associated with our clinical trials. These services are generally available from several providers and, accordingly, our arrangements are typically cancellable on 30 days notice.

**Off-Balance Sheet Arrangements**

We have not created, and are not party to, any special-purpose or off-balance sheet entities for the purpose of raising capital, incurring debt or operating parts of our business that are not consolidated into our financial statements. We do not have any arrangements or relationships with entities that are not consolidated into our financial statements that are reasonably likely to materially affect our liquidity or the availability of capital resources.

**Application of Critical Accounting Policies and Estimates**



## Edgar Filing: PRO PHARMACEUTICALS INC - Form 10-Q

The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to intangible assets, accrued expenses, stock-based compensation, convertible debt instrument and warrant liabilities, contingencies

## **Table of Contents**

and litigation. We base our estimates on historical experience, terms of existing contracts, our observance of trends in the industry, information available from other outside sources and on various other factors that we believe to be appropriate under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are those policies that affect our more significant judgments and estimates used in preparation of our consolidated financial statements. We believe our critical accounting policies include our policies regarding stock-based compensation, accrued expenses, income taxes and convertible debt instrument and warrant liabilities. For a more detailed discussion of our critical accounting policies, please refer to our 2010 Annual Report on Form 10-K.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Market risk represents the risk of loss that may impact our financial position, operating results or cash flows due to changes in the U.S. interest rates. The primary objective of our investment activities is to preserve cash until it is required to fund operations. To minimize risk, we maintain our portfolio of cash and cash equivalents in operating bank accounts and money market funds. Since our investments are short-term in duration, we believe that we are not subject to any material market risk exposure. As of March 31, 2011, we had \$294,000 of outstanding warrant liabilities. We account for the warrant liabilities on a fair value basis, and changes in share price and market interest rates will affect our earnings but will not affect our cash flows.

### **Item 4. Controls and Procedures**

Our management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures and internal control over financial reporting (as defined in the SEC rules promulgated under the Securities Exchange Act of 1934) and concluded that, as of March 31, 2011, our disclosure controls and procedures were effective. During the quarter ended March 31, 2011, no change in our internal control over financial reporting has materially affected, or is likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

Other than claims and legal proceedings that arise from time to time in the ordinary course of business which are not material there has been no change in the matters reported in our Annual Report on Form 10-K for the year ended December 31, 2010.

### **Item 1A. Risk Factors**

The risks we face, as set forth Item 1A, Risk Factors, of Part I of our Annual Report on Form 10-K for the year ended December 31, 2010, have not changed materially during the three months ended March 31, 2011.

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

During January 2011, the Company issued and sold 13 shares of its Series C Super Dividend Convertible Preferred Stock for gross proceeds of \$130,000. All shares of such series, including the 212 shares sold on December 29, 2010, were sold in reliance on the registration exemption set forth in Section 4(2) of the Securities Act and Rule 506 thereunder. During the three months ended March 31, 2011, the Company issued and sold 1,481,322 shares of its common stock pursuant to warrants issued and sold in February 2006 in reliance on such exemption.

### **Item 5. Other Information**

None

**Item 6. Exhibits**

**Table of Contents**

<b>Exhibit Number</b>	<b>Description of Document</b>	<b>Note Reference</b>
3.1	Articles of Incorporation of Pro Pharmaceuticals, Inc., dated January 23, 2001, as filed with the Secretary of State of the State of Nevada.	1
3.2	Certificate of Amendment to Articles of Incorporation of Pro Pharmaceuticals, Inc., as filed with the Secretary of State of the State of Nevada on May 28, 2004.	2
3.3	Certificate of Designation of Preferences, Rights and Limitations of Series A 12% Convertible Preferred Stock of Pro Pharmaceuticals, Inc., as filed with the Secretary of State of the State of Nevada on October 5, 2007.	3
3.4	Certificate of Amendment to Articles of Incorporation of Pro Pharmaceuticals, Inc., as filed with the Secretary of State of the State of Nevada on May 29, 2008.	4
3.5	Certificate of Designation of Preferences, Rights and Limitations of Series B-1 Convertible Preferred Stock and Series B-2 Convertible Preferred Stock of Pro Pharmaceuticals, Inc., as filed with the Secretary of State of the State of Nevada on February 11, 2009.	5
3.6	Certificate of Amendment to Articles of Incorporation of Pro Pharmaceuticals, Inc., as filed with the Secretary of State of the State of Nevada on May 27, 2009.	6
3.7	Certificate of Amendment to the Certificate of Designation of Preferences, Rights and Limitations of Series B-1 Convertible Preferred Stock and Series B-2 Convertible Preferred Stock of Pro-Pharmaceuticals, Inc., as filed with the Secretary of State of the State of Nevada on August 12, 2009.	7
3.8	Certificate of Amendment No. 2 to the Certificate of Designation of Preferences, Rights and Limitations of Series B-1 Convertible Preferred Stock and Series B-2 Convertible Preferred Stock of Pro-Pharmaceuticals, Inc., as filed with the Secretary of State of the State of Nevada on February 17, 2010.	8
3.9	Certificate of Amendment No. 3 to the Certificate of Designation of Preferences, Rights and Limitations of Series B-1 Convertible Preferred Stock and Series B-2 Convertible Preferred Stock of Pro-Pharmaceuticals, Inc., as filed with the Secretary of State of the State of Nevada on August 12, 2010.	9
3.10	Certificate of Amendment with respect to the Amended and Restated Certificate of Designation of Preferences, Rights and Limitations of Series B-1 Convertible Preferred Stock and Series B-2 Convertible Preferred Stock of Pro-Pharmaceuticals, Inc., as filed with the Secretary of State of the State of Nevada on January 26, 2011.	10
3.11	Certificate of Designation of Preferences, Rights and Limitations of Series C Super Dividend Convertible Preferred Stock of Pro-Pharmaceuticals, Inc., as filed with the Secretary of State of the State of Nevada on December 30, 2010.	11
4.1	Amended Form of Class A-1 Common Stock Purchase Warrant	10
4.2	Amended Form of Class A-2 Common Stock Purchase Warrant	10
4.3	Amended Form of Class B-1 Common Stock Purchase Warrant	10
10.1	Form of Securities Purchase Agreement for Series C Super Dividend Convertible Preferred Stock	11
10.2	Agreement Dated January 21, 2011 Between Pro-Pharmaceuticals, Inc. and 10X Fund L.P.	10
10.3	Common Stock Option Grant Agreement dated March 7, 2011 (Non-Plan Grant)	12
10.4	Amended Employment Agreement dated March 8, 2011 between Anthony D. Squeglia, and Pro-Pharmaceuticals, Inc.	13

**Table of Contents**

<b>Exhibit Number</b>	<b>Description of Document</b>	<b>Note Reference</b>
10.5	Amended Employment Agreement dated March 8, 2011 between Maureen Foley, and Pro-Pharmaceuticals, Inc.	13
10.6	Amended Employment Agreement dated March 31, 2011 between Anatole Klyosov, and Pro-Pharmaceuticals, Inc.	13
10.7	Employment Agreement dated March 31, 2011 between Eli Zomer, and Pro-Pharmaceuticals, Inc.	14
10.8	Separation Agreement dated March 31, 2011 between Theodore D. Zucconi and Pro-Pharmaceuticals, Inc.	14
31.1*	Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934	
31.2*	Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934	
32.1**	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	
32.2**	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	

\* Filed herewith.

\*\* Furnished herewith and not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

1. Incorporated by reference to the Company's Registration Statement on Form 10-SB, as filed with the Commission on June 13, 2001.
2. Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Commission on August 16, 2004.
  
3. Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on October 9, 2007.
  
4. Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on June 2, 2008.
  
5. Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on February 18, 2009.
6. Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on May 28, 2009.
7. Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Commission on August 14, 2009.
8. Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on February 17, 2010.
9. Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed with the Commission on August 13, 2010.
10. Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on January 27, 2011.
11. Incorporated by reference to the Company's Current Report on Form 8-K as filed with the Commission on January 6, 2011.
12. Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on March 9, 2011.
13. Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on March 14, 2011.
14. Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on April 6, 2011.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on May 13, 2011.

PRO-PHARMACEUTICALS, INC.

By: /s/ Peter G. Traber  
Name: Peter G. Traber, M.D.  
Title: Chief Executive Officer and President

/s/ Anthony D. Squeglia  
Name: Anthony D. Squeglia  
Title: Chief Financial Officer