

PRO PHARMACEUTICALS INC

Form 10-K

March 28, 2008

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**For the fiscal year ended December 31, 2007**

**.. 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.**

**Nevada**  
(State or other jurisdiction

of incorporation)

**7 Wells Avenue, Newton, Massachusetts**  
(Address of Principal Executive Offices)

**(617) 559-0033**

(Registrant's Telephone Number, Including Area Code)

**04-3562325**  
(I.R.S. Employer

Identification No.)

**02459**  
(Zip Code)

**Securities registered pursuant to Section 12(b) of the Act:**

| <b>Title of each class</b>     | <b>Name of Exchange on which registered</b> |
|--------------------------------|---------------------------------------------|
| Common Stock, Par Value \$.001 | American Stock Exchange                     |

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ☐ NO ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ☐ NO ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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 ☐ 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 aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of June 29, 2007 was \$11,046,971.

The number of shares outstanding of the registrant's common stock as of March 28, 2008 was 47,864,792.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive Proxy Statement for the 2008 Annual Meeting of Stockholders are incorporated by reference into Part III of this Report.

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### **FORWARD-LOOKING STATEMENTS**

This annual report on Form 10-K contains, in addition to historical information, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on management's current expectations and are subject to a number of factors and uncertainties, which could cause actual results to differ materially from those described in such statements. We caution investors that actual results or business conditions may differ materially from those projected or suggested in forward-looking statements as a result of various factors including, but not limited to, the following: uncertainties as to the utility and market for our potential products; uncertainties associated with pre-clinical and clinical trials of our product candidates; our limited experience in product development and expected dependence on potential licensees and collaborators for commercial manufacturing, sales, distribution and marketing of our potential products; possible development by competitors of competing products and technologies; lack of assurance regarding patent and other protection of our proprietary technology; compliance with and change of government regulation of our activities, facilities and personnel; uncertainties as to the extent of reimbursement for our potential products by government and private health insurers; our dependence on key personnel; our history of operating losses and accumulated deficit; and economic conditions related to the biotechnology and biopharmaceutical industry. We cannot assure you that we have identified all the factors that create uncertainties. Readers should not place undue reliance on forward-looking statements.

### **PART I**

#### **Item 1. Business**

We are a development-stage company engaged in the discovery, development, and commercialization of first-in-class, targeted therapeutic compounds for advanced treatment of cancer, liver, microbial and inflammatory diseases. Our initial focus is the development of a new generation of anti-cancer treatments using carbohydrate polymers to increase survival and improve the quality of life for cancer patients. DAVANAT®, our lead pipeline candidate, is a new, proprietary chemical entity that is currently in Phase II trials for first-line treatment of colorectal and biliary cancer.

Our proprietary technologies are target therapies that can also be used to treat other serious diseases such as liver and kidney fibrosis. We entered into research collaborations with the Mount Sinai School of Medicine to study the anti-fibrotic effects of our novel carbohydrate compounds on liver fibrosis and with Brigham and Women's Hospital to evaluate the anti-fibrotic effects of these compounds to treat acute and chronic kidney disease. Our first-in-class, novel carbohydrate compounds significantly reduced collagen expression and reversed fibrosis in animal models. Whereas previously, *in vitro* data indicated a reversal of fibrosis markers, in this proof-of-concept animal study, the compounds clearly reduced collagen expression and reversed liver fibrosis.

We were incorporated under Nevada law in January 2001 and in May of that year acquired a Massachusetts corporation engaged in the business we now undertake. We have a wholly-owned Delaware subsidiary that we formed in 2003 to hold our cash and cash equivalents in a tax efficient manner.

#### ***Background on Carbohydrates***

In order to function biologically, living organisms require the capability to recognize cellular information and trigger and perform biochemical reactions. Organisms as complex as human beings require systems with extraordinarily large capacity to recognize and translate information on a molecular level because of the tremendous number of different molecular messages that must be quickly and unambiguously deciphered, accepted or rejected. To accomplish this important task, a class of molecules capable of great variation in shape, orientation and composition is required. Carbohydrates serve this function in the body because they have the large range of structural properties, including linkage variations, branching and anomeric isomers, that enables them to provide the required cellular recognition capabilities. These complex molecules are also referred to as polysaccharides or complex sugars.

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The particular role of carbohydrates, in this regard, is recognition of molecular information that triggers biological reactions. These activities include signal transmission, cell recognition, interaction and binding by other cells, hormones and viruses. Carbohydrates often accomplish this by working with lectins, which are carbohydrate binding proteins that exist on cells. Biological processes that involve lectin binding include a vast array of cell-cell interactions including infections, toxins and many physiological processes such as control and spread of metastasis.

### ***Strengths and Strategies***

*Focus on novel therapeutic opportunities provided by carbohydrates.* As a result of their structural complexity, carbohydrates have not received as much scientific attention as nucleic acids and proteins, and are not as well understood. Carbohydrate molecules, which are essential to the transmission and recognition of cellular information, have been shown to play an important role in major diseases including cancer, cardiovascular disease, Alzheimer's disease, inflammatory disease and viral infections. We believe this offers a largely untapped area for treatment of disease including chemotherapeutics, infection treatment, vaccines and antibiotics. Our company is one of the pioneers focused on development of carbohydrate-based drugs.

*Leverage extensive scientific expertise.* Our scientists have substantial expertise, developed over decades, in the area of carbohydrates. Our team includes David Platt, our Chief Executive Officer, Anatole Klyosov, our Chief Scientist, and Eliezer Zomer, our Executive Vice President Manufacturing and Product Development. Dr. Platt, a chemical engineer, has conducted research in therapeutic application of carbohydrate technology for 20 years and holds many patents. Dr. Klyosov, who headed the Carbohydrate Research Laboratory at the USSR Academy of Sciences and taught at Harvard Medical School, holds more than 20 patents. Dr. Zomer, a biochemist and holder of more than 20 patents, has more than 20 years experience in the regulatory arena involving pharmaceutical products, development and diagnostics. We believe that this expertise, supplemented by members of our Scientific and Medical Advisory Boards, provides us with a substantial advantage in this relatively new area of drug development.

*Apply our technology to broad range of applications.* Our research indicates that DAVANAT® also has broad application. Following development of DAVANAT® in combination with chemotherapies and biologics, we plan to combine it with other drugs to extend its use to treat other serious diseases. Pre-clinical studies indicate that DAVANAT® and other proprietary carbohydrates we have in development may have application for advanced treatment of liver, microbial and inflammatory diseases. This could substantially increase the marketability of our products.

### ***Product Development***

We are initially developing a pipeline of compounds that may be combined with chemotherapies and biologics so as to improve the clinical benefit to patients. Based on our pre-clinical research, we believe DAVANAT®, when combined with chemotherapies and biologics, can significantly increase the clinical benefit to cancer patients by extending survival and increasing quality of life.

We are developing other carbohydrate-based therapeutic compounds for treatment of other serious disease, such as liver and kidney fibrosis. These product candidates are all in the pre-clinical stage of development.

### **DAVANAT®**

DAVANAT®, our lead product candidate in development, is a proprietary carbohydrate (polysaccharide) polymer comprised of mannose and galactose carbohydrates, that is derived from plant sources has a precisely defined chemical structure. It is the galactomannan isolated from seeds of *Cyamopsis Tetragonoloba*, and subjected to a controlled partial chemical and physical degradation.

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We believe the mechanism of action for DAVANAT® is based upon interaction with lectins, which are cell surface proteins that bind only to a particular kind of carbohydrate. DAVANAT® is formulated to attach to specific lectins (Galectins), which are abundant on the surface of tumor cells, while selectively avoiding healthy tissue. The galactose residue side chain attached to the carbohydrate polymer backbone targets lectin receptors that are specific and over-expressed on cancer cells. The receptor effectively interacts with the carbohydrate and chemotherapy and/or biologic combination and assists in the accumulation of the chemotherapy in the cancer cell. This may allow for administration of higher doses of chemotherapy thereby increasing efficacy while reducing toxicity.

### ***Pre-clinical Studies of DAVANAT®***

Our pre-clinical studies demonstrate that DAVANAT® when used in combination with chemotherapies and biologics may improve the clinical benefit to cancer patients. Pre-clinical studies also demonstrated delayed tumor growth and tumor shrinkage against a control group of animals when DAVANAT® was used in combination with standard therapies. These studies demonstrated that DAVANAT® can be used effectively with different chemotherapies and biologics.

### ***Clinical Trial Development of DAVANAT®***

Our clinical trial data to date in late stage cancer patients shows that DAVANAT® extends median survival and improves quality of life. We are currently conducting clinical trials with first line colorectal and biliary cancer patients to demonstrate increased efficacy of DAVANAT® and to further support that this occurs with no increase in key toxicity indicators.

*Phase I Trial for Third- and Fourth- Line Patients with Solid Tumors.* In 2005, we completed a Phase I study to evaluate DAVANAT®, alone and in combination with chemotherapy, to treat solid tumors in a trial of 40 end-stage patients with advanced solid tumors who failed chemotherapy, radiation therapy, and/or surgical treatments. The objective of the open label study was to evaluate the safety and tolerability of escalating doses of DAVANAT® (30-280mg/m<sup>2</sup>) when administered alone and in combination,. The third-and fourth-line cancer patients when entering the study had advanced metastatic tumors that averaged more than 100mm, had progressive disease, and were refractory to chemotherapeutic agents.

Based on objective tumor assessment, the disease was stabilized in 14 of 26 of evaluable patients with measurable disease. Furthermore, 7 of 10 patients were stabilized at the highest dose level of DAVANAT® administered in the sixth and final cohort. Efficacy results are analyzed based on Response Evaluation Criteria in Solid Tumors (RECIST) following completion of the second cycle of treatment. RECIST defines stable disease as [n]either sufficient shrinkage to qualify for Partial Response (more than 30% shrinkage) nor sufficient increase to qualify for Progressive Disease (greater than 20% increase) taking as reference the smallest sum longest diameter since the treatment started.

The Phase I data also indicates that DAVANAT® was well tolerated by patients. The maximum tolerated dose was not reached indicating DAVANAT® is safe and has the potential for further dose escalation. Adverse side effects were primarily disease related. Additionally, the results showed that DAVANAT® remained significantly longer in the bloodstream of cancer patients, increasing efficacy with no increase in toxicity.

*Phase II Trial for End Stage Patients with Third- and Fourth- Line Metastatic Colorectal Cancer.* In 2004, we initiated a Phase II clinical trial to further evaluate DAVANAT® for end-stage patients with third- and fourth-line metastatic colorectal cancer. The multi-center, open label, single-dose level study was designed to evaluate up to 15 patients in stage one, and up to 18 patients in stage two. The study, which was designed to evaluate the efficacy and safety of DAVANAT® in combination with chemotherapy when administered in monthly cycles, had two objectives: (1) to document the rate of response and stabilization of patients with advanced colorectal cancer; and (2) to continue evaluating

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the safety of the DAVANAT® in combination. Dosing of patients began in May 2005. We stopped recruiting for the study in May 2006 because we achieved our objective. The data for the study indicates that based on objective tumor assessment one patient experienced a partial tumor response and the disease was stabilized in 6 of 20 patients. New data of 20 patients from this trial showed that DAVANAT® extended median survival by more than six months. We tracked these patients and gathered data after they left the trial. The patients entered the trial with disease that progressed despite previously being treated with standard chemotherapies and biologics. Two patients survived more than two years. Data from the trial for all 20 end-stage patients also indicates that DAVANAT® extended median progression free survival to 8.4 weeks.

*Phase II Trial for First-line Treatment of Patients with Biliary Cancer.* In 2007, we initiated a Phase II trial for the first-line treatment of patients with biliary cancer. Biliary cancer may represent an opportunity for orphan drug status approval. See FDA Orphan Drug Designation below under Government Regulation. The multi-center, open label, single-dose level study is designed to evaluate up to 42 patients. The study, will evaluate the efficacy and safety of DAVANAT® when administered for at least two monthly cycles or until disease progression. The trial has two objectives: (1) complete/partial tumor response in 20% of patients (17% in the first stage); and (2) the safety of DAVANAT® regimen in this patient population.

*Phase II Trial for First-line Patients with Colorectal Cancer.* In 2006, we initiated a Phase II trial for first-line treatment of colorectal cancer patients. The multi-center, open label, single-dose level study is designed to evaluate up to 50 patients who are unable to sustain the high toxicity of current intensive combination chemotherapy. The study is expected to evaluate the efficacy and safety of DAVANAT® when administered in combination with the current standard of care in two monthly cycles or until disease progression or toxicity. The primary objectives of the study are a complete or partial response in 33 percent of the patients and a secondary measurement of progression free survival at 6 and 12 months.

Please see Risks Related to our Company Our Drug Candidates Are in Clinical Trials and Results Are Uncertain for additional discussion of risks related to clinical trials.

### ***Patents and Proprietary Rights***

Our success and competitiveness depend on our ability to develop and maintain the proprietary aspects of our technology and operate without infringing on the proprietary rights of others. We rely on a combination of patent, trademark, trade secret and copyright law and contract restrictions to protect the proprietary aspects of our technologies. We seek to limit disclosure of our intellectual property by requiring employees, consultants, and any third parties with access to our proprietary information to execute confidentiality agreements and by restricting access to that information.

As of December 31, 2007, we held 5 U.S. patents and have patent applications pending from the U. S. Patent and Trademark Office. Many of our patents and patent applications cover methods and composition for reducing toxicity and enhancing chemotherapeutic drugs by co-administering a polysaccharide with a chemotherapeutic agent. We have corresponding patent applications pending in Europe, Canada, Israel, Brazil, Japan, China and Australia. Additionally, we have patent applications in a number of other areas related to utilizing our carbohydrate-based compounds to treat major disease other than cancer.

Please see Risks Related to our Company We Are a Counterclaim Defendant in a Lawsuit Instituted by CEO David Platt and Risks Related to the Drug Development Industry Our Competitive Position Depends on Protection of Our Intellectual Property for additional discussion of risks related to protection of our intellectual property based on inventions.

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### ***Research***

Our initial focus is on the design and analysis of carbohydrate-based compounds to improve the clinical benefit of chemotherapeutic agents and biologics. We contract with independent laboratories and accredited facilities to conduct our research, which is designed, evaluated and managed by our scientists. We do not anticipate building in-house research or development facilities or hiring staff in this connection other than for purposes of designing and managing our out-sourced research.

As we develop products eligible for clinical trials, we contract with independent parties to design the trial protocols, arrange for and monitor the clinical trials, collect data and analyze data. In addition, certain clinical trials for our products may be conducted by government-sponsored agencies and will be dependent on governmental participation and funding. Our dependence on independent parties and clinical sites involves risks including reduced control over the timing and other aspects of our clinical trials.

Our research and development expenditures totaled approximately \$15.6 million for the cumulative period from inception (July 10, 2000) through December 31, 2007. During the year ended December 31, 2007, 2006 and 2005 our expenditures for research and development were, respectively, approximately \$2.05 million, \$3.02 million and \$3.04 million.

### ***Reports***

Our website is [www.pro-pharmaceuticals.com](http://www.pro-pharmaceuticals.com). We make available on this site our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports, filed or furnished pursuant to the Securities Exchange Act of 1934 as soon as reasonably practicable after the report are filed electronically with the SEC. The reports may be accessed through our investor relations page.

### ***Manufacturing and Marketing***

We are a development company at this time and do not intend to establish internal facilities for the manufacture of our products for clinical or commercial production. To have our products manufactured, we have developed and will continue to develop relationships with third-parties that have established manufacturing capabilities.

Because our products are in the development stage, we have not created a sales and marketing staff to commercialize pharmaceutical products. If we develop products eligible for commercial sale, we will need to develop a sales and marketing capability or rely on third parties such as licensees, collaborators, joint venture partners or independent distributors to market and sell those products. Our dependence on third-party manufacturers and marketers will involve risks relating to our reduced control, and other risks including those discussed in Risk Factors Related to our Company We Will Depend on Third Parties to Manufacture and Market Our Products.

### ***Competition***

Many biotechnology and pharmaceutical companies are developing new technologies for the treatment of cancer and other diseases. Technologies such as monoclonal antibodies could be competitive with our carbohydrate-based platforms. Several companies are developing carbohydrate technologies and sequencing of complex sugars to improve or develop new or existing drugs. Other companies are trying to improve the therapeutic profile of widely used protein-based drugs. While these companies may broaden the market for our products they may also provide competitive alternatives to our products.

Please see Risk Factors Related to the Drug Development Industry We Face Intense Competition in the Biotechnology and Pharmaceutical Industries for additional discussion related to our current and potential competition.

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### ***Government Regulation***

The research, development, testing, manufacture, labeling, promotion, advertising, distribution, and marketing, among other things, of our products are extensively regulated by governmental authorities in the United States and other countries. In the United States, the FDA regulates drugs under the federal Food, Drug, and Cosmetic Act and its implementing regulations. Failure to comply with the applicable U.S. requirements may subject us to administrative or judicial sanctions, such as FDA refusal to approve pending new drug applications, warning letters, product recalls, product seizures, total or partial suspension of production or distribution, injunctions, and/or criminal prosecution. Please see *Risks Related to the Drug development Industry We Will Need Regulatory Approvals To Commercialize Our Products* for additional discussion of risks related to regulatory compliance.

### ***Drug Approval Process***

Drugs may not be marketed in the U.S. until the FDA has approved them. The steps required before a drug may be marketed in the U.S. include (similar rules apply in other countries):

1. Pre-clinical laboratory tests, animal studies, and formulation studies,
2. Submission to the FDA of an Investigational New Drug (IND) application for human clinical testing, which must become effective before human clinical trials may begin,
3. Adequate and well-controlled human clinical trials to establish the safety and efficacy of the drug for each indication,
4. Submission to the FDA of a New Drug Application (NDA),
5. Satisfactory completion of an FDA inspection of the manufacturing facility or facilities, at which the drug is produced to assess compliance with current Good Manufacturing Process (cGMP) established by the FDA,
6. FDA review and approval of the NDA, and
7. FDA review and approval of a trademark used in connection with a pharmaceutical.

Pre-clinical tests include laboratory evaluation of product chemistry, toxicity, and formulation, as well as animal studies. The results of the pre-clinical tests, together with manufacturing information and analytical data, are submitted to the FDA as part of an IND application, which must become effective before human clinical trials may begin. An IND automatically becomes effective 30 days after receipt by the FDA, unless before that time the FDA raises concerns or questions about issues such as the conduct of the trials as outlined in the IND. In such a case, the IND sponsor and the FDA must resolve any outstanding FDA concerns or questions before clinical trials can proceed. There is no certainty that submission of an IND will result in the FDA allowing clinical trials to begin.

Clinical trials involve the administration of the investigational drug to human subjects under the supervision of qualified investigators. Clinical trials are conducted under protocols detailing the objectives of the study, the parameters to be used in monitoring safety, and the effectiveness criteria to be evaluated. Each protocol must be submitted to the FDA as part of the IND.

Clinical trials typically are conducted in three sequential phases, but the phases may overlap or be combined. Each trial must be reviewed and approved by an independent Institutional Review Board (IRB) before it can begin. Study subjects must sign an informed consent form before participating in a clinical trial. Phase I usually involves the initial introduction of the investigational drug into people to evaluate its safety, dosage tolerance, pharmacodynamics, and, if possible, to gain an early indication of its effectiveness. Phase II usually involves trials in a limited patient population to (i) evaluate dosage tolerance and appropriate dosage; (ii) identify possible adverse effects and safety risks; and

(iii) evaluate preliminarily the efficacy of the drug for specific

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indications. Phase III trials usually further evaluate clinical efficacy and test further for safety by using the drug in its final form in an expanded patient population. There is no assurance that these trials will be completed within a specified period of time, if at all.

Assuming successful completion of the required clinical testing, the results of the pre-clinical studies and of the clinical studies, together with other detailed information, including information on the manufacture and composition of the drug, are submitted to the FDA in the form of a New Drug Application (NDA) requesting approval to market the product for one or more indications. Before approving an NDA, the FDA usually will inspect the facilities at which the drug is manufactured, and will not approve the product unless cGMP compliance is satisfactory. If the FDA evaluates the NDA and the manufacturing facilities as acceptable, the FDA will issue an approval letter. If the FDA evaluates the NDA submission or the manufacturing facilities as not acceptable, the FDA will outline the deficiencies in the submission and often will request additional testing or information. Even if an applicant submits the requested additional information, the FDA ultimately may decide that the NDA does not satisfy the regulatory criteria for approval. The testing and approval process requires substantial time, effort, and financial resources, and there is no assurance that any approval will be granted on a timely basis, if at all. After approval, certain changes to the approved product, such as adding new indications, manufacturing changes, or additional labeling claims are subject to further FDA review and approval.

Please see **Risks Related to the Drug Development Industry** **We Will Need Regulatory Approvals to Commercialize Our Products** for additional discussion of regulatory risks related to our drug development program.

### *FDA Priority Review*

FDA procedures provide for priority review of an NDA submitted for drugs that, compared to currently marketed products, offer a significant improvement in the treatment, diagnosis, or prevention of a disease. NDAs that are granted priority review are acted upon more quickly than NDAs given standard review. There can be no guarantee that the FDA will grant priority review status in any instance, that priority review status will affect the time of review, or that the FDA will approve the NDA submitted for any of our product candidates, whether or not priority review status is granted.

### *Post-Approval Requirements*

If FDA approval of one or more of our products is obtained, we will be required to comply with a number of post-approval requirements. For example, holders of an approved NDA are required to report certain adverse reactions to the FDA and to comply with certain requirements concerning advertising and promotional labeling for their products. Also, quality control and manufacturing procedures must continue to conform to Current Good Manufacturing Process (cGMP) after approval, and the FDA periodically inspects manufacturing facilities to assess compliance with cGMP. Accordingly, manufacturers must continue to expend time, money, and effort in the area of production and quality control to maintain cGMP compliance. In addition, discovery of problems with a product after approval may result in restrictions on a product, manufacturer, or holder of an approved NDA, including withdrawal of the product from the market. Also, new government requirements may be established that could delay or prevent regulatory approval of our products under development.

### *FDA Orphan Drug Designation*

The FDA may grant orphan drug designation to drugs intended to treat a rare disease or condition, which generally is a disease or condition that affects fewer than 200,000 individuals in the United States. Orphan drug designation must be requested before submitting an NDA. After the FDA grants orphan drug designation, the identity of the therapeutic agent and its potential orphan use are publicly disclosed by the FDA. Orphan drug designation does not convey an advantage in, or shorten the duration of, the regulatory review and approval process. If a product which has an orphan drug designation subsequently receives the first FDA approval for the

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indication for which it has such designation, the product is entitled to orphan exclusivity, meaning that the FDA may not approve any other applications to market the same drug for the same indication, except in certain very limited circumstances, for a period of seven years. As well, orphan drugs usually receive ten years of marketing exclusivity in the European Union.

### *Non-United States Regulation*

Before our products can be marketed outside of the United States, they are subject to regulatory approval similar to that required in the United States, although the requirements governing the conduct of clinical trials, product licensing, pricing and reimbursement vary widely from country to country. No action can be taken to market any product in a country until an appropriate application has been approved by the regulatory authorities in that country. The current approval process varies from country to country, and the time spent in gaining approval varies from that required for FDA approval. In certain countries, the sales price of a product must also be approved. The pricing review period often begins after market approval is granted. No assurance can be given that even if a product is approved by a regulatory authority, satisfactory prices will be approved for such product.

### *Environmental Regulation*

Pharmaceutical research and development involves the controlled use of hazardous materials. Biotechnology and pharmaceutical companies must comply with laws and regulations governing the use, generation, manufacture, storage, air emission, effluent discharge, handling and disposal of certain materials, biological specimens and wastes. We do not anticipate building in-house research, development or manufacturing facilities, and, accordingly, do not expect to have to comply directly with environmental regulation. However, our contractors and others conducting research, development or manufacturing activities for us may be required to incur significant compliance costs, and this could in turn could increase our expense or delay our completion of research or manufacturing programs.

### *Employees*

As of December 31, 2007, we had seven full-time employees, three of whom are involved primarily in management of our pre-clinical research and development and clinical trials and four of whom are involved primarily in financial management and administration of our company. We also have two part-time contract employees, one of whom provides financial management services and the other serves as our medical director.

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

An investment in our common stock involves a high degree of risk. You should carefully consider the risks described below and the other information before deciding to invest in our common stock. The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we currently consider immaterial may also adversely affect our business. We have attempted to identify below the major factors that could cause differences between actual and planned or expected results, but we cannot assure you that we have identified all of those factors.

If any of the following risks actually happen, our business, financial condition and operating results could be materially adversely affected. In this case, the trading price of our common stock could decline, and you could lose all or part of your investment.

### **Risks Related to Our Company**

***We are at an early stage of development and have not generated any revenue.*** We are a development-stage company with a limited operating history, and we have not generated any revenues to date. We have no therapeutic products available for sale, and none are expected to be commercially available for several years, if at all. We may never generate revenue or become profitable, even if we are able to commercialize any products.

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***We have incurred net losses to date and must raise additional capital in 2008.*** We have incurred net losses in each year of operation. Our accumulated deficit as of December 31, 2007 was approximately \$35.2 million. We will need to continue to conduct significant research, development, testing and regulatory compliance activities that, together with projected general and administrative expenses, we expect will result in substantial operating losses for the next several years. Accordingly, we do not expect to be generating sales or other revenue and will remain dependent on outside sources of financing during that time. If we are unable to raise funds from outside sources for our continuing operations, we may be adversely affected.

We may raise such capital through public or private equity financings, partnerships, debt financings, bank borrowings, or other sources. Additional funding may not be available on favorable terms or at all. If adequate funds are not otherwise available, we may need to significantly curtail operations. To obtain additional funding, we may need to enter into arrangements that require us to relinquish rights to certain technologies, products and/or potential markets. To the extent that additional capital is raised through the sale of equity, or securities convertible into equity, our equity holders may experience dilution of their proportionate ownership of the company.

Based on approximately \$1.3 million of available cash and cash equivalents as of December 31, 2007 and net proceeds of approximately \$3.4 million from our registered direct offering completed on February 25, 2008, we believe that we have sufficient capital to fund our operations into October of 2008. We must raise cash before October 2008 or we may not be able to continue operations.

***Our drug candidates are based on novel unproven technologies.*** Our product candidates are based on novel unproven technologies using proprietary carbohydrate compounds in combination with FDA approved drugs currently used in the treatment of cancer and other diseases. Carbohydrates are difficult to synthesize, and we may not be able to synthesize carbohydrates that would be usable as target delivery vehicles for the anti-cancer drugs we are working with or other therapeutics we plan to develop.

***Our drug candidates are in clinical trials and results are uncertain.*** We have one product candidate in human clinical trials. Pre-clinical results in animal studies are not necessarily predictive of outcomes in human clinical trials. Clinical trials are expensive, time-consuming and may not be successful. They involve the testing of potential therapeutic agents, or effective treatments, in humans, typically in three phases, to determine the safety and efficacy of the product candidates necessary for an approved drug. Many products in human clinical trials fail to demonstrate the desired safety and efficacy characteristics. Even if our products progress successfully through initial human testing, they may fail in later stages of development. We may engage others to conduct our clinical trials, including clinical research organizations and, possibly, government-sponsored agencies. These trials may not start or be completed as we forecast, or may be unsuccessful.

***Our product candidates may not be successfully commercialized.*** Even if our product candidates are successful in clinical trials, they may not be successfully commercialized. Potential products may fail to receive necessary regulatory approvals, be difficult to manufacture on a large scale, be uneconomical to produce, fail to achieve market acceptance, or be precluded from commercialization by proprietary rights of third parties.

***Our lack of operating experience may cause us difficulty in managing our growth.*** We have limited experience in manufacturing or procuring products in commercial quantities, conducting other later-stage phases of the regulatory approval process, selling pharmaceutical products, or negotiating, establishing and maintaining strategic relationships. Any growth of our company will require us to expand our management and our operational and financial systems and controls. If we are unable to do so, our business and financial condition would be materially harmed. If rapid growth occurs, it may strain our operational, managerial and financial resources.

***We will depend on third parties to manufacture and market our products.*** We do not have, and do not now intend to develop, facilities for the manufacture of any of our products for clinical or commercial production. Accordingly, we will need to develop relationships with manufacturers and enter into collaborative

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arrangements with licensees or have others manufacture our products on a contract basis. We expect to depend on such collaborators to supply us with products manufactured in compliance with standards imposed by the FDA and foreign regulators.

In addition, we have limited experience in marketing, sales or distribution, and we do not intend to develop a sales and marketing infrastructure to commercialize our pharmaceutical products. If we develop commercial products, we will need to rely on licensees, collaborators, joint venture partners or independent distributors to market and sell those products.

***We depend on key individuals to develop our products and pursue collaborations.*** We are highly dependent on David Platt, Ph.D., Chief Executive Officer; Anatole Klyosov, Ph.D., Chief Scientist; and Eliezer Zomer, Ph.D., Executive Vice President, Manufacturing and Product Development, each of whom has scientific technical or other business expertise and experience that is critical to our success. The loss of any of these persons, or failure to attract or retain other key personnel, could prevent us from pursuing collaborations or developing our products and core technologies.

***We are a counterclaim defendant in a lawsuit instituted by David Platt.*** In January 2004, David Platt, our Chief Executive Officer, filed a lawsuit in Massachusetts against GlycoGenesys, Inc. for claims including breach of contract. GlycoGenesys subsequently named us as a counterclaim defendant alleging tortious interference and misappropriation of proprietary rights, and seeks monetary damages and injunctive relief related to our intellectual property. We and Dr. Platt intend to contest these counterclaims vigorously. In October 2006, Marlborough Research and Development, Inc. (now known as Prospect Therapeutics, Inc.) purchased selected assets of GlycoGenesys including this litigation in a bankruptcy liquidation. If we do not prevail there could be a material adverse impact on our financial position, results of operations or cash flows.

## **Risks Related to the Drug Development Industry**

***We will need regulatory approvals to commercialize our products.*** We are required to obtain approval from the FDA in order to sell our products in the U.S. and from foreign regulatory authorities in order to sell our products in other countries. The FDA's review and approval process is lengthy, expensive and uncertain. Extensive pre-clinical and clinical data and supporting information must be submitted to the FDA for each indication for each product candidate in order to secure FDA approval. The FDA could reject an application or require us to conduct additional clinical or other studies as part of the regulatory review process. Delays in obtaining or failure to obtain FDA approvals would prevent or delay the commercialization of our products, which would prevent, defer or decrease our receipt of revenues. If we receive initial regulatory approval, our product candidates will be subject to extensive and rigorous ongoing domestic and foreign government regulation.

***Our competitive position depends on protection of our intellectual property.*** Development and protection of our intellectual property are critical to our business. If we do not adequately protect our intellectual property, competitors may be able to practice our technologies. Our success depends in part on our ability to obtain patent protection for our products or processes in the United States and other countries, protect trade secrets, and prevent others from infringing on our proprietary rights.

Since patent applications in the United States are maintained in secrecy for at least portions of their pendency periods (published on U.S. patent issuance or, if earlier, 18 months from earliest filing date for most applications) and since other publication of discoveries in the scientific or patent literature often lags behind actual discoveries, we cannot be certain that we are the first to make the inventions to be covered by our patent applications. The patent position of biopharmaceutical firms generally is highly uncertain and involves complex legal and factual questions. The U.S. Patent and Trademark Office has not established a consistent policy regarding the breadth of claims that it will allow in biotechnology patents.

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We cannot assure you that all of our patent applications will issue as patents or that the claims of any issued patents will afford meaningful protection for our technologies or products. In addition, patents issued to us or our licensors may be challenged and subsequently narrowed, invalidated or circumvented. Patent litigation is widespread in the biotechnology industry and could harm our business. Litigation might be necessary to protect our patent position or to determine the scope and validity of third-party proprietary rights, and we may not have the required resources to pursue such litigation or to protect our patent rights.

Although we require our scientific and technical employees and consultants to enter into broad assignment of inventions agreements, and all of our employees, consultants and corporate partners with access to proprietary information to enter into confidentiality agreements, these agreements may not be honored.

We are a counterclaim defendant in a lawsuit instituted by our chief executive officer. See **Risks Related to our Company** above.

***Products we develop could be subject to infringement claims asserted by others.*** We cannot assure that products based on our patents or intellectual property that we license from others will not be challenged by a third party claiming infringement of its proprietary rights. If we were not able to successfully defend our patents or licensed rights, we may have to pay substantial damages, possibly including treble damages, for past infringement.

***We face intense competition in the biotechnology and pharmaceutical industries.*** The biotechnology and pharmaceutical industries are intensely competitive. We face direct competition from U.S. and foreign companies focusing on drug delivery technologies, which are rapidly evolving. Our competitors include major, multinational pharmaceutical and chemical companies, specialized biotechnology firms and universities and other research institutions. Many of these competitors have greater financial and other resources, larger research and development staffs and more effective marketing and manufacturing organizations, than we do. In addition, academic and government institutions are increasingly likely to enter into exclusive licensing agreements with commercial enterprises, including our competitors, to market commercial products based on technology developed at such institutions. Our competitors may succeed in developing or licensing technologies and products that are more effective or less costly than ours, or succeed in obtaining FDA or other regulatory approvals for product candidates before we do.

***Health care cost containment initiatives and the growth of managed care may limit our returns.*** Our ability to commercialize our products successfully will be affected by the ongoing efforts of governmental and third-party payers to contain the cost of health care. These entities are challenging prices of health care products and services, denying or limiting coverage and reimbursement amounts for new therapeutic products, and for FDA-approved products considered experimental or investigational, or which are used for disease indications without FDA marketing approval.

Even if we succeed in bringing any products to the market, they may not be considered cost-effective and third-party reimbursement might not be available or sufficient. If adequate third-party coverage is not available, we may not be able to maintain price levels sufficient to realize an appropriate return on our investment in research and product development. In addition, legislation and regulations affecting the pricing of pharmaceuticals may change in ways adverse to us before or after any of our proposed products are approved for marketing.

***Our insurance coverage may not be adequate in all circumstances.*** If we commercialize our products, their use by patients could expose us to potential product liability and other claims resulting from alleged injury. This liability may result from claims made directly by consumers or by pharmaceutical companies or others selling such products. Although we currently have insurance coverage for both product liability and professional liability, we may be unable to maintain such insurance on acceptable terms. Any inability to maintain insurance coverage on acceptable terms could prevent or limit the commercialization of any products we develop.

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### **Risks Related to Our Stock**

***Stock prices for pharmaceutical and biotechnology companies are volatile.*** The market price for securities of pharmaceutical and biotechnology companies historically has been highly volatile, and the market from time to time has experienced significant price and volume fluctuations that are unrelated to the operating performance of such companies. Fluctuations in the trading price or liquidity of our common stock may adversely affect, among other things, the interest in our stock by purchasers on the open market and our ability to raise capital.

***We are not in compliance with the continuing listing requirements of the American Stock Exchange.*** In June 2007, we received a notice from the American Stock Exchange that it is reviewing our eligibility for continued listing of our common stock. In particular, the exchange noted that we are not in compliance with its minimum stockholders' equity requirement in two of the last three years. In response to our plan to achieve and sustain compliance with the listing requirements, the exchange granted us an extension until October 13, 2008 to regain compliance with the standards. Failure to make progress consistent with the plan or to regain compliance with the continued listing standards by such date could result in our stock being de-listed from the exchange. If we are delisted, our ability to raise capital may be diminished.

***We could issue additional common stock, which might dilute the book value of our common stock.*** We are authorized to issue 100,000,000 shares of common stock, of which 40,364,792 shares were issued and outstanding on December 31, 2007. We issued and sold an additional 1,742,500 shares of preferred stock in a private placement that we completed on February 4, 2008 that may be converted at any time on a one-for-one basis into an aggregate of 1,742,500 shares of our common stock and an additional 7,500,000 shares of common stock in a registered direct offering that we closed on February 25, 2008. Our board of directors has authority, without action or vote of our stockholders in most cases, to issue all or a part of our authorized but unissued shares. Such stock issuances could be made at a price that reflects a discount from the then-current trading price of our common stock. In addition, in order to raise capital, we may need to issue securities that are convertible into or exchangeable for a significant amount of our common stock. These issuances would dilute your percentage ownership interest, which would have the effect of reducing your influence on matters on which our stockholders vote, and might dilute the book value of our common stock. You may incur additional dilution if holders of stock options, whether currently outstanding or subsequently granted, exercise their options, or if warrant holders exercise their warrants to purchase shares of our common stock.

***As a thinly-traded stock, large sales can place downward pressure on our stock price.*** Our common stock, despite certain increases of trading volume from time to time, experiences periods when it could be considered thinly traded. Finance transactions resulting in a large amount of newly issued shares that become readily tradable, or other events that cause current stockholders to sell shares, could place downward pressure on the trading price of our stock. In addition, the lack of a robust resale market may require a stockholder who desires to sell a large number of shares to sell the shares in increments over time to mitigate any adverse impact of the sales on the market price of our stock.

**Item 1B. Unresolved Staff Comments**  
None.

### **Item 2. Properties**

We lease approximately 9,400 square feet for our executive offices located at 7 Wells Avenue, Newton, Massachusetts. We have a five year lease that commenced in August 2006 with an option to extend for an additional five years. We believe this space is suitable for our present operations and adequate for foreseeable expansion of our business.

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### **Item 3.      *Legal Proceedings***

In January 2004, David Platt, Ph.D., our Chairman and Chief Executive Officer, filed a lawsuit in Massachusetts Superior Court against GlycoGenesys, Inc. for various claims including breach of contract. GlycoGenesys asserted counterclaims against us and Dr. Platt alleging tortious interference, misappropriation of proprietary rights, defamation and unfair competition, and seeks monetary damages and injunctive relief related to our intellectual property. We and Dr. Platt have denied any liability for the counterclaims. Prospect Therapeutics, Inc. (formerly known as Marlborough Research and Development, Inc.) purchased certain assets including this lawsuit from the GlycoGenesys bankruptcy estate and continues prosecuting the counterclaims against us and Dr. Platt. We filed a motion for summary judgment on November 8, 2007. Limited discovery may still be taken. We believe the counterclaims are without merit and intend to contest them vigorously.

Our Board of Directors authorized indemnification of Dr. Platt for the expenses of his defense of the counterclaims. No expenses have been incurred during the twelve month period ended December 31, 2007 in connection with this defense. Through December 31, 2007, we have incurred cumulative expenses of approximately \$438,000 in connection with this defense.

In January 2005, we filed a request with the U.S. Patent and Trademark Office for an inter partes re-examination of U.S. Patent No. 6,680,306 owned by GlycoGenesys, Inc. because we believe that the invention claimed in this patent is anticipated by other inventions (technically, prior art), including our U.S. Patent No. 6,645,946 for DAVANAT<sup>®</sup>. The Patent Office agreed with our argument that all claims stated in the 306 patent are anticipated by prior art. The matter is now before the Patent Office for a final decision. We believe that the actions of the Patent Office support our belief that the invention claimed in our DAVANAT<sup>®</sup> patent is prior art relative to the GlycoGenesys patent.

On January 30, 2008, Custom Equity Research, Incorporated (d/b/a Summer Street Research Partners) filed a lawsuit against us in the Superior Court of the Commonwealth of Massachusetts, alleging claims for breach of contract, declaratory judgment and unjust enrichment arising out of an engagement letter under which Summer Street agreed to provide institutional investment placement services to us. Summer Street claims it is entitled to a placement fee for each placement made during the term of the agreement and for each issuance of securities made or agreed to be made by us from October 17, 2007 through November 16, 2008. On February 20, 2008, we filed a Motion to Dismiss. We believe the lawsuit is without merit and intend to contest it vigorously.

### **Item 4.      *Submission of Matters to a Vote of Security Holders***

No matter was submitted to a vote of our stockholders during the fourth quarter of the fiscal year covered by this report.

**Table of Contents****PART II****Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***  
***Price Range of Common Stock***

Our common stock trades under the symbol PRW on the American Stock Exchange. The high and low closing prices for our common stock as reported on the American Stock Exchange for the periods indicated below were as follows:

|                                            | High    | Low     |
|--------------------------------------------|---------|---------|
| <b>Fiscal Year Ended December 31, 2007</b> |         |         |
| First Quarter                              | \$ 1.39 | \$ 0.25 |
| Second Quarter                             | \$ 0.93 | \$ 0.35 |
| Third Quarter                              | \$ 0.72 | \$ 0.31 |
| Fourth Quarter                             | \$ 0.89 | \$ 0.60 |
| <b>Fiscal Year Ended December 31, 2006</b> |         |         |
| First Quarter                              | \$ 3.78 | \$ 2.85 |
| Second Quarter                             | \$ 3.98 | \$ 3.13 |
| Third Quarter                              | \$ 3.00 | \$ 0.59 |
| Fourth Quarter                             | \$ 0.97 | \$ 0.35 |

***Holders of Common Stock***

As of February 25, 2008, there were approximately 230 holders of record of our common stock. Because shares of our common stock are held by depositaries, brokers and other nominees, the number of beneficial holders of our shares is substantially larger than the number of record holders. Based on information available to us, we believe there are approximately 4,300 beneficial owners of our shares of our common stock in addition to the record holders.

***Dividends***

There have been no cash dividends declared on our common stock since our company was formed. Dividends are declared at the sole discretion of our Board of Directors. Our intention is not to declare cash dividends and retain all cash for our operations.

***Recent Sales of Unregistered Securities***

On February 4, 2008, we completed a private placement begun in October 2007 in which we sold an aggregate of 1,742,500 units of securities, each unit comprised of one share of our Series A 12% Convertible Preferred Stock ( Series A Preferred ), a warrant exercisable at \$1.50 to purchase one share of our common stock, and a warrant exercisable at \$2.00 to purchase one share of our common stock. Each unit was offered and sold for \$1.00. As of December 31, 2007, we had received gross proceeds of \$1,667,500, and during 2008, we received an additional \$75,000, resulting in total advance gross proceeds of \$1,742,500. Net proceeds after transaction costs were approximately \$1.7 million. The securities were offered and sold to accredited investors pursuant to Rule 506 promulgated under Section 4(2) of the Securities Act of 1933.

Each share of the Series A Preferred has voting rights and is convertible at any time at the election of the holder into one share of our common stock subject to adjustment for stock splits, recapitalizations and the like. We may require conversion if the closing price of our common stock exceeds \$3.00 for 15 consecutive trading days. Each share of the Series A Preferred accrues interest at 12% per annum payable at our option in cash

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or shares of common stock valued per share at the higher of \$1.00 or 100% of the value weighted average price of our shares of common stock for the 20 consecutive trading days prior to the applicable dividend payment date.

The warrants are exercisable for cash consideration for four years beginning the 181<sup>st</sup> day after the date of issue. The exercise price is subject to adjustment for stock splits, recapitalizations and the like and in the event of certain business combinations.

### Item 6. *Selected Consolidated Financial Data (in thousands except share and per share data)*

The following table sets forth financial data for the years ended December 31, 2007, 2006, 2005, 2004, 2003 and for the cumulative period since inception (July 10, 2000) through December 31, 2007. This selected financial data should be read in conjunction with the consolidated financial statements and related notes included in Item 15 of this Annual Report on Form 10-K.

|                                                           | Fiscal Year Ended December 31, |            |            |            |            | Cumulative<br>Period from<br>Inception<br>(July 10, 2000) to<br>December 31,<br>2007 |
|-----------------------------------------------------------|--------------------------------|------------|------------|------------|------------|--------------------------------------------------------------------------------------|
|                                                           | 2007                           | 2006       | 2005       | 2004       | 2003       |                                                                                      |
|                                                           | (dollars in thousands)         |            |            |            |            |                                                                                      |
| Consolidated Statements of<br>Operations Data:            |                                |            |            |            |            |                                                                                      |
| Operating expenses:                                       |                                |            |            |            |            |                                                                                      |
| Research and development                                  | \$ 2,053                       | \$ 3,019   | \$ 3,040   | \$ 3,042   | \$ 1,950   | \$ 15,581                                                                            |
| General and administrative                                | 4,402                          | 4,029      | 3,615      | 4,262      | 2,988      | 22,455                                                                               |
| Operating loss                                            | (6,455)                        | (7,048)    | (6,655)    | (7,304)    | (4,938)    | (38,036)                                                                             |
| Interest and other income                                 | 102                            | 281        | 111        | 124        | 69         | 737                                                                                  |
| Interest and other expenses                               | (3,080)                        | 3,574      | (311)      | 3,410      | 793        | 2,139                                                                                |
| Total other income and<br>(expense)                       | (2,978)                        | 3,855      | (200)      | 3,534      | 862        | 2,876                                                                                |
| Net loss                                                  | \$ (9,433)                     | \$ (3,193) | \$ (6,855) | \$ (3,770) | \$ (4,076) | \$ (35,160)                                                                          |
| Net loss per share: basic and<br>diluted (1)              | \$ (0.24)                      | \$ (0.11)  | \$ (0.25)  | \$ (0.15)  | \$ (0.19)  |                                                                                      |
| Weighted average shares<br>outstanding: basic and diluted | 38,980,548                     | 28,472,898 | 27,315,411 | 25,750,789 | 21,360,572 |                                                                                      |

|                                                                                                                | 2007                   | 2006    | As of December 31,<br>2005 | 2004     | 2003     |
|----------------------------------------------------------------------------------------------------------------|------------------------|---------|----------------------------|----------|----------|
|                                                                                                                | (dollars in thousands) |         |                            |          |          |
| Consolidated Balance Sheet Data:                                                                               |                        |         |                            |          |          |
| Working capital (2)                                                                                            | \$ 426                 | \$ (53) | \$ 3,314                   | \$ 9,819 | \$ 7,318 |
| Total assets                                                                                                   | 1,782                  | 6,363   | 4,963                      | 11,110   | 8,002    |
| Advances received from subscribers for shares of Series A 12% Convertible Preferred Stock and related warrants | 1,637                  |         |                            |          |          |
| Convertible debt instrument                                                                                    |                        | 5,137   |                            |          |          |
| Warrant liabilities                                                                                            | 2,069                  | 371     | 5,936                      | 5,625    | 1,925    |
| Stockholders' (deficit) equity                                                                                 | (2,924)                | (22)    | (2,353)                    | 4,480    | 5,699    |

- (1) Basic and net loss per share is the same for each reporting period as the anti-dilutive shares were not included in the per-share calculations.
- (2) Excludes amount stated in Advances received from subscribers for Series A 12% Convertible Preferred Stock and related warrants .

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### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **RECENT EVENTS**

On February 25, 2008, in a registered direct offering we issued and sold an aggregate of 7,500,000 shares of our common stock at \$0.50 per share for gross proceeds of \$3.75 million. Net proceeds were approximately \$3.4 million after transaction expenses of approximately \$0.3 million. We also sold in the offering an aggregate of 10,500,000 warrants, 7,500,000 of which are exercisable for five years to purchase our common stock at \$0.70 per share and 3,000,000 of which are exercisable for four months to purchase shares of our common stock at \$0.67 per share. The warrants are not exercisable until August 26, 2008.

We received proceeds of \$75,000 subsequent to December 31, 2007, in a private placement begun in October 2007 of our Series A 12% Convertible Preferred Stock and related warrants. Total gross proceeds of this offering were approximately \$1.74 million. For additional detail, see Item 5 Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities under *Recent Sales of Unregistered Securities*.

#### **Overview**

We are a development-stage company engaged in the discovery, development, and commercialization of first-in-class, therapeutic compounds for advanced treatment of cancer, liver, microbial and inflammatory diseases. Our initial focus is the development of a new generation of anti-cancer treatments using carbohydrate polymers to target deliver chemotherapeutics to reduce toxicity and increase efficacy. DAVANAT®, the Company's lead pipeline candidate, is currently in Phase II trials for first-line treatment of colorectal and biliary cancer.

Our technology also is being used to rescue drugs that were shelved for toxicity or half-life issues, increase the solubility of existing drugs and as new chemical entities to treat diseases such as liver and kidney fibrosis. We have entered into a research collaboration with the Mount Sinai School of Medicine to study the anti-fibrotic effects of our novel carbohydrate compounds on liver fibrosis, and with Brigham and Women's Hospital to evaluate the anti-fibrotic effects of these compounds to treat acute and chronic kidney disease. Our first-in-class, novel carbohydrate compounds significantly reduced collagen expression and reversed fibrosis in animal models. Whereas previously, *in vitro* data indicated a reversal of fibrosis markers, in this proof-of-concept animal study, the compounds clearly reduced collagen expression and reversed liver fibrosis.

Upon approval by the appropriate regulatory authorities, we may commence commercial marketing and distribution of the product. This process typically takes several years to complete and requires the expenditure of substantial resources. Any delay in obtaining or failure to obtain required approvals will materially adversely affect our ability to generate revenues from commercial sales relating to our drug candidates. We may file an NDA for a drug candidate in 2008. We anticipate our source of funding for the next several years to come from either financing transactions or collaborations with other pharmaceutical companies.

We are devoting substantially all of our efforts toward product research and development, and raising capital. We have no source of revenue and have incurred significant losses to date. We have incurred net losses of approximately \$35.2 million for the cumulative period from inception (July 10, 2000) through December 31, 2007. Our losses have resulted principally from costs associated with research and development expenses, including clinical trial costs, and general and administrative activities. As a result of planned expenditures for future research, discovery, development and commercialization activities, we expect to incur additional operating losses for the foreseeable future.

From our inception (July 10, 2000) through December 31, 2007, we have raised approximately \$37.6 million principally through the private placements of convertible notes, preferred stock subscriptions, common stock and warrants, and in registered direct offerings of common stock and warrants. From inception through

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December 31, 2007, we have expended cash of approximately \$33.7 million for our operations. At December 31, 2007, we had approximately \$1.3 million of cash and cash equivalents. When combined with approximately \$3.4 million of net proceeds from an equity finance transaction completed subsequent to our year-end, we believe there is sufficient cash to fund our operations into October 2008.

Because we lack revenue and must continue our research and development, we must continually identify new sources of capital and complete financing transactions in order to continue our business. We must continually monitor the monthly burn rate of our capital resources.

### **Critical Accounting Policies and Estimates**

Our significant accounting policies are more fully described in Note 2 to our Consolidated Financial Statements included in this Annual Report. Certain of our accounting policies, however, are critical to the portrayal of our financial position and results of operations and require the application of significant judgment by our management, which subjects them to an inherent degree of uncertainty. In applying our accounting policies, our management uses its best judgment to determine the appropriate assumptions to be used in the determination of certain estimates. Those estimates are based on our 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. We believe that the critical accounting policies discussed below involve more complex management judgment due to the sensitivity of the methods, assumptions and estimates necessary in determining the related asset, liability, revenue and expense amounts.

*Accrued Expenses.* As part of the process of preparing our consolidated financial statements, we are required to estimate accrued expenses. This process involves identifying services that third parties have performed on our behalf and estimating the level of service performed and the associated cost incurred on these services as of each balance sheet date in our financial statements. Examples of estimated accrued expenses include contract service fees in conjunction with pre-clinical and clinical trials, professional service fees, such as those arising from the services of attorneys and accountants and accrued payroll expenses. In connection with these service fees, our estimates are most affected by our understanding of the status and timing of services provided relative to the actual services incurred by the service providers. In the event that we do not identify certain costs that have been incurred or we under- or over-estimate the level of services or costs of such services, our reported expenses for a reporting period could be understated or overstated. The date on which certain services commence, the level of services performed on or before a given date, and the cost of services are often subject to our judgment. We make these judgments based upon the facts and circumstances known to us in accordance with accounting principles generally accepted in the United States.

*Convertible Debt Instrument.* Our convertible debt instrument issued in February 2006 (the Debentures) constitutes a hybrid instrument that has the characteristics of a debt host contract containing several embedded derivative features that would require bifurcation and separate accounting as a derivative instrument pursuant to the provisions of Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). As permitted by SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140, we irrevocably elected to initially and subsequently measure the Debentures in their entirety at fair value with changes in fair value recorded as either a gain or loss in the consolidated statement of operations under the caption Change in fair value of convertible debt instrument. Fair value of the Debentures is determined using a binomial financial valuation model that requires assumptions that are subject to significant management judgment such as volatility of our common share price, interest rates and our intention to redeem the Debentures in cash or common shares. Volatility and interest rate expectations are based on the remaining time to maturity of the Debentures.

*Warrants.* We have issued common stock warrants in connection with the execution of certain equity and debt financings and consulting agreements. Certain warrants are accounted for as derivative liabilities at fair value in accordance with SFAS 133. Such warrants do not meet the criteria in paragraph 11(a) of SFAS 133 that a contract should not be considered a derivative instrument if it is (1) indexed to its own stock and (2) classified

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in stockholders' equity. Changes in fair value of derivative liabilities are recorded in the consolidated statement of operations under the caption "Change in fair value of warrant liabilities." Warrants that are not considered derivative liabilities as defined in SFAS 133 are accounted for at fair value at the date of issuance in additional paid-in capital. The fair value of warrants is determined using the Black-Scholes option-pricing model using assumptions regarding volatility of our common share price, remaining life of the warrant, and risk-free interest rates at each period end.

**Income Taxes.** We determine if our deferred tax assets and liabilities are realizable on an ongoing basis by assessing our valuation allowance and by adjusting the amount of such allowance, as necessary. At this time our primary deferred tax asset relates to our net operating loss carryforwards. In the determination of the valuation allowance, we have considered future taxable income and the feasibility of tax planning initiatives. Should we determine that it is more likely than not that we will realize certain of our deferred tax assets for which we previously provided a valuation allowance, an adjustment would be required to reduce the existing valuation allowance. In addition, we operate within multiple taxing jurisdictions and are subject to audit in these jurisdictions. These audits may require an extended period of time for resolution. Although we believe that adequate consideration has been made for such issues, there is the possibility that the ultimate resolution of such issues could have an adverse effect on the results of our operations.

**Stock-Based Compensation.** Through December 31, 2005, we accounted for stock-based compensation to employees and non-employee directors under the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," (APB No. 25) and the related interpretations. Under APB No. 25, no compensation expense is recognized for stock options granted to employees at fair market value and with fixed terms. On January 1, 2006, we adopted SFAS 123(R), "Share Based Payment," (SFAS 123(R)) using the modified prospective method, which results in the provisions of SFAS 123(R) being applied to the consolidated financial statements on a going-forward basis. Prior periods have not been restated. SFAS 123(R) requires companies to recognize stock-based compensation awards granted to its employees as compensation expense on a fair value method. Under the fair value recognition provisions of SFAS 123(R), stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the service period, which generally represents the vesting period. The grant date fair value of stock options is calculated using the Black-Scholes option-pricing model. The expense recognized over the service period is required to include an estimate of the awards that will be forfeited. Previously, we recorded the impact of forfeitures as they occurred. We do not anticipate any awards will be forfeited in our calculation of compensation expense due to the limited number of employees that receive stock option grants and our historical employee turnover.

We consider equity compensation to be an important component in attracting and retaining key employees. During 2007, 2006 and 2005, we awarded approximately 1,048,500, 399,000 and 272,000 stock options, respectively, to employees, consultants and non-employee members of our Board of Directors for normal services and we recorded approximately \$616,000 of related stock option expense in 2007. Because the exercise price of the options granted equal the fair market value of a share of our common stock on the date of grant and the options have fixed terms, we recorded no stock compensation expense on these awards in 2005. If we had used the fair value method provided for under SFAS No. 123, "Accounting for Stock-Based Compensation," our net loss in 2005 of approximately \$6.86 million would have increased by approximately \$287,000.

## **Results of Operations**

### ***Fiscal Year Ended December 31, 2007 Compared to Fiscal Year Ended December 31, 2006***

**Research and Development Expenses.** Research and development expenses were approximately \$2.05 million during the year ended December 31, 2007 as compared to approximately \$3.02 million incurred during the year ended December 31, 2006. We generally categorize research and development expenses as either direct external expense, comprised of amounts paid to third party vendors for services, or all other expenses, comprised of employee payroll and general overhead allocable to research and development. We subdivide external

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expenses between clinical programs and preclinical 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 twelve months ended December 31, 2007 as compared to the twelve months ended December 31, 2006 were as follows:

|                                             | <b>Year Ended<br/>December 31,<br/>(\$000)</b> |                 |
|---------------------------------------------|------------------------------------------------|-----------------|
|                                             | <b>2007</b>                                    | <b>2006</b>     |
| Direct external expenses                    |                                                |                 |
| Clinical programs                           | \$ 809                                         | \$ 1,504        |
| Pre-clinical activities                     | 357                                            | 589             |
| All other research and development expenses | 887                                            | 926             |
|                                             | <b>\$ 2,053</b>                                | <b>\$ 3,019</b> |

Clinical trial expenses decreased by approximately \$695,000. The decrease was due to a reduction of approximately \$426,000 in expenses related to the Phase II DAVANAT<sup>®</sup> Colorectal Cancer trial and the Phase I DAVANAT<sup>®</sup> Colorectal Cancer trial that, for the most part, were completed in 2006. In addition, a reduction of approximately \$362,000 in 2007 as compared to 2006 is due to lower expenses related to our Phase III European colorectal cancer trial. We initiated the trial in 2006 but did not begin dosing patients due to financial constraints. These reductions were offset by an increase of approximately \$93,000 associated with our two current Phase II trials for first-line treatment of colorectal and biliary cancer trial with DAVANAT<sup>®</sup>. Pre-clinical expenses in 2007 decreased by approximately \$232,000 compared to 2006 due to lower research activity. Other research and development costs decreased by approximately \$39,000. This is the result of lower payroll expense of approximately \$154,000 due principally to salary reductions to conserve cash, offset by higher non-cash stock compensation expense and higher space lease expense.

We expect our research and development expenses in 2008 will remain at approximately the same level as 2007 and will shift from the two current Phase II clinical trials to an NDA for DAVANAT<sup>®</sup> and development of our new fibrosis compounds.

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 hence we are unable at this stage of our development to forecast useful estimates. Variables that make 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. Please see *Risks Related to Pro-Pharmaceuticals* and *Risks Related to the Drug Development Industry* for additional risks and other factors that make estimates difficult at this time. 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.

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**General and Administrative Expenses.** General and administrative expenses were approximately \$4.4 million in 2007, an increase of approximately \$373,000 compared to approximately \$4.03 million in 2006. 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 costs. Of the approximately \$373,000 increase in expense in 2007, approximately \$405,000 consisted of an increase in legal expenses. Of this amount, approximately \$250,000 was due to expenses related to the counterclaims asserted against us by Prospect Therapeutics, Inc. described in Item 3. Legal Proceedings. An increase of approximately \$250,000 in additional legal expense was due to our equity finance efforts. The increase in legal expense was offset by reductions in general legal and patent legal expense of approximately \$95,000. Additionally, non-cash stock based compensation increased by approximately \$135,000, which was offset by a reduction in payroll expense of approximately \$191,000 as certain employees voluntarily reduced salaries to conserve cash. All other spending increased by approximately \$24,000, due principally to higher space lease expense.

We expect general and administrative expenses to decrease in 2008 as compared to 2007 due to lower legal and accounting expenses.

**Other Income and Expense.** Other income and expense was expense of approximately \$2.98 million in 2007 as compared to income of approximately \$3.86 million in 2006. Of the \$6.84 million increase, approximately \$9.52 million is related to fair value accounting for warrant liabilities. This was offset by approximately a \$1.36 million decrease in expense related to our convertible debt instrument's fair value accounting. Interest expense was approximately \$350,000 in 2007, as compared to approximately \$1.85 million in 2006. Interest expense decreased by approximately \$1.5 million due to lower convertible debenture amounts outstanding. Approximately \$350,000 of interest expense includes approximately \$257,000 of debt discount amortization and approximately \$93,000 of interest expense. Interest income was approximately \$102,000 in 2007 or a decrease of approximately \$179,000 as compared to approximately \$281,000 in 2006. Interest income consists primarily of interest income on interest-bearing cash equivalents and the certificate of deposit. The decrease in interest income is due primarily to lower average cash balances.

**Fiscal Year Ended December 31, 2006 Compared to Fiscal Year Ended December 31, 2005**

**Research and Development Expenses.** Research and development expenses were approximately \$3.02 million during the year ended December 31, 2006 as compared to approximately \$3.04 million incurred during the year ended December 31, 2005.

Our research and development expenses for the twelve months ended December 31, 2006 as compared to the twelve months ended December 31, 2005 were as follows:

|                                             | Year Ended<br>December 31,<br>(\$000) |          |
|---------------------------------------------|---------------------------------------|----------|
|                                             | 2006                                  | 2005     |
| Direct external expenses                    |                                       |          |
| Clinical programs                           | \$ 1,504                              | \$ 1,557 |
| Pre-clinical activities                     | 589                                   | 959      |
| All other research and development expenses | 926                                   | 524      |
|                                             | \$ 3,019                              | \$ 3,040 |

Clinical trial expense decreased by approximately \$53,000 as the Phase I late stage cancer patient trial was completed and the Phase II late stage colorectal cancer patient trial completed dosing resulting in reduced spending that was offset by the initiation of the line I biliary duct cancer, the line I colorectal cancer and line II colorectal cancer trials. Pre-clinical spending decreased due principally to reduced DAVANAT<sup>®</sup> manufacturing costs. All other research and development costs increased due to the addition of our Chief Scientist, additional

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personnel to support our clinical trials and expensing stock based compensation largely related to the fair value method as required by SFAS 123(R). In summary, research and development expense in 2006 shifted from pre-clinical activities to clinical programs. The increase in clinical trial expense was due to the start-up and costs associated with the Phase II trial. We completed dosing patients in a Phase I clinical trial of DAVANAT® in March 2005 and began dosing patients in a Phase II clinical trial of DAVANAT® in May 2005, while the pre-clinical tests and experiments associated with DAVANAT® diminished in 2006 as compared to 2005.

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 hence we are unable at this stage of our development to forecast useful estimates. Variables that make 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. Please see *Risks Related to Pro-Pharmaceuticals* and *Risks Related to the Drug Development Industry* for additional risks and other factors that make estimates difficult at this time. 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 Expenses.* General and administrative expenses were approximately \$4.3 million in 2006 or an increase of 12%, as compared to approximately \$3.62 million in 2005. 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 costs. Of the approximately \$414,000 increase in expense in 2006, approximately \$385,000 consisted of an increase in accounting and other costs associated primarily with the convertible debentures. Approximately \$273,000 of the increase was due to expensing stock based compensation related to the fair value method as required by SFAS 123(R). These increases were offset by a reduction in legal expense of approximately \$261,000. Legal expenses decreased due to lower expenses associated with the intellectual property litigation with GlycoGenesys. Payroll expense decreased due to lower incentive compensation payments

*Other Income and Expense.* Other income and expense was income of approximately \$3.86 in 2006 as compared to expense of approximately \$200,000 in 2005. Of the \$4.06 million increase, \$8.13 million is related to fair value accounting for warrant liabilities. This was offset by \$4.24 million of charges related to our convertible debt instrument of which approximately \$2.39 million is related to fair value accounting and approximately \$1.85 million is interest expense approximately \$1.85 million of interest includes approximately \$1.36 million of debt discount amortization and Approximately \$492,000 of interest expense. Additionally, interest income in 2006 was approximately \$281,000 or an increase of approximately \$170,000 as compared to approximately \$111,000 in 2005. Interest income consists primarily of interest income on interest-bearing cash equivalents and the certificate of deposit. The increase in interest income is due primarily to higher average interest rates and to a lesser degree due to higher average cash balances. Average interest rates were approximately 3.2% per annum in 2006 versus approximately 1.4% per annum in 2005.

## **Liquidity and Capital Resources**

As described in the section entitled *Overview* above and elsewhere in this Annual Report on Form 10-K, we are in the development stage and have not generated any revenues to date. Since our inception on July 10, 2000, we have financed our operations primarily through private placements of convertible debt, preferred stock subscriptions, common stock and warrants, and registered direct offerings of common stock and warrants. From inception through our 2007 fiscal year, we raised approximately \$37.6 million from these offerings and at December 31, 2007 had approximately \$1.32 million of cash available. Between October and December 2007,

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we received net proceeds of approximately \$1.6 million in subscriptions for a private placement of Series A 12% Convertible Preferred Stock and common stock warrants. We may pay the dividend on the preferred stock in shares of our common stock subject to certain provisions. The terms of this transaction are more fully described in Item 5 *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities* *Recent Sales of Unregistered Securities*.

Net cash used in operations decreased by approximately \$1.27 million to approximately \$5.48 million in 2007 as compared to approximately \$6.76 million in 2006. Approximately \$684,000 of the decrease was due to lower cash operating costs. Approximately \$590,000 was due to lower working capital requirements. These decreases were offset by lower net cash interest income of approximately \$118,000. The increased use of cash in operations in 2006 as compared to 2005 was primarily due to increased working capital needs. We expect our cash needs in 2008 to remain at approximately the same level as 2007.

Net cash provided by investing activities was approximately \$4.94 million in 2007 as compared to cash used of approximately \$5.24 million in 2006. The increase of approximately \$10.18 million was principally due to a \$5.0 million certificate of deposit which was initiated in 2006 and matured in 2007. The remaining \$180,000 is principally due to lower expenditures on property and equipment, patent costs and restricted cash requirements.

Net cash provided by financing activities was approximately \$1.08 million in 2007 and \$8.3 million in 2006. The 2007 cash provided consisted of \$1.64 million of advances related to our preferred stock and common warrant private placement subscriptions, see Item 5 *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities* under *Recent Sales of Unregistered Securities* offset by cash payments of approximately \$555,000 in accordance with the terms of the convertible debenture. Net cash provided by financing activities in 2006 resulted from the sale of the 7% Convertible Debentures and common stock warrants. In 2006, we elected to make two principal payments, amounting to approximately \$1.0 million in cash.

On February 25, 2008, we raised approximately \$3.4 million of net proceeds in a registered direct offering. See *Recent Events* above in this Item 7 *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

We believe that our cash on hand of approximately \$1.3 million at December 31, 2007 when combined with the \$3.4 million raised through our February 25, 2008 registered direct offering will be sufficient to enable us to meet our financing and operating obligations into October 2008. We will require more cash to fund our operations and believe that 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 obtainable on terms favorable to us.

***Payments Due Under Contractual Obligations***

The following table summarizes the payments due under our contractual obligations at December 31, 2007, and the effect such obligations are expected to have on liquidity and cash flow in future periods:

|                                                  |        | Payments due by period |                |                |                      |
|--------------------------------------------------|--------|------------------------|----------------|----------------|----------------------|
|                                                  |        | (\$000)                |                |                |                      |
| Contractual Obligations                          | Total  | Less than<br>1 year    | 1 - 3<br>years | 3 - 5<br>years | More than<br>5 years |
| Operating leases                                 | 999    | 289                    | 710            |                |                      |
| Total payments due under contractual obligations | \$ 999 | \$ 289                 | \$ 710         | \$             | \$                   |

On May 1, 2006 we entered into a 5 year lease for office space. The lease commenced on August 11, 2006 and terminates on September 30, 2011. The lease provides for annual base rental payments of approximately \$235,000 in the first year increasing in each subsequent lease year to approximately \$244,000, \$253,000,

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\$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 office space lease, a commercial bank has issued a letter of credit collateralized by cash we have on deposit with the bank of approximately \$59,000. Additionally, we have a non-cancellable lease for a car which expires in January 2011 and an executive housing lease which expires in October 2008.

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 a 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.

### ***Impact of New Accounting Standards***

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS No. 157 ). SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. In February 2008, the FASB decided that an entity need not apply this standard to non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis until the subsequent year. We will be required to adopt SFAS No. 157 in the first quarter of fiscal year 2008. Management is currently evaluating the requirements of SFAS No. 157 and has not yet determined the impact, if any, on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS No. 159 ). SFAS No. 159 provides entities with an option to report selected financial assets and liabilities at fair value, with the objective to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. We will be required to adopt SFAS No. 159 in the first quarter of fiscal year 2008. Management is currently evaluating the requirements of SFAS No. 159 and has not yet determined the impact, if any, of its adoption on our consolidated financial statements.

In June 2007, the FASB issued Emerging Issues Task Force ( EITF 07-3), Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities ( EITF 07-3 ). EITF 07-3 provides that non-refundable advance payments for goods or services that will be used or renders for future research and development activities should be deferred and capitalized. We have historically expensed such payments and will begin capitalizing such payments in the first quarter of 2008. As of December 31, 2007, there are no such payments currently recorded as expense.

### **Item 8. Financial Statements and Supplementary Data**

The financial statements required by this item are attached to this Annual Report on Form 10-K beginning on Page F-1.

### **Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

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### **Item 9A(T). Controls and Procedures**

#### *(a) Evaluation of Disclosure Controls and Procedures*

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as of the end of the period covered by this Annual Report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of December 31, 2007. Our management has concluded, based on their evaluation, that as of the end of the period covered by this report, our disclosure controls and procedures were effective as of December 31, 2007 to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

This Annual Report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit us to provide only management's report in this Annual Report.

#### *(b) Changes in Internal Control Over Financial Reporting*

There was no change in our internal control over financial reporting that occurred during the fourth quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### **Item 9B. Other Information**

None.

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**PART III**

**Item 10. *Directors, Executive Officers and Corporate Governance***

The information required by this Item will be contained in our definitive Proxy Statement to be filed with the SEC in connection with our 2008 Annual Meeting of Stockholders to be held on May 21, 2008 (the 2008 Proxy Statement ) under the captions Election of Directors, Board of Directors Meetings and Committees of the Board, Executive Officers and Section 16(a) Beneficial Ownership Reporting Compliance and is incorporated herein by reference.

We have adopted a Code of Ethics that applies to all our directors, officers and employees. The Code of Ethics is publicly available on our website at [www.pro-pharmaceuticals.com](http://www.pro-pharmaceuticals.com). Amendments to the Code of Ethics and any grant of a waiver from a provision of the Code of Ethics requiring disclosure under applicable SEC and American Stock Exchange rules will be disclosed on our website.

**Item 11. *Executive Compensation***

The information required by this Item will be incorporated by reference from the information under the caption Compensation of Named Executive Officers contained in our 2008 Proxy Statement.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required by this item will be incorporated by reference from the information under the caption Security Ownership of Certain Beneficial Owners and Management contained in our 2008 Proxy Statement.

**Item 13. *Certain Relationships, Related Transactions and Director Independence***

The information required by this item will be incorporated by reference from the information under the caption Certain Relationships and Related Transactions contained in our 2008 Proxy Statement.

**Item 14. *Principal Accounting Fees and Services***

The information required by this item will be incorporated by reference from the information under the captions Audit Fees , Audit-Related Fees, Tax Fees, All Other Fees and Pre-Approval Policies and Procedures contained in our 2008 Proxy Statement.

**Table of Contents****PART IV****Item 15. Exhibits and Financial Statement Schedules**

## (a) 1. Consolidated Financial Statements

The Consolidated Financial Statements are filed as part of this report.

## 2. Consolidated Financial Statement Schedules

All schedules are omitted because of the absence of conditions under which they are required or because the required information is included in the Consolidated Financial Statements or notes thereto.

## 3. Exhibits

| <b>Exhibit<br/>Number</b> | <b>Description of Document</b>                                                                                                                                                                                  | <b>Note<br/>Reference</b> |
|---------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|
| 3.1                       | Articles of Incorporation of the Registrant, 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 the Registrant, as filed with the Secretary of State of the State of Nevada Secretary of State on May 28, 2004                                         | 2                         |
| 3.3                       | Certificate of Designation of Preferences, Rights and Limitations of Series A 12% Convertible Preferred Stock of the Registrant, as filed with the Secretary of State of the State of Nevada on October 5, 2007 | 3                         |
| 3.4                       | Amended and Restated Bylaws of the Registrant                                                                                                                                                                   | 4                         |
| 10.1                      | Pro-Pharmaceuticals, Inc. 2001 Stock Incentive Plan.                                                                                                                                                            | 5                         |
| 10.2                      | Pro-Pharmaceuticals, Inc. 2003 Non-employee Director Stock Incentive Plan.                                                                                                                                      | 6                         |
| 10.3                      | Employment Agreement, effective January 2, 2004, by and between the Registrant and David Platt.                                                                                                                 | 7                         |
| 10.4                      | Form of Incentive Stock Option Agreement (under the 2001 Stock Incentive Plan).                                                                                                                                 | 8                         |
| 10.5                      | Form of Non-Qualified Stock Option Agreement (under the 2001 Stock Incentive Plan).                                                                                                                             | 8                         |
| 10.6                      | Form of Non-Qualified Stock Option Agreement (under the 2003 Non-Employee Director Stock Incentive Plan).                                                                                                       | 8                         |
| 10.7                      | Form of 7% Convertible Debenture issued on February 14, 2006                                                                                                                                                    | 9                         |
| 10.8                      | Securities Purchase Agreement dated February 14, 2006, between Pro-Pharmaceuticals, Inc. and the Purchasers named therein                                                                                       | 9                         |
| 10.9                      | Registration Rights Agreement dated February 14, 2006, between Pro-Pharmaceuticals, Inc. and the Purchasers named therein.                                                                                      | 9                         |
| 10.10                     | Form of Common Stock Purchase Warrant issued on February 14, 2006.                                                                                                                                              | 9                         |
| 10.11                     | Office Lease Agreement dated May 2, 2006 between NS 5/27 Acquisition LLC, landlord, and the Registrant, tenant.                                                                                                 | 10                        |

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|       |                                                                                                                                                                |    |
|-------|----------------------------------------------------------------------------------------------------------------------------------------------------------------|----|
| 10.12 | Waiver and Exchange Agreement dated March 21, 2007.                                                                                                            | 11 |
| 10.13 | Employment Agreement effective October 1, 2007 between Theodore D. Zucconi, President, and the Registrant.                                                     | 12 |
| 10.14 | Employment Agreement dated May 1, 2003 between Anthony D. Squeglia, and Registrant filed upon succession as Chief Financial Officer effective October 1, 2007. | 13 |

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| Exhibit Number | Description of Document                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | Note Reference |
|----------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|
| 10.15          | Form of Securities Purchase Agreement for units of Series A 12% Convertible Preferred Stock and Common Stock Purchase Warrants.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | 3              |
| 10.16          | Form of Registration Rights Agreement                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | 3              |
| 10.17          | Form of Common Stock Purchase Warrant                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | 3              |
| 10.18          | Form of Common Stock Purchase Warrant                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | 3              |
| 10.19          | Amended and Restated Employment Agreement dated December 20, 2007 between Anthony D. Squeglia and the Registrant.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | 14             |
| 10.20          | Amended and Restated Employment Agreement dated December 19, 2007 between Theodore D. Zucconi and the Registrant                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | 15             |
| 10.21          | Securities Purchase Agreement dated February 14, 2008 between the Registrant and Alpha Capital, Rockmore Investment Master Fund, Ltd., Iroquois Master Fund, Ltd., Cranshire Capital, L.P., Hudson Bay Fund, L.P., Hudson Bay Overseas Fund, Ltd., Truk International Fund, L.P., Truk Opportunity Fund, LLC, ICM Business Trust, Ionic Capital Master Fund, Ltd., Highbridge Capital Management, LLC, Portside Growth & Opportunity Fund, Millenium Partners, L.P., Peter Hauser, Peter L. Hauser IRA, Enable Growth Partners L.P., George Macricostas, CAMOFI Master LDC, Cougar Trading, LLC, Brio Capital L.P., Fairfield Investments | 16             |
| 10.22          | Form of Common Stock Purchase Warrant issued on February 25, 2008                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | 16             |
| 10.23          | Placement Agent Agreement dated February 12, 2008 between Maxim Group LLC and the Registrant                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 16             |
| 21.1*          | Subsidiaries of the Registrant                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                |
| 23.1*          | Consent of Deloitte & Touche LLP, an independent registered public accounting firm                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |                |
| 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 Registrant's Registration Statement on Form 10-SB, as filed with the Commission on June 13, 2001.
2. Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q filed with the Commission on August 16, 2004.
3. Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Commission on October 9, 2007.
4. Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Commission on December 17, 2007.
5. Incorporated by reference to the Registrant's Quarterly Report on Form 10-QSB for the quarter ended September 30, 2001 filed with the Commission on November 14, 2001.
6. Incorporated by reference to the Registrant's Registration Statement on Form S-8, as filed with the Commission on October 22, 2003.

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7. Incorporated by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2003, as filed with the Commission on March 30, 2004.
8. Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the period ended September 30, 2004 as filed with the Commission on November 19, 2004.
9. Incorporated by reference to the Registrant's Current Report on Form 8-K as filed with the Commission on February 15, 2006.
10. Incorporated by reference to the Registrant's Current Report on Form 8-K as filed with the Commission on May 5, 2006.
11. Incorporated by reference to the Registrant's Current Report on Form 8-K as filed with the Commission on March 21, 2007.
12. Incorporated by reference to the Registrant's Current Report on Form 8-K as filed with the Commission on September 27, 2007.
13. Incorporated by reference to the Registrant's Current Report on Form 8-K as filed with the Commission on October 4, 2007.
14. Incorporated by reference to the Registrant's Current Report on Form 8-K as filed with the Commission on October December 20, 2007.
15. Incorporated by reference to the Registrant's Current Report on Form 8-K as filed with the Commission on October December 26, 2007.
16. Incorporated by reference to the Registrant's Current Report on Form 8-K as filed with the Commission on October February 15, 2008.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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 March 28, 2008.

PRO-PHARMACEUTICALS, INC.

By: /s/ DAVID PLATT  
Name: David Platt, Ph.D.  
Title: Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature                                                   | Title                                | Date           |
|-------------------------------------------------------------|--------------------------------------|----------------|
| /s/ DAVID PLATT<br><br>David Platt, Ph.D.                   | Chief Executive Officer and Director | March 28, 2008 |
| /s/ THEODORE D. ZUCCONI<br><br>Theodore D. Zucconi, Ph.D.   | President and Director               | March 28, 2008 |
| /s/ ANTHONY D. SQUEGLIA<br><br>Anthony D. Squeglia          | Chief Financial Officer              | March 28, 2008 |
| /s/ MILDRED S. CHRISTIAN<br><br>Mildred S. Christian, Ph.D. | Director                             | March 28, 2008 |
| /s/ DALE H. CONAWAY<br><br>Dale H. Conaway, D.V.M.          | Director                             | March 28, 2008 |
| /s/ HENRY J. ESBER<br><br>Henry Esber, Ph.D.                | Director                             | March 28, 2008 |
| /s/ JAMES T. GOURZIS<br><br>James T. Gourzis, M.D., Ph.D.   | Director                             | March 28, 2008 |
| /s/ S. COLIN NEILL<br><br>S. Colin Neill                    | Director                             | March 28, 2008 |
| /s/ STEVEN PRELACK<br><br>Steven Prelack                    | Director                             | March 28, 2008 |

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/s/ JERALD K. ROME

Director

March 28, 2008

Jerald K. Rome

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**Pro-Pharmaceuticals, Inc.**

**(A Development Stage Company)**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of Pro-Pharmaceuticals, Inc.

Newton, Massachusetts

We have audited the accompanying consolidated balance sheets of Pro-Pharmaceuticals, Inc. and subsidiary (a development stage company) (the Company ) as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' (deficit) equity, and cash flows for each of the three years in the period ended December 31, 2007, and for the period from inception (July 10, 2000) to December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, and for the period from inception (July 10, 2000) to December 31, 2007 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 123(R), Share-Based Payment on January 1, 2006 based on the modified prospective application transition method and the Company adopted Financial Accounting Standards Board ( FASB ) Interpretation ( FIN ) No. 48 Accounting For Uncertainty in Income Taxes on January 1, 2007.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company's recurring losses from operations and stockholders' deficit raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also discussed in Note 1 to the consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Deloitte & Touche LLP

Boston, Massachusetts

March 28, 2008

**Table of Contents****PRO-PHARMACEUTICALS, INC.****(A Development-Stage Company)****CONSOLIDATED BALANCE SHEETS**

DECEMBER 31, 2007 AND 2006 (dollars in thousands except share and per share data)

|                                                                                                                                                                                                                                                                                                                                                             | 2007     | 2006     |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|----------|
| <b>ASSETS</b>                                                                                                                                                                                                                                                                                                                                               |          |          |
| <b>CURRENT ASSETS:</b>                                                                                                                                                                                                                                                                                                                                      |          |          |
| Cash and cash equivalents                                                                                                                                                                                                                                                                                                                                   | \$ 1,319 | \$ 773   |
| Prepaid expenses and other current assets                                                                                                                                                                                                                                                                                                                   | 70       | 163      |
| Certificate of deposit                                                                                                                                                                                                                                                                                                                                      |          | 5,000    |
| Total current assets                                                                                                                                                                                                                                                                                                                                        | 1,389    | 5,936    |
| PROPERTY AND EQUIPMENT NET                                                                                                                                                                                                                                                                                                                                  | 73       | 112      |
| RESTRICTED CASH                                                                                                                                                                                                                                                                                                                                             | 70       | 59       |
| INTANGIBLE ASSETS NET                                                                                                                                                                                                                                                                                                                                       | 250      | 256      |
| TOTAL ASSETS                                                                                                                                                                                                                                                                                                                                                | \$ 1,782 | \$ 6,363 |
| <b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>                                                                                                                                                                                                                                                                                                                 |          |          |
| <b>CURRENT LIABILITIES:</b>                                                                                                                                                                                                                                                                                                                                 |          |          |
| Accounts payable                                                                                                                                                                                                                                                                                                                                            | \$ 601   | \$ 340   |
| Accrued expenses                                                                                                                                                                                                                                                                                                                                            | 362      | 512      |
| Convertible debt instrument                                                                                                                                                                                                                                                                                                                                 |          | 5,137    |
| Advances received from subscribers for Series A 12% Convertible Preferred Stock and related warrants                                                                                                                                                                                                                                                        | 1,637    |          |
| Total current liabilities                                                                                                                                                                                                                                                                                                                                   | 2,600    | 5,989    |
| WARRANT LIABILITIES                                                                                                                                                                                                                                                                                                                                         | 2,069    | 371      |
| OTHER LONG TERM LIABILITIES                                                                                                                                                                                                                                                                                                                                 | 37       | 25       |
| Total liabilities                                                                                                                                                                                                                                                                                                                                           | \$ 4,706 | \$ 6385  |
| <b>COMMITMENTS AND CONTINGENCIES (Note 10)</b>                                                                                                                                                                                                                                                                                                              |          |          |
| <b>STOCKHOLDERS DEFICIT:</b>                                                                                                                                                                                                                                                                                                                                |          |          |
| Undesignated shares, \$0.01 par value; 10,000,000 shares authorized; 5,000,000 shares designated Series A 12% Convertible Preferred Stock and 10,000,000 shares undesignated at December 31, 2007 and 2006 respectively; 1,667,500 shares of Series A 12% Convertible Preferred Stock subscribed, none issued and outstanding at December 31, 2007 and 2006 |          |          |
| Common stock, \$0.001 par value; 100,000,000 shares authorized; 40,364,792 and 32,518,643 shares of common stock issued and outstanding at December 31, 2007 and 2006, respectively; Undesignated shares, \$0.01 par value; 10,000,000 shares authorized; 5,000,000 and 10,000,000 undesignated at December 31, 2007 and 2006, respectively                 | 40       | 32       |
| Additional paid-in capital                                                                                                                                                                                                                                                                                                                                  | 32,196   | 25,673   |
| Deficit accumulated during the development stage                                                                                                                                                                                                                                                                                                            | (35,160) | (25,727) |
| Total stockholders deficit                                                                                                                                                                                                                                                                                                                                  | (2,924)  | (22)     |

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|                                             |          |          |
|---------------------------------------------|----------|----------|
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT | \$ 1,782 | \$ 6,363 |
|---------------------------------------------|----------|----------|

See notes to consolidated financial statements.

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**Table of Contents****PRO-PHARMACEUTICALS, INC.****(A Development-Stage Company)****CONSOLIDATED STATEMENTS OF OPERATIONS****YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005, AND CUMULATIVE PERIOD****FROM INCEPTION (JULY 10, 2000) TO DECEMBER 31, 2007 (dollars in thousands except per share data)**

|                                                                         | Years Ended December 31, |                   |                   | Cumulative<br>Period from<br>Inception<br>(July 10,<br>2000) to<br>December 31,<br>2007 |
|-------------------------------------------------------------------------|--------------------------|-------------------|-------------------|-----------------------------------------------------------------------------------------|
|                                                                         | 2007                     | 2006              | 2005              |                                                                                         |
| <b>OPERATING EXPENSES:</b>                                              |                          |                   |                   |                                                                                         |
| Research and development                                                | \$ 2,053                 | \$ 3,019          | \$ 3,040          | \$ 15,581                                                                               |
| General and administrative                                              | 4,402                    | 4,029             | 3,615             | 22,455                                                                                  |
| Operating loss                                                          | (6,455)                  | (7,048)           | (6,655)           | (38,036)                                                                                |
| <b>OTHER INCOME AND (EXPENSE):</b>                                      |                          |                   |                   |                                                                                         |
| Interest income                                                         | 102                      | 281               | 111               | 737                                                                                     |
| Interest expense                                                        | (350)                    | (1,850)           |                   | (4,451)                                                                                 |
| Change in fair value of convertible debt instrument                     | (1,032)                  | (2,394)           |                   | (3,426)                                                                                 |
| Change in fair value of warrant liabilities                             | (1,698)                  | 7,818             | (311)             | 10,016                                                                                  |
| Total other income (expense)                                            | \$ (2,978)               | \$ 3,855          | \$ (200)          | \$ 2,876                                                                                |
| <b>NET LOSS</b>                                                         | <b>\$ (9,433)</b>        | <b>\$ (3,193)</b> | <b>\$ (6,855)</b> | <b>\$ (35,160)</b>                                                                      |
| <b>NET LOSS PER SHARE BASIC AND DILUTED</b>                             | <b>\$ (0.24)</b>         | <b>\$ (0.11)</b>  | <b>\$ (0.25)</b>  |                                                                                         |
| <b>WEIGHTED AVERAGE COMMON SHARES<br/>OUTSTANDING BASIC AND DILUTED</b> | <b>38,980,548</b>        | <b>28,472,898</b> | <b>27,315,411</b> |                                                                                         |

See notes to consolidated financial statements.

**Table of Contents****PRO-PHARMACEUTICALS, INC.****(A Development-Stage Company)****CONSOLIDATED STATEMENTS OF STOCKHOLDERS (DEFICIT) EQUITY****YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005, AND CUMULATIVE PERIOD****FROM INCEPTION (JULY 10, 2000) TO DECEMBER 31, 2007 (dollars in thousands)**

|                                                                                                                   | Common Stock |             |            |              | Deficit     | Total        |
|-------------------------------------------------------------------------------------------------------------------|--------------|-------------|------------|--------------|-------------|--------------|
|                                                                                                                   | Number       | \$0.001 Par | Additional | Deferred     | Accumulated | Stockholders |
|                                                                                                                   | of Shares    | Value       | Paid-in    | Compensation | During the  | (Deficit)    |
|                                                                                                                   |              |             | Capital    |              | Development | Equity       |
|                                                                                                                   |              |             |            |              | Stage       |              |
| Issuance of founders shares in 2000                                                                               | 12,354,670   | \$ 12       | \$ (3)     | \$           | \$          | \$ 9         |
| Beneficial conversion feature and rights to common stock embedded in convertible note in 2000                     |              |             | 222        |              |             | 222          |
| Issuance of common stock and beneficial conversion feature related to convertible note in 2001                    | 660,321      | 1           | 1,035      |              |             | 1,036        |
| Issuance of common stock in connection with reverse merger of Pro-Pharmaceuticals-NV in 2001                      | 1,221,890    | 1           | 106        |              |             | 107          |
| Conversion of notes payable and accrued interest to common stock in 2001                                          | 598,229      | 1           | 1,125      |              |             | 1,126        |
| Issuance of warrants to induce conversion of notes payable in 2001                                                |              |             | 503        |              |             | 503          |
| Issuance of common stock and warrants (net of issuance costs of \$17) in 2001                                     | 689,300      | 1           | 2,220      |              |             | 2,221        |
| Issuance of common stock (net of issuance costs of \$49) in 2002                                                  | 185,999      |             | 602        |              |             | 602          |
| Issuance of common stock related to 2002 private placement (net of issuance costs of \$212)                       | 3,223,360    | 3           | 2,858      |              |             | 2,861        |
| Conversion of notes payable and accrued interest to common stock                                                  | 105,877      |             | 290        |              |             | 290          |
| Issuance of warrants to purchase common stock in consideration for placement of convertible notes payable in 2002 |              |             | 236        |              |             | 236          |
| Issuance of common stock to investors in 2002 private placement (net of issuance costs of \$18)                   | 1,088,000    | 1           | 1,069      |              |             | 1,070        |
| Issuance of common stock to consultants for services related to 2002 private placement                            | 12,250       |             | 12         |              |             | 12           |
| Receipt of subscription receivable                                                                                |              |             | 150        |              |             | 150          |
| Conversion of accrued expenses to common stock and options                                                        | 201,704      |             | 302        |              |             | 302          |
| Issuance of common stock to investors in May, 2003 private placement (net of issuance costs of \$128)             | 2,399,500    | 3           | 4,407      |              |             | 4,410        |
| Fair value of common stock warrants issued to placement agents in May, 2003 private placement                     |              |             | 261        |              |             | 261          |
| Issuance of common stock to investors in October, 2003 private placement (net of issuance costs of \$559)         | 1,314,571    | 1           | 1,318      |              |             | 1,319        |
| Cashless exercise of employee stock options                                                                       | 16,629       |             | 74         |              |             | 74           |
| Issuance of common stock to investors in April, 2004 private placement (net of issuance costs of \$466))          | 1,236,111    | 1           | 1,897      |              |             | 1,898        |
| Issuance of common stock to investors in August, 2004 private placement (net of issuance costs of \$485)          | 2,000,000    | 2           | 488        |              |             | 490          |
| Common stock issued in 2006 related to convertible debenture conversions                                          | 476,202      | 1           | 1,744      |              |             | 1,745        |
| Common stock issued in 2006 and 2007 related to convertible debenture redemptions                                 | 7,367,831    | 7           | 3,941      |              |             | 3,948        |
|                                                                                                                   | 5,205,348    | 5           | 5,325      |              |             | 5,330        |

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Common stock issued in 2007 related to convertible debenture  
waiver and exchange agreement

|                                                               |                   |              |                    |
|---------------------------------------------------------------|-------------------|--------------|--------------------|
| Deferred compensation relating to issuance of stock options   | 455               | (455)        |                    |
| Amortization of deferred compensation                         |                   | 612          | 612                |
| Stock compensation expense related to fair market revaluation | 157               | (157)        |                    |
| Stock based compensation expense                              | 1,375             |              | 1,375              |
| Stock compensation related to the issuance of common shares   | 7,000             | 27           | 27                 |
| Net loss since inception                                      |                   | (35,160)     | (35,160)           |
| <b>BALANCE, DECEMBER 31, 2007</b>                             | <b>40,364,792</b> | <b>\$ 40</b> | <b>\$ 32,196</b>   |
|                                                               |                   | <b>\$</b>    | <b>\$ (35,160)</b> |
|                                                               |                   |              | <b>\$ (2,924)</b>  |

See notes to consolidated financial statements.

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**Table of Contents****PRO-PHARMACEUTICALS, INC.****(A Development-Stage Company)****CONSOLIDATED STATEMENTS OF STOCKHOLDERS (DEFICIT) EQUITY****YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005, AND CUMULATIVE PERIOD****FROM INCEPTION (JULY 10, 2000) TO DECEMBER 31, 2007 (dollars in thousands)**

|                                                                                             | Common Stock |             |            |              | Deficit     | Total        |
|---------------------------------------------------------------------------------------------|--------------|-------------|------------|--------------|-------------|--------------|
|                                                                                             | Number       | \$0.001 Par | Additional | Deferred     | Accumulated | Stockholders |
|                                                                                             | of Shares    | Value       | Paid-in    | Compensation | During the  | (Deficit)    |
|                                                                                             |              |             | Capital    |              | Development | Equity       |
|                                                                                             |              |             |            |              | Stage       |              |
| BALANCE, JANUARY 1, 2005                                                                    | 27,315,411   | \$ 27       | \$ 20,133  | \$ (1)       | \$ (15,679) | \$ 4,480     |
| Issuance of common stock options in consideration for investor relations and other services |              |             | 21         |              |             | 21           |
| Amortization of deferred compensation                                                       |              |             |            | 1            |             | 1            |
| Net loss                                                                                    |              |             |            |              | (6,855)     | (6,855)      |
| BALANCE, DECEMBER 31, 2005                                                                  | 27,315,411   | \$ 27       | \$ 20,154  | \$           | \$ (22,534) | \$ (2,353)   |
| Common stock issued related to convertible debenture conversions                            | 476,202      | 1           | 1,744      |              |             | 1,745        |
| Common stock issued related to convertible debenture redemptions                            | 4,727,030    | 4           | 3,359      |              |             | 3,363        |
| Stock based compensation expense                                                            |              |             | 416        |              |             | 416          |
| Net loss                                                                                    |              |             |            |              | (3,193)     | (3,193)      |
| BALANCE DECEMBER 31, 2006                                                                   | 32,518,643   | \$ 32       | \$ 25,673  |              | \$ (25,727) | \$ (22)      |
| Common stock issued related to convertible debenture redemptions                            | 2,640,801    | 3           | 582        |              |             | 585          |
| Common Stock issued related to waiver and exchange agreement                                | 5,205,348    | 5           | 5,325      |              |             | 5,330        |
| Stock based compensation expense                                                            |              |             | 616        |              |             | 616          |
| Net loss                                                                                    |              |             |            |              | (9,433)     | (9,433)      |
| BALANCE DECEMBER 31, 2007                                                                   | 40,364,792   | \$ 40       | 32,196     |              | \$ (35,160) | \$ (2,924)   |

(Concluded)

See notes to consolidated financial statements.

**Table of Contents****PRO-PHARMACEUTICALS, INC.****(A Development-Stage Company)****CONSOLIDATED STATEMENTS OF CASH FLOWS****YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005, AND CUMULATIVE PERIOD****FROM INCEPTION (JULY 10, 2000) TO DECEMBER 31, 2007 (dollars in thousands)**

|                                                                                                  | Years Ended December 31, |            |            | Cumulative<br>Period from<br>Inception<br>(July 10, 2000) to<br>December 31,<br>2007 |
|--------------------------------------------------------------------------------------------------|--------------------------|------------|------------|--------------------------------------------------------------------------------------|
|                                                                                                  | 2007                     | 2006       | 2005       |                                                                                      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                                     |                          |            |            |                                                                                      |
| Net loss                                                                                         | \$ (9,433)               | \$ (3,193) | \$ (6,855) | \$ (35,160)                                                                          |
| Adjustments to reconcile net loss to net cash used in operating activities:                      |                          |            |            |                                                                                      |
| Depreciation and amortization                                                                    | 64                       | 67         | 82         | 439                                                                                  |
| Stock-based compensation expense                                                                 | 616                      | 416        | 22         | 2,088                                                                                |
| Non-cash interest expense                                                                        | 333                      | 1,772      |            | 4,279                                                                                |
| Change in fair value of convertible debt instrument                                              | 1,032                    | 2,394      |            | 3,426                                                                                |
| Change in fair value of warrant liabilities                                                      | 1,698                    | (7,818)    | 311        | (10,016)                                                                             |
| Write-off of intangible assets                                                                   | 23                       | 11         | 20         | 170                                                                                  |
| Changes in other assets and liabilities:                                                         |                          |            |            |                                                                                      |
| Prepaid expenses and other current assets                                                        | 61                       | 97         | (81)       | (67)                                                                                 |
| Accounts payable and accrued expenses                                                            | 111                      | (528)      | 374        | 1,081                                                                                |
| Changes in long term liabilities                                                                 | 12                       | 25         |            | 37                                                                                   |
| Net cash used in operating activities                                                            | (5,483)                  | (6,757)    | (6,127)    | (33,723)                                                                             |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                                     |                          |            |            |                                                                                      |
| Maturity/(Purchase) of certificate of deposit                                                    | 5,000                    | (5,000)    |            |                                                                                      |
| Purchases of property and equipment                                                              | (5)                      | (98)       | (21)       | (419)                                                                                |
| Increase in restricted cash                                                                      | (11)                     | (59)       |            | (70)                                                                                 |
| Increase in patents costs and other assets                                                       | (37)                     | (79)       | (90)       | (404)                                                                                |
| Net cash provided by/ (used in) investing activities                                             | 4,947                    | (5,236)    | (111)      | (893)                                                                                |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                                     |                          |            |            |                                                                                      |
| Net proceeds from issuance of common stock and warrants                                          |                          |            |            | 25,309                                                                               |
| Net proceeds from issuance of convertible debt instrument                                        |                          | 9,300      |            | 10,621                                                                               |
| Repayment of convertible debt instrument                                                         | (555)                    | (1,000)    |            | (1,641)                                                                              |
| Advances received from stock subscriptions for series A convertible Preferred Stock and Warrants | 1,637                    |            |            | 1,637                                                                                |
| Proceeds from shareholder advances                                                               |                          |            |            | 9                                                                                    |
| Net cash provided by financing activities                                                        | 1,082                    | 8,300      |            | 35,935                                                                               |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS                                             | 546                      | (3,693)    | (6,238)    | 1,319                                                                                |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD                                                   | 773                      | 4,466      | 10,704     |                                                                                      |
| CASH AND CASH EQUIVALENTS, END OF PERIOD                                                         | \$ 1,319                 | \$ 773     | \$ 4,466   | \$ 1,319                                                                             |

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|                                                                                        |                        |    |       |    |       |    |  |    |  |        |
|----------------------------------------------------------------------------------------|------------------------|----|-------|----|-------|----|--|----|--|--------|
| SUPPLEMENTAL DISCLOSURE                                                                | Cash paid for interest | \$ | 17    | \$ | 78    | \$ |  | \$ |  | 114    |
| NONCASH FINANCING ACTIVITIES                                                           |                        |    |       |    |       |    |  |    |  |        |
| Issuance of equity warrants in connection with equity offerings                        |                        |    |       |    |       |    |  |    |  | 1,172  |
| Conversion of accrued expenses into common stock                                       |                        |    |       |    |       |    |  |    |  | 303    |
| Cashless exercise of employee stock options                                            |                        |    |       |    |       |    |  |    |  | 74     |
| Conversion and redemptions of convertible notes and accrued interest into common stock |                        |    | 5,915 |    | 5,108 |    |  |    |  | 12,243 |
| Conversion of extension costs related to convertible notes into common stock           |                        |    |       |    |       |    |  |    |  | 171    |
| Conversion of Prepaid Interest into common stock                                       |                        |    | (32)  |    | (49)  |    |  |    |  |        |
| Issuance of warrants to induce conversion of notes payable                             |                        |    |       |    |       |    |  |    |  | 503    |
| Issuance of stock to acquire Pro-Pharmaceuticals-NV                                    |                        |    |       |    |       |    |  |    |  | 107    |
| See notes to consolidated financial statements.                                        |                        |    |       |    |       |    |  |    |  |        |

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**PRO-PHARMACEUTICALS, INC.**

**(A DEVELOPMENT-STAGE COMPANY)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (dollar amounts in thousands)**

**1. NATURE OF BUSINESS AND BASIS OF PRESENTATION AND SUBSEQUENT EVENTS**

Pro-Pharmaceuticals, Inc. (the Company) is a development stage life sciences company established in July 2000. The Company is developing technologies that are intended to reduce toxicity and improve the efficacy of chemotherapy drugs by combining the drugs with proprietary carbohydrate compounds. The carbohydrate-based drug delivery compounds may also have application for drugs to treat other diseases and chronic health conditions.

The Company is devoting substantially all of its efforts toward product research and development, and raising capital. Its first product candidate began a Phase I clinical trial in end stage patients in February 2003. Patient dosing in this trial was completed in March 2005. This same product candidate began a concurrent Phase II clinical trial in end stage patients in January 2004. Patient dosing in this trial commenced in May of 2005 and was completed in May 2006. The Company has initiated two additional Phase II trials in early stage patients to test the safety and efficacy of the product.

The Company incurred net losses of \$35,160 for the cumulative period from inception (July 10, 2000) through December 31, 2007. The Company expects to incur additional losses and use additional cash in its operations in the near future. Through December 31, 2007, the Company had raised \$37,567 in capital through the issue and sale in private placements of convertible notes, advance preferred stock subscriptions, common stock and warrants. From inception (July 10, 2000) through December 31, 2007, the Company used cash of \$33,723 in its operations.

In July 2007, in order to conserve cash, employees took an approximate 50% pay reduction and reduced other expenses thereby extending the Company's cash runway. In October 2007, the Company commenced a private placement of units Company's Series A 12% Convertible Preferred Stock and warrants which was offered to accredited investors. As of December 31, 2007, the Company held net proceeds, which represent advances for stock subscriptions, from the transaction of approximately \$1,637. In 2008, the Company raised an additional \$75 through this private placement. The stock subscriptions were accepted and the Private Placement was closed on February 4, 2008. This transaction is further discussed in Note 7. At December 31, 2007, the Company had \$1,319 of cash and cash equivalents available to fund future operations, which when combined with the net proceeds of approximately \$3,400 from its February 25, 2008 registered direct share issuance as further discussed in Note 12, management believes is sufficient cash to fund its operations into October 2008. The Company is actively pursuing additional sources of financing and other strategic alternatives.

In June 2007, the Company received a notice from the American Stock Exchange that it is reviewing the Company's eligibility for continued listing of its common stock. In particular, the exchange noted that the Company is not in compliance with its minimum stockholders' equity requirement in two of the last three years. In response to the Company's plan to achieve and sustain compliance with the listing requirements, the exchange granted the Company an extension until October 13, 2008 to regain compliance with the standards. Failure to make progress consistent with the plan or to regain compliance with the continued listing standards by such date could result in the Company's stock being de-listed from the exchange.

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

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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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying consolidated financial statements reflect the application of certain accounting policies, as described in this note and elsewhere in the accompanying notes to financial statements.

*Basis of Consolidation* The consolidated financial statements include the accounts of the Company and Pro-Pharmaceuticals Securities Corp., its wholly owned subsidiary, which was incorporated in Delaware on December 23, 2003. Pro-Pharmaceuticals Securities Corp. holds the cash and cash equivalents that are not required to fund current operating needs. All intercompany transactions have been eliminated.

*Use of Estimates* The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, expenses and disclosure of contingent assets and liabilities. Management's estimates are based primarily on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

*Cash and Cash Equivalents* The Company considers all highly liquid investments with original maturities of 90 days or less at the time of acquisition to be cash equivalents.

*Prepaid and Other Current Assets* Deposits and other assets consist principally of lease deposits on the Company's leased executive office space.

*Property and Equipment* Property and equipment, including leasehold improvements, are stated at cost, net of accumulated depreciation, and are depreciated using the straight-line method over the lesser of the estimated useful lives of the assets or the related lease term.

The estimated useful lives of property and equipment are as follows:

| <b>Asset Classification</b>    | <b>Estimated Useful Life</b> |
|--------------------------------|------------------------------|
| Computers and office equipment | Three years                  |
| Furniture and fixtures         | Five years                   |
| Leasehold improvements         | Life of lease                |

*Intangible Assets* Intangible assets include patent costs, consisting primarily of related legal fees, which are capitalized as incurred and amortized over an estimated useful life of five years from issuance. Amortization expense in 2007, 2006 and 2005 was, \$20, \$21 and \$17 respectively and accumulated amortization at December 31, 2007 and 2006 totaled \$90 and \$70, respectively.

*Long-Lived Assets* In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the Company reviews all long-lived assets for impairment whenever events or circumstances indicate the carrying amount of such assets may not be recoverable. Recoverability of assets to be held or used is measured by comparison of the carrying value of the asset to the future undiscounted net cash flows expected to be generated by the asset. If such asset is considered to be impaired, the impairment recognized is measured by the amount by which the carrying value of the asset exceeds the discounted future cash flows expected to be generated by the asset.

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The Company wrote off capitalized patent costs of \$23, \$11, and \$20 in 2007, 2006, and 2005, respectively, when it was determined that the underlying intellectual property would have no future benefit to the Company.

*Convertible Debt Instrument* The Company's 7% Convertible Debt instrument issued in 2006 (the "Debentures") constitutes a hybrid instrument that has the characteristics of a debt host contract containing several embedded derivative features that would require bifurcation and separate accounting as a derivative instrument pursuant to the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133). As permitted by SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments" an amendment of FASB Statements No. 133 and 140, the Company irrevocably elected to initially and subsequently measure the Debentures in their entirety at fair value with changes in fair value recorded as either a gain or loss in the consolidated statement of operations under the caption "Change in fair value of convertible debt instrument." Fair value of the Debentures is determined using a financial valuation model that requires assumptions that subject to significant management judgment.

*Warrants* The Company has issued common stock warrants in connection with the execution of certain equity and debt financings. Certain warrants are accounted for as derivative liabilities at fair value in accordance with SFAS 133. Such warrants do not meet the criteria in paragraph 11(a) of SFAS 133 that a contract should not be considered a derivative instrument if it is (1) indexed to its own stock and (2) classified in stockholders' equity. Changes in fair value of derivative liabilities are recorded in the consolidated statement of operations under the caption "Change in fair value of warrant liabilities." Warrants that are not considered derivative liabilities as defined in SFAS 133 are accounted for at fair value at the date of issuance in additional paid-in capital. The fair value of warrants is determined using the Black-Scholes option-pricing model.

*Research and Development Expenses* Costs associated with research and development are expensed as incurred. Research and development expenses include, among other costs, salaries and other personnel-related costs, and costs incurred by outside laboratories and other accredited facilities in connection with clinical trials and preclinical studies.

*Income Taxes* The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes" (SFAS No. 109). This statement requires an asset and liability approach to accounting for income taxes based upon the future expected values of the related assets and liabilities. Deferred income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and for tax loss and credit carry forwards, and are measured using the expected tax rates estimated to be in effect when such basis differences reverse. Valuation allowances are established, if necessary, to reduce the deferred tax asset to the amount that will, more likely than not, be realized. In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48 or the "Interpretation"). This Interpretation clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, "Accounting for Income Taxes." This Interpretation prescribes a more-likely-than not recognition threshold that a tax position will be sustained upon examination and a measurement attribute for the financial statement recognition of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48 on January 1, 2007. As of the date of adoption, the total amount of unrecognized tax benefits was \$1,031 of which \$880, if recognized, would affect the effective tax. As a result of the implementation of FIN 48, the Company did not recognize an adjustment to the deficit accumulated during the development stage for the unrecognized tax benefits because the Company has recorded a full valuation allowance against net operating loss carry forwards. There have been no changes in unrecognized tax benefits as a result of the tax positions taken during the current period (See Note 11 for further detail).

*Comprehensive Income (Loss)* Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner

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sources. The Company does not have any items of comprehensive income (loss) other than net losses as reported.

*Fair Value of Financial Instruments* SFAS No. 107, Disclosures About Fair Value of Financial Instruments, requires disclosure of the fair value of certain financial instruments. 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. Additionally, certain common stock warrants and the Convertible Debentures are recorded as liabilities at fair value as discussed in Note 6.

*Concentration of Credit Risk* Financial instruments that subject the Company to credit risk consist of cash and cash equivalents and certificates of deposit. The Company maintains cash and cash equivalents and certificates of deposit with well-capitalized financial institutions. The Company has no significant concentrations of credit risk.

*Segment Information* SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, requires companies to report selected information about operating segments, as well as enterprise-wide disclosures about products, services, geographic areas and major customers. Operating segments are determined based on the way management organizes its business for making operating decisions and assessing performance. The Company has concluded that it operates in one operating segment.

*Stock-Based Compensation* Through December 31, 2005, the Company accounted for stock-based compensation to employees and non-employee directors under the intrinsic value method in accordance with Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees, ( APB No. 25 ) and the related interpretations. Under APB No. 25, no compensation expense is recognized for stock options granted at fair market value and with fixed terms. On January 1, 2006, the Company adopted SFAS 123(R), Share-Based Payment, ( SFAS 123(R) ) using the modified prospective method, which results in the provisions of SFAS 123(R) being applied to the consolidated financial statements on a going-forward basis. Prior periods have not been restated. SFAS 123(R) requires companies to recognize stock-based compensation awards as compensation expense on a fair value method. Under the fair value recognition provisions of SFAS 123(R), stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the service period, which generally represents the vesting period. The Company uses the Black-Scholes option-pricing model to calculate the grant date fair value of stock options. The expense recognized over the service period is required to include an estimate of the awards that will be forfeited. Previously, the Company recorded the impact of forfeitures as they occurred. FASB Staff Position ( FSP ) No. 123(R)-3, Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards required an entity to follow either the transition guidance for the additional-paid-in-capital pool as prescribed in SFAS No. 123(R) or the alternative transition method described in FSP No. 123(R)-3. An entity that adopted SFAS No. 123(R) using the modified prospective application method may make a one-time election to adopt the transition method described in the FSP No. 123(R)-3, and may take up to one year from the latter of its initial adoption of SFAS No. 123(R) or the effective date of the FSP No. 123(R)-3 to evaluate the available transition alternatives and make its one-time election. The Company adopted the alternative transition method provided in the FSP No. 123(R)-3 for calculating the tax effects of stock-based compensation under SFAS No. 123(R). Stock-based compensation is more fully described in Note 8.

*Impact of New Accounting Standards* In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS No. 157 ). SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. In February 2008 the

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FASB decided that an entity need not apply this standard to nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis until the subsequent year. The Company will be required to adopt SFAS No. 157 in the first quarter of fiscal year 2008. The Company is currently evaluating the requirements of SFAS No. 157 and has not yet determined the impact, if any, on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 provides entities with an option to report selected financial assets and liabilities at fair value, with the objective to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. The Company will be required to adopt SFAS No. 159 in the first quarter of fiscal year 2008. The Company is currently evaluating the requirements of SFAS No. 159 and has not yet determined the impact, if any, of its adoption on its consolidated financial statements.

In June 2007, the FASB issued Emerging Issues Task Force, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* (EITF 07-3). EITF 07-3 provides that nonrefundable advance payments for goods or services that will be used or renders for future research and development activities should be deferred and capitalized. The Company has historically expensed such payments and will begin capitalizing such payments in the first quarter of 2008. As of December 31, 2007 there are no such payments currently recorded as expense.

**3. PROPERTY AND EQUIPMENT**

Property and equipment consists of the following at December 31:

|                               | 2007  | 2006   |
|-------------------------------|-------|--------|
| Leasehold improvements        | \$ 15 | \$ 119 |
| Computer and office equipment | 192   | 189    |
| Furniture and fixtures        | 107   | 107    |
| Total                         | 314   | 415    |
| Less accumulated depreciation | (241) | (303)  |
| Property and equipment - net  | \$ 73 | \$ 112 |

**4. ACCRUED EXPENSES**

Accrued expenses consist of the following at December 31:

|                              | 2007   | 2006   |
|------------------------------|--------|--------|
| Legal and accounting fees    | \$ 14  | \$ 215 |
| Scientific and clinical fees | 214    | 198    |
| Accrued payroll              | 97     | 87     |
| Other                        | 37     | 12     |
| Total                        | \$ 362 | \$ 512 |

**5. RELATED PARTY TRANSACTIONS**

In 2002, a stockholder and director of the Company agreed to receive compensation for certain 2002 scientific advisory services in the form of 25,354 shares of common stock and 25,354 options at an exercise price of \$2.96 to purchase common stock of the Company. As of

December 31, 2002, the Company

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recorded the deemed fair value of such compensation of approximately \$122 as an accrued liability. The common stock was valued at \$76, based on the closing price of the publicly traded shares of common stock on the date of grant. The options were valued at \$46 using the Black-Scholes option-pricing model, based on a deemed fair value of the Company's common stock of \$3.00 per share. The accrued liability at December 31, 2002 was converted to equity in 2003 when the 25,354 shares of common stock and 25,354 options were issued to this individual. There are no other related party transactions.

### **6. CONVERTIBLE DEBT AND WARRANT LIABILITIES**

The Company has raised capital through a number of debt and equity financing transactions. The following provides a chronological description of the Company's debt financings and certain warrants issued in connection with debt and equity financings.

*2000 and 2001 Convertible Notes* During 2001 and 2000, the Company issued \$1,036 and \$285 of convertible notes, respectively. In August 2001, the Company offered warrants to holders of its outstanding convertible notes as an inducement to convert the notes prior to the maturity. Holders representing \$1,126 of the outstanding principal and accrued interest chose to convert at a conversion price of \$2.00 per share and received 598,229 common shares and 562,801 warrants. The unexercised warrants expired in 2005. As described in Note 7, the Company valued the warrants at \$503 using the Black-Scholes option-pricing model, and recorded such value as a debt conversion in 2001.

In May 2002, the Company extended the maturity date on the \$195 of convertible notes payable at December 31, 2001. In consideration for the extension, the holders received one-quarter of one share of the Company's common stock for each whole dollar amount of principal outstanding, or 48,750 shares of common stock. The Company deferred \$171 in costs associated with the extension, based on the fair value of the Company's common stock of \$3.50 at the time of the extension. These deferred convertible notes payable costs were amortized ratably over the twelve-month extended term of the notes, or until conversion.

In June 2002, \$80 in convertible notes payable and \$10 in related accrued interest was converted into 45,128 shares of common stock. In October 2002, the Company settled convertible notes payable of \$100 through a cash payment of \$86 and conversion of \$14 of principal into 7,000 shares of common stock pursuant to the original terms of the note. In addition, \$17 of related accrued interest was repaid in cash. In 2003 the remaining \$15 of convertible note payable was converted into common stock.

During 2002, the remaining \$167 of the deferred convertible notes payable extension costs was amortized to interest expense.

*October 2003, April 2004 and August 2004 PIPE Transactions* In connection with the October 2003 PIPE transaction, as described in Note 7, the Company issued 657,293 warrants (the 2003 Investor Warrants) with an initial exercise price of \$5.29 per share to the investors and 65,729 warrants (the 2003 Placement Agent Warrants) with an initial exercise price of \$6.86 per share to its placement agent. The exercise price of the warrants is subject to adjustment pursuant to anti-dilution and other provisions. The fair value of the 2003 Investor Warrants and the 2003 Placement Agent Warrants was determined based on a fair market value of the Company's common stock of \$5.29 per share. The 2003 Investor Warrants and 2003 Placement Agent Warrants were valued at \$2,531 and \$191, respectively. The Company uses the Black-Scholes pricing model to value these warrants. The 2003 Investor Warrants and the 2003 Placement Agent Warrants were accounted for as freestanding derivative instruments in the consolidated balance sheet under the caption Warrant Liabilities. Changes in fair value are recognized as either a gain or loss in the consolidated statement of operations under the caption Change in fair value of warrant liabilities.

In connection with the April 2004 PIPE transaction, as described in Note 7, the Company issued 618,056 warrants (the April 2004 Investor Warrants) and 61,806 warrants (the April 2004 Placement Agent Warrants) with an initial exercise price of \$5.30 per share to the investors and to the placement agent.

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respectively. The exercise price of the warrants is subject to adjustment pursuant to anti-dilution and other provisions. The fair value of the April 2004 Investor Warrants and the April 2004 Placement Agent Warrants was determined based on a fair market value of the Company's common stock of \$4.41 per share. The April 2004 Investor Warrants and April 2004 Placement Agent Warrants were valued at \$1,931 and \$154, respectively. The Company uses the Black-Scholes pricing model to value these warrants. The April 2004 Investor Warrants and April 2004 Placement Agent Warrants were accounted for as freestanding derivative instruments in the consolidated balance sheet under the caption Warrant Liabilities. Changes in fair value are recognized as either a gain or loss in the consolidated statement of operations under the caption Change in fair value of warrant liabilities.

In connection with the August 2004 PIPE transaction, as described in Note 7, the Company issued 2,000,000 warrants (the August 2004 Investor Warrants) and 100,000 warrants (the August 2004 Placement Agent Warrants) with an exercise price of \$4.20 per share to the investors and to the placement agent, respectively. The exercise price of the warrants is subject to adjustment solely as a result of stock splits, recapitalizations and similar events. The fair value of the August 2004 Investor Warrants and the August 2004 Placement Agent Warrants was determined based on a fair market value of the Company's common stock of \$3.39 per share. The August 2004 Investor Warrants and August 2004 Placement Agent Warrants were valued at \$4,786 and \$239, respectively. The Company uses the Black-Scholes pricing model to value these warrants. The August 2004 Investor Warrants and August 2004 Placement Agent Warrants were accounted for as freestanding derivative instruments in the consolidated balance sheet under the caption Warrant Liabilities. Changes in fair value are recognized as either a gain or loss in the consolidated statement of operations under the caption Change in fair value of warrant liabilities.

*February 2006 PIPE Transaction* In February 2006, the Company issued \$10,000 in aggregate principal amount of convertible debentures (the Debentures) together with warrants to purchase approximately 1,490,313 shares of the Company's common stock (the 2006 Investor Warrants). Additionally, in connection with issuance of the Debentures and Warrants, the placement agent received a fee of \$550 and approximately 149,031 fully vested warrants (the 2006 Placement Agent Warrants) to purchase shares of the Company's common stock. Net proceeds were approximately \$9,300, net of approximately \$700 in direct transaction costs, including the placement agent fee. Redemptions and conversions of the Debentures are described in the table below.

The Debentures bear interest at 7% and are required to be redeemed in eighteen equal monthly installments beginning in August 2006 and continuing through January 2008. Interest is payable monthly beginning in July 2006. Each redemption installment and accrued interest may be settled in cash or in shares of common stock at the option of the Company. The number of shares deliverable under the share-settlement option is determined based on the lower of (a) \$3.35 per share, as adjusted pursuant to the terms of the Debentures or (b) 90% applied to the average of the lowest five volume-weighted-average trading prices in a twenty day period immediately preceding each share settlement. If the share-settlement option is elected by the Company, the Company is required to make an estimated payment in shares approximately 30 days prior to the scheduled maturity date.

On March 20, 2007, the Company entered into a Waiver and Exchange Agreement (the Agreement) with six of seven remaining holders of the Debentures, representing \$3,889 of the \$4,444 outstanding principal. Pursuant to the Agreement, on March 21, 2007, the Company issued approximately 5.2 million shares of its common stock at \$0.75 per share to discharge the principal, accrued and unpaid interest and any other obligations under the Debentures subject to the Agreement. The Agreement also provided that the exercise price of the common stock purchase warrants issued by the Company contemporaneously with the Debentures, would be reduced to \$1.00 (and the number of shares issuable on exercise proportionately increased) to take into account the dilutive effect of this transaction.

On December 14, 2007 the Company made its last scheduled payment of principal and interest of the remaining outstanding Debentures. At December 31, 2007, the Convertible Debenture has been repaid in full.

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The exercise price of the 2006 Investor and Placement Agent Warrants are subject to certain anti-dilution protections, including for stock splits, stock dividends, change in control events and dilutive issuances of common stock or common stock equivalents, such as stock options, at an effective price per share that is lower than the then conversion price. In the event of a dilutive issuance of common stock or common stock equivalents, the exercise price would be reduced to equal the lower price per share of the subsequent transaction together with a corresponding increase in the number of warrants.

As described in Note 2, the Company has irrevocably elected to initially and subsequently measure the Debentures in their entirety at fair value with changes in fair value recognized as either a gain or loss in the consolidated statement of operations. Upon issuance of the Debentures, the Company allocated proceeds received to the Debentures and the 2006 Investor Warrants on a relative fair value basis. As a result of such allocation, the Company determined the initial carrying value of the Debentures to be \$7,747. The Debentures were immediately marked to fair value, resulting in a liability in the amount of \$9,126 and a charge to Change in fair value of convertible debt instrument of \$1,379.

Upon issuance, the Company allocated \$2,253 of the initial proceeds to the 2006 Investor Warrants and immediately marked them to fair value resulting in a derivative liability of \$2,654 and a charge to change in fair value of warrant liabilities of \$401. The Company paid approximately \$700 in cash transaction costs and incurred another \$266 in costs based upon the fair value of the 2006 Placement Agent Warrants. Such costs were expensed immediately as part of fair value adjustments required in connection with the Debentures and the Company's irrevocable election to initially and subsequently measure the Debentures at fair value with changes in fair value recognized in earnings.

The debt discount in the amount of \$2,253 (resulting from the allocation of proceeds) was amortized to interest expense using the effective interest method over the expected term of the Debentures. The Company amortized \$559 and \$1,694 of this amount in 2007 and 2006 respectively with a corresponding increase in the carrying value of the Debentures. Of this amount \$257 and \$1,358 was charged to interest expense and \$302 and \$336 was recorded in additional paid-in capital as a result of redemptions and conversions during 2007 and 2006 respectively. An additional \$93 and \$492 in interest expense was recorded during 2007 and 2006 respectively based upon the 7% coupon rate.

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A summary of changes in the Debentures and Warrant Liabilities is as follows:

|                                                                                                                                                    | Fair Value of<br>Debentures | Fair Value of<br>Warrant<br>Liabilities | Total    |
|----------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------|-----------------------------------------|----------|
| Balance January 1, 2004                                                                                                                            | \$                          | \$ 1,925                                | \$ 1,925 |
| April 2004 Investor Warrants, April 2004 Placement Agent Warrants, August 2004 Investor Warrants and August 2004 Placement Agent Warrants issuance |                             | 7,110                                   | 7,110    |
| Fair value adjustment                                                                                                                              |                             | (3,410)                                 | (3,410)  |
| Balance December 31, 2004                                                                                                                          |                             | 5,625                                   | 5,625    |
| Fair value adjustment                                                                                                                              |                             | 311                                     | 311      |
| Balance December 31, 2005                                                                                                                          |                             | 5,936                                   | 5,936    |
| February 2006 PIPE Transaction allocation of initial proceeds                                                                                      | 7,747                       | 2,253                                   | 10,000   |
| Cash transaction costs                                                                                                                             | (700)                       |                                         | (700)    |
| Conversions, at net carrying amount (1)                                                                                                            | (1,726)                     |                                         | (1,726)  |
| Redemptions, at net carrying amount (2)                                                                                                            | (2,936)                     |                                         | (2,936)  |
| Redemptions paid in cash                                                                                                                           | (1,000)                     |                                         | (1,000)  |
| Amortization of debt discount                                                                                                                      | 1,358                       |                                         | 1,358    |
| Fair value adjustment                                                                                                                              | 2,394                       | (7,818)                                 | (5,424)  |
| Balance December 31, 2006                                                                                                                          | \$ 5,137                    | \$ 371                                  | \$ 5,508 |
| Redemptions, at net carrying amount (3)                                                                                                            | (556)                       |                                         | (556)    |
| Conversions, related to waiver and exchange agreement dated March 20, 2007 at net carrying amount (4)                                              | (5,315)                     |                                         | (5,315)  |
| Redemptions paid in cash                                                                                                                           | (555)                       |                                         | (555)    |
| Amortization of debt discount                                                                                                                      | 257                         |                                         | 257      |
| Fair value adjustment                                                                                                                              | 1,032                       | 1,698                                   | 2,730    |
| Balance December 31, 2007                                                                                                                          | \$                          | \$ 2,069                                | \$ 2,069 |

- (1) Represents conversions of principal value of \$1,575, debt discount charge of \$336 and a fair value adjustment credit of \$487. These amounts plus \$19 of accrued interest were credited to common stock and additional paid in capital.
- (2) Represents payments in common stock of principal value of \$2,500 prepayment of January 1 and February 1, 2007 scheduled maturity of principal value of \$500 each and a fair value adjustment credit of \$436. These amounts plus \$427 of accrued interest were credited to common stock and additional paid in capital.
- (3) Represents payments in common stock of principal value of \$481 and a fair value adjustment credit of \$75. These amounts plus \$29 of accrued interest were credited to common stock and additional paid in capital.
- (4) Represents payments in common stock of principal value of \$3,889, debt discount charge of \$302 and a fair value adjustment credit of \$1,728. These amounts plus \$15 of accrued interest were credited to common stock and additional paid in capital.

The following table summarizes information with regard to outstanding warrants issued in connection with equity and debt financings as of December 31, 2007. These warrants are classified as warrant liabilities with the exception of the 2001 Placement Agent Warrants which expire on February 1, 2012 and are classified in additional paid-in capital:

| Issued in Connection With         | Number<br>Issued | Exercise<br>Price | Exercisable Date  | Expiration Date  |
|-----------------------------------|------------------|-------------------|-------------------|------------------|
| 2001 Placement Agents             | 110,000          | \$ 3.50           | February 1, 2002  | February 1, 2012 |
| October 2003 PIPE Transaction (1) |                  |                   |                   |                  |
| 2003 Investor Warrants            | 657,293          | 4.75              | October 2, 2003   | October 2, 2008  |
| April 2004 PIPE Transaction (2)   |                  |                   |                   |                  |
| April 2004 Investor Warrants      | 618,056          | 4.82              | April 7, 2004     | April 7, 2009    |
| August 2004 PIPE Transaction      |                  |                   |                   |                  |
| August 2004 Investor Warrants     | 2,000,000        | 4.20              | February 13, 2005 | August 12, 2009  |

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|                                      |                  |      |                   |                 |
|--------------------------------------|------------------|------|-------------------|-----------------|
| August 2004 Placement Agent Warrants | 100,000          | 4.20 | February 13, 2005 | August 12, 2009 |
| February 2006 PIPE Transaction       |                  |      |                   |                 |
| 2006 Investor Warrants (3)           | 4,493,295        | 1.00 | August 15, 2006   | August 14, 2011 |
| 2006 Investor Warrants (4)           | 149,031          | 3.35 | August 15, 2006   | August 14, 2011 |
| 2006 Placement Agent Warrants        | 149,031          | 3.35 | August 15, 2006   | August 14, 2011 |
| <b>Total</b>                         | <b>8,276,706</b> |      |                   |                 |

- (1) The exercise price of the warrants have been adjusted from \$5.29 per share to \$4.75 per share due to the subsequent issuance of equity related instruments.
- (2) The exercise price of the warrants have been adjusted from \$5.30 per share to \$4.82 per share due to the subsequent issuance of equity related instruments.

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- (3) The exercise price of the warrants has been adjusted from \$3.35 per share to \$1.00 per share and an additional 3,152,014 warrants were issued in connection with the Waiver and Exchange Agreement dated March 20, 2007, entered into with certain holders of the 7% Convertible Debentures.
- (4) Original investor warrants not subject to the Waiver and Exchange Agreement dated March 20, 2007.

The Company used a binomial financial model to calculate the fair value of the Debentures. The Company uses the Black-Scholes pricing model to calculate fair value of the 2006 Investor Warrants, 2006 Placement Agent Warrants, August 2004 Investor Warrants, August 2004 Placement Agent Warrants, April 2004 Investor Warrants, April 2004 Placement Agent Warrants (expired unexercised in 2007) and the 2003 Investor Warrants.

Key assumptions used to apply these models as of December 31, 2007 and 2006 are as follows:

|                                           | Warrants               |                         | Debentures |        |
|-------------------------------------------|------------------------|-------------------------|------------|--------|
|                                           | 2007                   | 2006                    | 2006       | 2006   |
| Risk free interest rate                   | 3.16% -3.34%           | 4.71% - 5.00%           |            | 5.00%  |
| Expected life                             | 0.75 years -3.62 years | 0.25 years - 5.08 years |            | 1 year |
| Expected volatility of common share price | 95%                    | 65% - 80%               |            | 104%   |
| Common share price                        | \$ 0.70                | \$ 0.45                 | \$         | 0.45   |

As noted above, the Debentures were repaid in full on December 14, 2007. During 2007 the Company used the same binomial financial model as in 2006 to calculate the fair value of the Debentures. The last fair value calculation was performed as of September 30, 2007. The key assumptions used to apply this model on September 30, 2007 were as follows: risk free interest rate 4.12%, expected life 0.25 years, expected volatility of common share price 100% and common price per share \$0.67. When the Company repaid the Debentures, the difference between the fair value of the Debenture, the final cash payment and the remaining debt discount were recorded in the consolidated statement of operations under the caption Change in fair value of the convertible debt instrument.

## 7. STOCKHOLDERS (DEFICIT) EQUITY

The Company has raised capital through a number of debt and equity financing transactions. The following provides a chronological description of the Company's equity financings and certain warrants issued in connection with such equity financings.

**2001 Private Placement** From May 25, 2001 through December 3, 2001, the Company sold a total of 689,300 shares of common stock for proceeds of \$2,221, net of \$17 of issuance costs through a private placement of securities (the 2001 Private Placement).

In connection with the 2001 Private Placement, the Company issued 339,200 and 350,100 warrants to purchase common stock at \$6.50 and \$5.00 per share, respectively. The Company valued the warrants at \$886, based on a deemed fair market value of the Company's common stock of \$2.28 per share. These warrants expired unexercised in 2005.

As described in Note 6, in August 2001, the Company offered warrants to holders of its outstanding convertible notes as an inducement to convert prior to the maturity of the notes. Holders representing \$1,126 of the outstanding principal and accrued interest chose to convert at a conversion price of \$2.00 per share and received 598,229 common shares and 562,801 warrants. These warrants have an exercise price of \$6.50 per share and are immediately exercisable. The Company valued the warrants at \$503 based on a deemed fair market value of the Company's common stock of \$2.28 per share. The value of the warrants has been recorded as a debt conversion expense. These warrants expired unexercised in 2005.

In 2002, the Company issued 110,000 warrants to the agents in connection with the 2001 debt offering. The warrants are exercisable immediately at an exercise price of \$3.50 per share and have a 10 year life. The Company valued these warrants at \$236 based on a deemed fair value of the Company's common stock of

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\$3.50 per share and recorded such value as interest expense in the statement of operations for the year ended December 31, 2002.

*Public Offering* On December 13, 2001, the Company commenced a public offering of 1,428,572 shares of common stock, at a price to the public of \$3.50 per share. The Company concluded the offering on June 30, 2002. The Company sold 185,999 shares of common stock in this offering for proceeds of \$602, net of \$49 of issuance costs, all in 2002.

*2002 Private Placement* In September 2002, the Company began a private placement (the 2002 Private Placement) of up to 10,000,000 shares of common stock at \$1.00 per share. As of December 31, 2002, the Company had sold 3,223,360 shares for proceeds of \$2,861, net of issuance costs of \$212 and stock subscription receivable of \$150, which related to shares purchased but for which payment had not been received as of December 31, 2002. This offering was closed on January 14, 2003, although subsequent to year end the Company sold an additional 1,088,000 shares for additional proceeds of \$1,070, net of \$18 of offering costs.

The Company compensated a registered investment adviser with respect to shares purchased by its clients. As of December 31, 2002, the adviser was entitled to receive 173,500 shares of common stock. The Company also agreed to compensate a finder registered under applicable law, and such finder's agents, for identifying qualified investors. As of December 31, 2002, one of the finder's agents was entitled to receive 750 shares of common stock. On January 14, 2003, the Company closed the 2002 Private Placement, at which point the Company agreed to issue the adviser an additional 2,500 shares, and the finder and its other agent an aggregate of 9,750 additional shares and \$3 in cash in connection with the shares sold subsequent to December 31, 2002 and through the closing date.

Shares placed by such registered adviser, finder and finder's agent were accounted for as offering costs and valued at \$1.00 per share, consistent with the price paid for the shares placed in the offering. Such offering costs were netted against the proceeds of the 2002 Private Placement. Since none of the 174,250 shares had been issued as of December 31, 2002, the Company recorded the obligation to issue such shares as offering costs payable. The additional 12,250 shares issued in January 2003 were also valued at \$1.00 per share and included in the \$18 offering costs recorded at the closing. These shares were subsequently issued in 2003.

During 2002, the Company also agreed to issue 2,100 shares of common stock to an employee for finding investors in connection with the 2002 Private Placement. None of the shares had been issued as of December 31, 2002. These shares were subsequently issued in 2003. Accordingly, the Company recorded the obligation to general and administrative expenses in the statement of operations in the amount of \$6. On January 14, 2003, the Company closed the 2002 Private Placement, at which point the Company agreed to issue such employee an additional 7,000 shares in connection with shares sold subsequent to December 31, 2002 and through the closing date. The Company recorded an additional obligation of \$27 to general and administrative expenses in 2003 representing the fair value of the additional 7,000 shares.

*2002 Related Party Transaction* As discussed in Note 5, the Company agreed to issue 25,354 shares of common stock as payment for 2002 scientific advisory services. These shares were subsequently issued in 2003.

*May 2003 Private Placement* In May 2003, the Company began a private placement of up to 2.5 million shares of common stock at \$2.00 per share. As of the closing on July 15, 2003, the Company had sold 2,399,500 shares of common stock for proceeds of \$4,671, net of issuance costs of \$128. In connection with this offering the Company issued 109,613 common stock warrants (exercisable at \$5.40 per share) to its placement agents.

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The Company valued the warrants at \$261 using the Black-Scholes pricing model and recorded the warrant value as offering costs with a corresponding increase to additional paid-in capital. These warrants expired unexercised in 2006.

*October 2003 PIPE Transaction* On October 2, 2003 the Company closed a private offering, structured as a Private Investment, Public Equity ( PIPE ), exempt from registration under Section 4(2) of the Securities Act of 1933, in which it sold to institutional investors 1,314,571 of the 1,428,571 offered shares of common stock at \$3.50 per share for proceeds of \$4,041, net of issuance costs of \$559. In connection with this offering, the Company issued warrants (defined in Note 6 as the 2003 Investor Warrants and the 2003 Placement Agent Warrants). The Company allocated proceeds from this offering in the amounts of \$2,531 and \$191 representing the fair value of the 2003 Investor Warrants and the 2003 Placement Agent Warrants, respectively. See Note 6 for additional description of these warrants which are recorded as derivative liabilities.

*April 2004 PIPE Transaction* On April 7, 2004, the Company closed a private equity offering, structured as a PIPE in which it sold to certain institutional investors 1,236,111 shares of common stock at \$3.60 per share for proceeds of approximately \$3,983, net of cash issuance costs of approximately \$466. In connection with this offering, the Company issued warrants (defined in Note 6 as the April 2004 Investor Warrants and the April 2004 Placement Agent Warrants). The Company allocated proceeds from this offering in the amounts \$1,931, and \$154 representing the fair value of the April 2004 Investor Warrants and the April 2004 Placement Agent Warrants, respectively. See Note 6 for additional description of these warrants which are recorded as derivative liabilities. The placement agent warrants expired unexercised in 2007.

*August 2004 PIPE Transaction* On August 12, 2004, the Company closed a private offering, structured as a PIPE in which it sold to certain institutional investors 2,000,000 shares of common stock at \$3.00 per share for proceeds of approximately \$5,515, net of cash issuance costs of approximately \$485. In connection with this offering the Company issued warrants (defined in Note 6 as the August 2004 Investor Warrants and the August 2004 Placement Agent Warrants). The Company allocates proceeds from this offering in the amounts of \$4,786 and \$239 representing the fair value of the August 2004 Investor Warrants and the August 2004 Placement Agent Warrants, respectively. See Note 6 for additional description of these warrants, which are recorded as derivative liabilities.

In 2004, the stockholders approved an increase in the number of undesignated shares that the Company is authorized to issue by 5,000,000 such that the total number of authorized undesignated shares following the effectiveness of such increase is 10,000,000 at December 31, 2006.

*2008 Private Placement.* On February 4, 2008, the Company closed a private placement begun in October 2007 of its Series A 12% Convertible Preferred Stock (the Series A Preferred ) and related warrants to accredited investors (the 2008 Private Placement ). In the 2008 Private Placement, the Company offered to sell, for \$1.00 per unit, a unit comprised of (i) one share of Series A 12% Convertible Preferred Stock, (ii) a warrant to purchase one share of common stock for \$1.50, and (iii) a warrant to purchase one share of common stock for \$2.00. The Series A Preferred accrues interest at 12% per annum payable at the Company's option in cash or shares of common stock valued per share at the higher of \$1.00 or 100% of the value weighted average price of the Company's share price for the 20 consecutive trading days prior to the applicable dividend payment date. Each share of Series A Preferred is entitled to one vote on matters presented to stockholders for action, and is convertible at any time by the holder to one share of common stock, subject to adjustment in the event of a stock dividend, stock split or combination, reclassification or similar event. The Company has the right to require conversion if the closing price of the Common Stock exceeds \$3.00 for 15 consecutive trading days and a registration statement covering the resale of the shares of common stock issuable upon conversion of the Series A Preferred is then in effect. Each warrant is exercisable at the option of the holder solely for cash beginning August 13, 2008 and expires on February 4, 2012. The exercise price of each warrant is adjustable in the event of a stock split or stock combination, capital reorganization, merger or similar event.

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As of December 31, 2007, the Company had received subscription advances of \$1,637 net of transaction expenses of \$31. In 2008, the Company received additional subscription proceeds of \$75. The subscriptions for the securities offered in the 2008 Private Placement were accepted by the Company and the 2008 Private Placement was closed on February 4, 2008. As of December 31, 2007, the Company had not accepted the subscriptions or issued securities to investors whose subscription advances had been received prior to year end. The advanced proceeds received in 2007 from subscribers are recorded on the consolidated balance sheet as "Advances received from subscribers for Series A 12% Convertible Preferred Stock and related warrants.

**8. STOCK BASED COMPENSATION**

*Summary of Stock-Based Compensation Plans* In October 2001, the Company's Board of Directors adopted the Pro-Pharmaceuticals, Inc. 2001 Stock Incentive Plan (the Incentive Plan), which permits awards of incentive and nonqualified stock options and other forms of incentive compensation to employees and non-employees such as directors and consultants. The Board has 5,000,000 shares of common stock for issuance upon exercise of grants made under the Incentive Plan. Options granted under the Incentive Plan vest either immediately or over a period of up to three years, and expire 3 years to 10 years from the grant date. At December 31, 2007, 1,907,000 shares were available for future grant under the Incentive Plan.

In 2003, the stockholders approved the Pro-Pharmaceuticals, Inc. 2003 Non-Employee Director Stock Option Plan (the Director Plan), which permits awards of stock options to non-employee directors. The stockholders reserved 1,000,000 shares of common stock for issuance upon exercise of grants made under the Director Plan. At December 31, 2007, 829,750 shares were available for future grant under the Director Plan.

In addition, the Company has awarded 464,604 non-plan stock option grants to non-employees. The non-plan grants have vesting periods and expiration dates similar to those options granted under the Incentive Plan. All 464,604 non-plan grants are outstanding at December 31, 2007.

*Change in Accounting for Stock-Based Compensation* As disclosed in Note 2, on January 1, 2006, the Company adopted SFAS No. 123(R). Due to the adoption of SFAS No. 123(R), the Company's results for the years ended December 31, 2007 and December 31, 2006 include incremental compensation related to stock options totaling \$616 and \$416 respectively.

Stock-based compensation expense for both employees and non-employees totaled \$616, \$416 and \$22 in 2007, 2006 and 2005 respectively. Members of the Board of Directors receive stock options for each Board and Committee meeting attended. The options are typically granted in the year following service. The Company expenses the value of stock options as earned. In 2007 and 2006, Board members earned approximately 67,000 and 42,000 stock options respectively.

Prior to January 1, 2006, the Company accounted for stock-based compensation plans in accordance with the provisions of APB Opinion No. 25, as permitted by SFAS No. 123. Under APB Opinion No. 25, the Company was not required to recognize compensation expense for the cost of stock options, when such options had an exercise price equal to the market price at the date of grant. If the employee fair value based method as prescribed by SFAS No. 123 had been applied by the Company, the effect on net loss and loss per share for 2005 and net loss for the cumulative period from inception to December 31, 2007 would have been as follows:

|                                                                        | 2005       |
|------------------------------------------------------------------------|------------|
| Net loss                                                               | \$ (6,855) |
| Deduct stock-based compensation determined under the fair-value method | (287)      |
| Net loss pro forma                                                     | \$ (7,142) |
| Basic and diluted loss per share:                                      |            |
| As reported                                                            | \$ (0.25)  |
| Pro forma                                                              | \$ (0.26)  |

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The fair value of the equity instruments granted to employees and non-employees, including options and, is determined using the Black-Scholes option-pricing model. Key assumptions used to apply this option-pricing model are as follows:

|                                             | 2007    |         | 2006    | 2005    | Cumulative<br>Period from<br>Inception<br>(July 10, 2000) to<br>December 31,<br>2007 |
|---------------------------------------------|---------|---------|---------|---------|--------------------------------------------------------------------------------------|
| Risk-free interest rate                     | 3.41%   | 4.45%   | 4.75%   | 3.48%   | 3.21%                                                                                |
| Expected life of the options                | 5 years | 5 years | 5 years | 3 years | 3.70 years                                                                           |
| Expected volatility of the underlying stock | 95%     | 65%     | 65%     | 75%     | 91%                                                                                  |
| Expected dividend rate                      | None    | None    | None    | None    | None                                                                                 |

As noted above, the fair value of stock options is determined by using the Black-Scholes option pricing model. In general employee options vest over a period of three years. Board of Director and other options vest upon grant. For all options granted since January 1, 2006 the Company has used five years as the option term which represents the estimated life of options granted. Prior to January 1, 2006 the Company used three years as the option term.

The volatility of the common stock is estimated using a combination of historical and implied volatility, as discussed in SEC Staff Accounting Bulletin No. 107. By using this combination, the Company is taking into consideration the historical realized volatility, as well as factoring in estimates of future volatility that the Company believes will differ from historical volatility as a result of the market performance of the common stock, the volume of activity of the underlying shares, the availability of actively traded common stock options, and overall market conditions.

The risk-free interest rate used in the Black-Scholes option pricing model is determined by reference to historical U.S. Treasury zero-coupon bond issues with terms equal to the expected terms of the equity awards. In addition, an expected dividend yield of zero is used in the option valuation model, because the Company does not expect to pay any cash dividends in the foreseeable future. Lastly, in accordance with SFAS No. 123(R), the Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. In order to determine an estimated pre-vesting option forfeiture rate, the Company used historical forfeiture data. This estimated forfeiture rate has been applied to all unvested options outstanding as of January 1, 2006 and to all options granted since January 1, 2006. Therefore, stock-based compensation expense is recorded only for those options that are expected to vest. At December 31, 2007, the Company does not anticipate any awards will be forfeited in the calculation of compensation expense due to the limited number of employees that receive stock option grants and the Company's historical employee turnover.

The following table summarizes the stock option activity in the stock based compensation plans from January 1, 2005 through December 31, 2007:

|                                | Shares    | Exercise Price<br>Per Share |      | Weighted Average<br>Exercise Price |      |
|--------------------------------|-----------|-----------------------------|------|------------------------------------|------|
| Outstanding, January 1, 2005   | 2,403,354 | \$ 1.90                     | 5.80 | \$                                 | 3.61 |
| Granted                        | 272,000   | 2.61                        | 5.16 |                                    | 3.31 |
| Outstanding, December 31, 2005 | 2,675,354 | \$ 1.90                     | 5.80 | \$                                 | 3.57 |
| Granted                        | 399,000   |                             | 3.75 |                                    | 3.75 |
| Forfeited                      | (15,000)  |                             | 3.75 |                                    | 3.75 |
| Outstanding, December 31, 2006 | 3,059,354 | \$ 1.90                     | 5.80 | \$                                 | 3.60 |
| Granted                        | 1,048,500 | 0.63                        | 1.01 |                                    | 0.94 |
| Forfeited                      | (430,000) | 1.01                        | 5.80 |                                    | 2.82 |
| Outstanding, December 31, 2007 | 3,677,854 | \$ 0.63                     | 4.05 | \$                                 | 2.93 |



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The following tables summarize information about stock options outstanding at December 31, 2007:

| Options Outstanding |        |                  | Options Exercisable                                 |                                 |                  |                                 |
|---------------------|--------|------------------|-----------------------------------------------------|---------------------------------|------------------|---------------------------------|
|                     |        |                  | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number of Shares | Weighted Average Exercise Price |
| Exercise Price      |        | Number of Shares |                                                     |                                 |                  |                                 |
| \$0.63              | \$0.70 | 225,000          | 4.97                                                | \$ 0.69                         | 205,000          | \$ 0.70                         |
| \$1.01              | \$2.70 | 955,500          | 4.69                                                | \$ 1.32                         | 385,500          | \$ 1.78                         |
| \$2.92              | \$4.05 | 2,497,354        | 4.63                                                | \$ 3.75                         | 2,302,356        | \$ 3.75                         |
|                     |        | 3,677,854        | 4.66                                                | \$ 2.93                         | 2,892,856        | \$ 3.27                         |

The weighted-average grant-date fair values of options granted during 2007, 2006 and 2005 were \$0.70, \$2.20 and \$1.41, respectively. As of December 31, 2007 there were 784,998 of unvested options which will vest as follows: 296,671 in 2008, 291,663 in 2009 and 196,664 in 2010. Total expected unrecognized compensation cost related to such unvested options is \$570, which is expected to be recognized over a weighted average period of 1.0 years. As of December 31, 2007, the aggregate intrinsic value of outstanding options is \$18 based on the Company's closing common stock price of \$0.70 as of December 31, 2007. The aggregate intrinsic value of outstanding fully vested options and exercisable options is \$4, based on the Company's closing common stock price of \$0.70 as of December 31, 2007.

No options were exercised during the years ended December 31, 2007, 2006 and 2005. No cash has been received from the exercise of employee stock options during the cumulative period from inception to December 31, 2007. The intrinsic value of options exercised for the cumulative period from inception was \$74 resulting from the cashless exercise of options in October 2003.

During the years ended December 31, 2007, 2006, 2005 and the cumulative period from inception to December 31, 2007, 485,169, 160,667, 193,667 and 2,892,856 stock options, net of forfeitures vested respectively. The total fair value of options vested during the years ended December 31, 2007, 2006, 2005 and the cumulative period from inception to December 31, 2007 was \$491, \$241, \$250 and \$5,568, respectively.

**Other Stock Based Compensation Transactions** During 2001, the Company entered into a consulting agreement with a non-employee, who was also a Board member and former member of the Audit Committee, pursuant to which the Company granted 200,000 options to purchase common stock at an exercise price of \$3.50 in consideration for services to be performed. At the time of issuance, these options were valued at \$239 based on a deemed fair market value of the Company's common stock of \$2.28 per share. A portion of these options vested during fiscal years 2001 and 2002, and the remainder vested in 2003. The Company recorded fair value adjustments of \$28 and \$16 related to the unvested consultant options during 2003 and 2002, respectively. Total expense for the years ended December 31, 2003, 2002 and 2001 related to these options was \$71, \$64 and \$147, respectively.

In March 2002, the Company entered into a second agreement with the same non-employee, by which the Company granted 2,000 options a month to purchase common stock at an exercise price of \$3.50 in consideration for monthly consulting services. On November 11, 2002 such agreement was superseded by an amendment, which was effective retroactively to the date of the original agreement, March 1, 2002. Under the amended agreement, the Company granted 24,000 options on March 1, 2002, which vest at a rate of 2,000 options per month, as services are performed. These options were valued at \$11 using the Black-Scholes option-pricing model, based on a grant date fair value of the Company's common stock of \$2.16 per share. During 2002, the Company recorded a \$41 charge to stock compensation expense related to the 20,000 options that vested during the year. As of December 31, 2002, the Company had deferred compensation of \$11 that related to the remaining unvested options, which was recognized in 2003.

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In June 2003, the Company entered into a third agreement with the same non-employee, by which the Company granted 24,000 options effective retroactively to March 1, 2003, which vest at a rate of 2,000 options per month as services are performed. These options were valued at \$33 using the Black-Scholes option-pricing model, based on a fair market value of the Company's common stock of \$3.50 per share. The consulting arrangement was concluded on March 1, 2004. The Company recorded fair value adjustments of (\$2) and \$21 related to the unvested consultant options during 2004 and 2003, respectively. Total expense for the years ended December 31, 2004 and 2003 related to these options was \$17 and \$40, respectively.

In January 2003, the Company granted 100,000 options at an exercise price of \$3.50 to a Board member for consulting services unrelated to services performed as a director. One-third of the options vested immediately and the balance vests in equal amounts on the first and second anniversaries of the award. The options were valued at \$156 using the Black-Scholes option-pricing model, based on a fair market value of the Company's common stock of \$2.80 per share. The consulting services were completed and the consulting arrangement was concluded as of March 31, 2004. The Company recorded fair value adjustments of \$4 and \$82 related to the unvested consultant options during 2004 and 2003, respectively. Total expense for the years ended December 31, 2004 and 2003 related to these options was \$51 and \$193, respectively.

In May 2003, the Company granted 10,000 options at an exercise price of \$3.50 to a new member of the Scientific Advisory Board. One-half of the options vested immediately and the balance vests on the second anniversary. These options were valued at \$16 using the Black-Scholes option-pricing model based on a fair market value of the Company's common stock of \$2.80 per share. The Company recorded fair value adjustments of \$2 and \$6 related to the unvested consultant options during 2004 and 2003, respectively. Total expense for the years ended December 31, 2004 and 2003 related to these options was \$5 and \$13, respectively.

In September 2003, the Company granted 25,000 options each to a Board member and to a member of the Scientific Advisory Board for consulting services. The options were exercisable immediately at \$4.05 per share. These options were valued using the Black-Scholes option-pricing model based on a grant date fair value of the Company's common stock of \$2.44 per share. The Company recorded a \$122 charge to stock compensation expense in 2003 related to these awards.

In October 2003, in connection with the resignation of its former Chief Financial Officer, the Company accelerated the vesting on 100,000 options granted to such officer in September 2003 at an exercise price of \$4.05, which was equal to the fair market value of the common stock on the date of grant. As the fair market value of the common stock was \$4.45 per share at the time the vesting was accelerated, the Company recorded a \$40 charge to stock compensation expense as required under APB No. 25 and related interpretations. Also, in October 2003, such officer exercised on a cashless basis 50,000 options at an exercise price of \$2.97 per share resulting in the issuance of 16,629 shares. As the fair market value of the Company's common stock on the date of exercise was \$4.45 per share, the Company recorded a charge of \$74 to stock compensation expense in 2003 related to the exercise of these options.

In March 2004, the Company issued 25,000 options in fulfillment of a September 2003 agreement with an investor relations firm. The agreement obligated the Company to pay a monthly retainer and issue options at a rate of 5,000 options per month, up to a maximum of 100,000 options, exercisable at \$5.80 per share as services are performed. The Company concluded the engagement in February 2004. The options were exercisable immediately and expired on March 26, 2007. Accordingly, the Company recorded \$29 as stock compensation expense in 2003 on the 15,000 options that vested as of December 31, 2003 and an additional stock compensation expense of \$23 in 2004 on the 10,000 options that vested in January and February 2004. The stock compensation expense was determined based on a fair market value of the options when the options were earned. These options expired unexercised in 2007.

In April 2004, the Company entered into an agreement with an investor relations firm. The agreement obligated the Company to pay a monthly retainer and issue options at a rate of 5,000 per month up to a

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maximum of 60,000 options exercisable at \$5.16 per share as services are performed. During 2004, 45,000 options were earned but not issued. During 2005 15,000 options were earned and the full 60,000 options were issued. The Company recorded \$67 in 2004 and \$14 in 2005 as stock compensation expense related to this agreement. The stock compensation expense was determined based on the fair market value of the options when the options were earned. The options were exercisable immediately and expired three years from the agreement date. These options expired unexercised in 2007.

In November 2005, the Company issued 5,000 options to a member of the Scientific Advisory Board for consulting services. The options were exercisable immediately at \$2.61 per share. These options were valued using the Black-Scholes option-pricing model based on a grant date fair value of the Company's common stock of \$1.35 per share which was the fair market value at the date of the grant. The Company recorded a \$7 charge to stock compensation expense in 2005 related to this award.

In March 2006 the Company issued 15,000 options to a consultant for consulting services. 5,000 of the options were exercisable immediately, 5,000 options vest in March 2008 and 5,000 options vest in March 2009. The options are exercisable at \$3.75 per share. These options were valued using the Black-Scholes option-pricing model based on a grant date fair value of the Company's common stock of \$2.20 per share which was the fair market value at the date of the grant. The Company is recording a \$33 charge to stock compensation expense over the vesting period of the options.

In December 2007, the Company issued 5,000 options to a consultant for consulting services. The options were exercisable immediately at \$0.63 per share. These options were valued using the Black-Scholes option-pricing model based on a grant date fair value of the Company's common stock of \$0.46 per share which was the fair market value at the date of the grant. The Company recorded a \$2 charge to stock compensation expense in 2007 related to this award.

**9. EARNINGS 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 and convertible debenture using the if-converted 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 years ended December 31, 2007, 2006 and 2005, all stock options and warrants were excluded from the computation of diluted net income (loss) per share. For the year ended December 31, 2006 all potential shares related to conversion of the convertible debentures were excluded from the computation of diluted net income (loss) per share as the effect would be anti-dilutive. During the year ended December 31, 2007 all potential shares related to the conversion of the convertible debenture were excluded from the computation of diluted net income (loss) per share since to include them would be anti-dilutive and as of December 31, 2007 the convertible debenture has been repaid in full. Dilutive shares which could exist pursuant to the exercise of outstanding stock options and warrants at December 31, 2007, 2006 and 2005 totaled approximately 11,954,561, 8,245,853, and 6,397,851 respectively. These amounts were not included in the calculation because their affect would have been anti-dilutive.

|                            | 2007       | 2006       | 2005       |
|----------------------------|------------|------------|------------|
| Net Loss-basic and diluted | \$ (9,433) | \$ (3,193) | \$ (6,855) |

|                                                              | 2007       | 2006       | 2005       |
|--------------------------------------------------------------|------------|------------|------------|
| Weighted average common shares outstanding-basic and diluted | 38,980,548 | 28,472,898 | 27,315,411 |
| Net Loss Per Share-basic and diluted                         | \$ (0.24)  | \$ (0.11)  | \$ (0.25)  |

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**Lease Commitments** The Company leases its facility under a non-cancelable operating lease that expires in August 2011. In connection with the operating lease, the Company has issued a letter of credit which is secured by restricted cash on deposit with the bank as a security deposit of approximately \$59. Prior to this lease, the Company leased its facility under a non-cancelable operating lease that expired in May of 2006. Rent expense under these operating leases was \$259, \$170, and \$111 for the years ended December 2007, 2006, 2005 and the cumulative period from inception (July 10, 2000) to December 31, 2007, respectively.

Future minimum payments under this lease as of December 31, 2007 are approximately as follows:

| Year ended December 31, |        |
|-------------------------|--------|
| 2008                    | \$ 289 |
| 2009                    | 267    |
| 2010                    | 276    |
| 2011                    | 167    |
| 2012                    |        |
| Total lease payments    | \$ 999 |

**Contingency** In January 2004, David Platt, Ph.D., our Chairman and Chief Executive Officer, filed a lawsuit in Massachusetts Superior Court against GlycoGenesys, Inc. for various claims including breach of contract. GlycoGenesys asserted counterclaims against us and Dr. Platt alleging tortious interference, misappropriation of proprietary rights, defamation and unfair competition, and seeks monetary damages and injunctive relief related to our intellectual property. The Company and Dr. Platt have denied any liability for the counterclaims. Prospect Therapeutics, Inc. (formerly known as Marlborough Research and Development, Inc.) purchased certain assets including this lawsuit from the GlycoGenesys bankruptcy estate and continues prosecuting the counterclaims against the Company and Dr. Platt. The Company filed a motion for summary judgment relative to the counterclaims on November 8, 2007. Limited discovery may still be taken. The Company believes these claims are without merit and intends to contest them vigorously. Additionally, the Company believes that any impact on the financial statements is neither probable or reasonably estimable and therefore no amounts have been recorded as of December 31, 2007.

The Company's Board of directors authorized the indemnification of Platt for the expenses of his defense of the counterclaims. In 2007 the Company incurred no expenses in connection with this defense. Through December 31, 2007 the Company has incurred cumulative expenses of approximately \$438 in connection with this defense.

In January 2005, the Company filed a request with the U.S. Patent and Trademark Office for an inter partes re-examination of U.S. Patent No. 6,680,306 owned by GlycoGenesys, Inc. because the Company believes that the invention claimed in this patent is anticipated by other inventions (technically, prior art), including the Company's U.S. Patent No. 6,645,946 for DAVANAT<sup>®</sup>. The Patent Office agreed with the Company's argument that all claims stated in the 306 patent are anticipated by prior art. The matter is now before the Patent Office for a final decision. The Company believes that the actions of the Patent Office support the Company's belief that the invention claimed in the Company's DAVANAT<sup>®</sup> patent is prior art relative to the GlycoGenesys patent. Additionally, the Company believes that any impact on the financial statements is neither probable nor reasonably estimable and therefore no amounts have been recorded as of December 31, 2007.

On January 30, 2008, Custom Equity Research, Incorporated (d/b/a Summer Street Research Partners) (Summer Street) filed a lawsuit against the Company in the Superior Court of the Commonwealth of Massachusetts, alleging claims for breach of contract, declaratory judgment and unjust enrichment arising

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out of an engagement letter under which Summer Street agreed to provide institutional investment placement services to the Company. Summer Street claims it is entitled to a placement fee for each placement made during the term of the agreement and for each issuance of securities made or agreed to be made by the Company from October 17, 2007 through November 16, 2008. On February 20, 2008, the Company filed a Motion to Dismiss. The Company believes the lawsuit is without merit and intend to contest it vigorously. Additionally, the Company believes that any impact on the financial statements is neither probable or reasonably estimable and therefore no amounts have been recorded as of December 31, 2007.

In the ordinary course of business, the Company may from time to time be involved in other legal matters that in the Company's estimation will not have a material adverse impact on it. 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.

### 11. INCOME TAXES

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized approximately a \$1,031 increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007, related deferred tax asset and the corresponding valuation allowance.

The components of the net deferred tax assets are as follows at December 31:

|                              | 2007     | 2006      |
|------------------------------|----------|-----------|
| Operating loss carryforwards | 14,187   | \$ 11,901 |
| Tax credit carryforwards     | 82       | 1,035     |
| Other temporary differences  | 19       | (85)      |
|                              | 14,288   | 12,851    |
| Less valuation allowance     | (14,288) | (12,851)  |
| Net deferred tax asset       | \$       | \$        |

The primary factors affecting the Company's income tax rates were as follows:

|                                     | 2007    | 2006    | 2005    |
|-------------------------------------|---------|---------|---------|
| Tax benefit at U.S. statutory rates | (34.0%) | (34.0%) | (34.0%) |
| State tax benefit                   | (6.2%)  | (10.9%) | (6.2%)  |
| Permanent differences               | 12.1%   | (38.8%) | .2%     |
| Research and development credits    | (0.8%)  | (12.2%) | (2.3%)  |
| Valuation allowance                 | 28.9%   | 95.9%   | 42.3%   |
|                                     | 0%      | 0%      | 0%      |

As of December 31, 2007, the Company has federal and state net operating loss carryforwards totaling \$36,012 and \$30,993, respectively, which expire through 2027. In addition, the Company has federal and state research and development credits of \$49 and \$29 and investment tax credits of approximately \$4, which expire through 2027. Changes in the Company's ownership, as defined by Section 382 of the Internal Revenue Code, could limit the amount of carryforwards which may be realized in future periods. Because of the Company's limited operating history and its recorded losses, management has provided, in each of the last two years, a 100% allowance against the Company's net deferred tax assets.

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The following is a tabular reconciliation of the total amounts of unrecognized tax benefits for the year:

|                                  |          |
|----------------------------------|----------|
| Beginning Uncertain Tax Benefits | \$ 1,031 |
| Current Year Increase            | 51       |
| Current Year Decrease            | None     |
| Current Year Interest/Penalties  | None     |
| Settlements                      | None     |
| Expire Statutes                  | None     |
| Ending Uncertain Tax Benefits    | \$ 1,082 |

Included in the balance of unrecognized tax benefits at December 31, 2007, are \$1,082 of tax benefits \$890 of which, would affect the effective tax rate. We have not recognized an adjustment to the deficit accumulated during the development stage for unrecognized tax benefits because we have recorded a full valuation allowance against net operating loss carry forwards.

Since the Company's net deferred tax assets and the unrecognized tax benefits determined under FIN 48 would not result in a cash payment, the Company has not accrued for any interest and penalties relating to these unrecognized tax benefits. Should the Company incur interest and penalties related to income taxes, those amounts would be included in income tax expense.

Total amounts of unrecognized tax benefits are not expected to significantly increase or decrease within 12 months of the reporting date.

The Company is subject to taxation in the U.S. and various states. Based on the history of net operating losses all jurisdictions and tax years are open for examination until the operating losses are utilized or the statute of limitations expires.

**12. SUBSEQUENT EVENTS**

On January 29, 2008 the Company filed registration statement on Form S-3 with the Securities and Exchange Commission ( SEC ), under which the Company may offer shares of its common stock, preferred stock, common stock, warrants and units in one or more offerings with a total value of up to \$10 million. Unless otherwise stated in a prospectus supplement, net proceeds of securities issued and sold may include working capital, capital expenditures, research and development expenditures and other matters stated in the prospectus contained in the registration statement. The staff of the SEC declared the registration statement effective on February 5, 2008. On February 15, 2008, the Company filed a prospectus supplement (the Prospectus Supplement ) in which it offered (i) an aggregate of 7,500,000 shares of common stock at \$0.50 per share, (ii) warrants , with a term of five years, to purchase an aggregate of 7,500,000 share of its common stock at an exercise price of \$0.70 per share, and (iii) warrants, with a term of four months, to purchase an aggregate of 3,000,000 share of its common stock at an exercise price of \$0.67 per share. The warrants are exercisable 181 days after the transaction closes. On February 25, 2008, the Company closed the transaction set forth in the Prospectus Supplement and received net proceeds of approximately \$3.4 million after transaction costs.

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Summarized quarterly financial data for the last two years as originally reported are as follows:

|                              | <b>First<br/>Quarter</b> | <b>Second<br/>Quarter</b> | <b>Third<br/>Quarter</b> | <b>Fourth<br/>Quarter</b> |
|------------------------------|--------------------------|---------------------------|--------------------------|---------------------------|
| <b>2007</b>                  |                          |                           |                          |                           |
| Total operating expenses     | \$ 1,924                 | \$ 1,772                  | \$ 1,368                 | \$ 1,391                  |
| Total other income (expense) | (3,650)                  | 1,808                     | (1,218)                  | 82                        |
| Net income (loss)            | (5,574)                  | 36                        | (2,586)                  | (1,309)                   |
| Net income (loss) per share: |                          |                           |                          |                           |
| Basic                        | (0.16)                   | (0.00)                    | (0.06)                   | (0.02)                    |
| Diluted                      | (0.16)                   | (0.00)                    | (0.06)                   | (0.02)                    |

|                              | <b>First<br/>Quarter</b> | <b>Second<br/>Quarter</b> | <b>Third<br/>Quarter</b> | <b>Fourth<br/>Quarter</b> |
|------------------------------|--------------------------|---------------------------|--------------------------|---------------------------|
| <b>2006</b>                  |                          |                           |                          |                           |
| Total operating expenses     | \$ 1,724                 | \$ 2,099                  | \$ 1,929                 | \$ 1,296                  |
| Total other income (expense) | (6,602)                  | 2,329                     | 7,600                    | 528                       |
| Net income (loss)            | (8,326)                  | 230                       | 5,671                    | (768)                     |
| Net income (loss) per share: |                          |                           |                          |                           |
| Basic                        | (0.30)                   | 0.01                      | 0.20                     | (0.03)                    |
| Diluted                      | (0.30)                   | (0.03)                    | 0.18                     | (0.03)                    |

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