

OSCIENT PHARMACEUTICALS CORP

Form 10-Q

August 10, 2004

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# SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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## FORM 10-Q

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

For the Quarterly Period Ended: June 26, 2004

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

Commission File No: 0-10824

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# OSCIENT PHARMACEUTICALS CORPORATION

(Exact name of registrant as specified in its charter)

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MASSACHUSETTS  
(State or other jurisdiction of

incorporation or organization)

04-2297484  
(I.R.S. Employer

Identification no.)

**100 BEAVER STREET**

**WALTHAM, MASSACHUSETTS 02453**

**(Address of principal executive offices) (Zip code)**

**Registrant's telephone number: (781) 398-2300**

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

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

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

**COMMON STOCK  
\$0.10 PAR VALUE**

**74,891,931 Shares  
Outstanding August 4, 2004**

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**OSCIENT PHARMACEUTICALS CORPORATION AND SUBSIDIARIES**

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	December 31, 2003	June 26, 2004
	<u>2003</u>	<u>2004</u>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 20,969,292	\$ 87,266,332
Marketable securities (held-to-maturity)	4,595,740	97,333,401
Marketable securities (available-for-sale)	3,100,000	
Interest receivable	138,189	1,863,959
Accounts receivable	257,389	359,358
Unbilled costs and fees	78,899	734,103
Inventory		4,912,416
Prepaid expenses and other current assets	41,953	2,927,160
	<u>29,181,462</u>	<u>195,396,729</u>
Total Current Assets	29,181,462	195,396,729
Property and Equipment, at cost:		
Laboratory and scientific equipment	12,573,855	12,747,715
Leasehold improvements	7,516,159	7,551,702
Equipment and furniture	1,240,682	1,318,891
	<u>21,330,696</u>	<u>21,618,308</u>
Less Accumulated depreciation	18,009,495	18,445,381
	<u>3,321,201</u>	<u>3,172,927</u>
Restricted cash		18,792,760
Long-term marketable securities (held-to-maturity)		22,698,377
Notes receivable	6,238,219	
Other assets	1,775,433	5,680,169
Intangible assets		72,805,050
Goodwill		55,610,085
	<u>\$ 40,516,315</u>	<u>\$ 374,156,097</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Current maturities of long-term obligations	1,166,667	\$ 1,109,127
Accounts payable	1,523,633	3,818,493
Accrued expenses	3,483,308	6,998,920
Accrued facilities impairment charge		2,384,012
Clinical trial expense accrual	3,652,604	5,483,171
Deferred revenue	458,333	
	<u>10,284,545</u>	<u>19,793,723</u>
Total Current Liabilities	10,284,545	19,793,723
Long-term Liabilities:		
Long-term obligations, net of current maturities	291,666	175,059,647
Accrued facilities impairment charge		13,509,399
Other long-term liabilities		603,052
Shareholders' Equity:		

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Common stock and additional paid-in capital	185,875,163	363,171,908
Accumulated deficit	(155,564,152)	(192,309,812)
Other shareholders' equity	(370,907)	(5,671,820)
	<u>                    </u>	<u>                    </u>
Total Shareholders' Equity	29,940,104	165,190,276
	<u>                    </u>	<u>                    </u>
	\$ 40,516,315	\$ 374,156,097
	<u>                    </u>	<u>                    </u>

See Notes to Consolidated Condensed Financial Statements

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	Thirteen Week Period Ended		Twenty-Six Week Period Ended	
	June 28, 2003	June 26, 2004	June 28, 2003	June 26, 2004
<b>Revenues:</b>				
Biopharmaceutical	\$ 1,457,057	\$ 709,775	\$ 2,911,414	\$ 2,370,920
Genomics services	252,974		1,537,667	100,000
<b>Total revenues</b>	<b>1,710,031</b>	<b>709,775</b>	<b>4,449,081</b>	<b>2,470,920</b>
<b>Costs and Expenses:</b>				
Cost of services			1,902,561	
Research and development (1)	4,337,911	6,165,948	11,053,351	11,360,781
Write-off of in-process technology at merger				11,704,396
Restructuring charge	3,990,748		3,990,748	98,649
Convertible debt retirement expense	5,527,833		5,527,833	
Stock based compensation	179,275	1,881,717	226,685	2,446,296
Selling, general and administrative (1)	1,489,522	9,266,010	3,666,476	12,891,001
<b>Total costs and expenses</b>	<b>15,525,289</b>	<b>17,313,675</b>	<b>26,367,654</b>	<b>38,501,123</b>
<b>Loss from operations</b>	<b>(13,815,258)</b>	<b>(16,603,900)</b>	<b>(21,918,573)</b>	<b>(36,030,203)</b>
<b>Other Income (Expense):</b>				
Interest income	147,582	497,808	379,661	689,865
Interest expense	(261,872)	(1,245,073)	(972,324)	(1,540,885)
Gain (loss) on sale of fixed assets	(2,157)	84,829	(132,158)	126,513
Other income				9,050
<b>Net other income (expense)</b>	<b>(116,447)</b>	<b>(662,436)</b>	<b>(724,821)</b>	<b>(715,457)</b>
<b>Net Loss</b>	<b>\$ (13,931,705)</b>	<b>\$ (17,266,336)</b>	<b>\$ (22,643,394)</b>	<b>\$ (36,745,660)</b>
<b>Net Loss per Common Share:</b>				
Basic and diluted	\$ (0.58)	\$ (0.23)	\$ (0.95)	\$ (0.56)
<b>Weighted Average Common Shares Outstanding:</b>				
Basic and diluted	24,192,302	74,325,687	23,893,661	65,237,885
(1) Excludes non-cash stock based compensation as follows:				
Research and development	\$ 179,275	\$ 1,661,619	\$ 226,685	\$ 2,098,655
Selling, general and administrative		220,098		347,641
	\$ 179,275	\$ 1,881,717	\$ 226,685	\$ 2,446,296

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See Notes to Consolidated Condensed Financial Statements.





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Net cash provided by (used in) financing activities	(11,443,173)	229,021,890
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>(945,083)</b>	<b>66,297,040</b>
<b>Cash and Cash Equivalents, beginning of period</b>	<b>14,228,507</b>	<b>20,969,292</b>
<b>Cash and Cash Equivalents, end of period</b>	<b>\$ 13,283,424</b>	<b>\$ 87,266,332</b>
<b>Supplemental Disclosure of Cash Flow Information:</b>		
Interest paid during period	\$ 544,847	\$ 41,518
Income tax paid during period	\$ 12,213	\$ 17,939
<b>Supplemental Disclosure of Non-cash Investing and Financing Activities:</b>		
Unrealized gain on marketable securities	\$ 153,451	\$
Issuance of warrant in connection with convertible notes payable	\$ 149,781	\$
Issuance of common stock related to interest payable under convertible notes	\$ 581,096	\$
Issuance of common stock upon conversion of convertible notes payable	\$ 5,000,000	\$
Deferred Compensation related to unvested stock options at merger	\$	\$ 7,701,247
Notes receivable and accrued interest forgiven at merger	\$	\$ 6,268,795
Issuance of common stock related to merger	\$	\$ 74,878,945
Issuance of options and warrants in exchange of Genesoft's options and warrants	\$	\$ 19,533,549

See Notes to Consolidated Condensed Financial Statements

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**OSCIENT PHARMACEUTICALS CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

**(unaudited)**

**(1) BASIS OF PRESENTATION**

These consolidated condensed financial statements have been prepared by the Company without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of the Company's management, the unaudited consolidated condensed financial statements have been prepared on the same basis as audited consolidated financial statements and include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of results for the interim period. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The Company believes, however, that its disclosures are adequate to make the information presented not misleading. The accompanying consolidated condensed financial statements should be read in conjunction with the Company's audited financial statements and related footnotes for the year ended December 31, 2003 which are included in the Company's Annual Report on Form 10-K. Such Annual Report on Form 10-K was filed with the Securities and Exchange Commission on March 5, 2004.

**(2) SUMMARY OF SIGNIFICANT BUSINESS AND ACCOUNTING POLICIES**

Oscient Pharmaceuticals Corporation along with its subsidiaries (the Company) is a biopharmaceutical company committed to the clinical development and commercialization of important new therapeutics to serve unmet medical needs. On February 6, 2004, the Company completed its merger with GeneSoft Pharmaceuticals, Inc. (Genesoft), a privately-held pharmaceutical company based in South San Francisco. The Company's product portfolio is now led by the FDA-approved fluoroquinolone antibiotic FACTIVE (gemifloxacin mesylate) tablets, indicated for the treatment of community-acquired pneumonia of mild-to-moderate severity and acute bacterial exacerbations of chronic bronchitis. On April 13, 2004, the Company changed its name from Genome Therapeutics Corp. to Oscient Pharmaceuticals Corporation.

In addition, the Company is developing a novel antibiotic candidate, Ramoplanin, which is currently in clinical trials for the prevention and treatment of serious hospital-acquired infections. On August 10, 2004, the Company announced preliminary results of its Phase II trial of Ramoplanin for the treatment of Clostridium difficile-associated diarrhea (CDAD). Pending the outcome of a full analysis of the trial data and discussions with the FDA, the Company plans to commence a Phase III trial for CDAD by the end of this year. In July 2004, in order to devote resources to the CDAD trial, the Company decided to close enrollment on its Phase III clinical trial of Ramoplanin for the prevention of bloodstream infections caused by vancomycin-resistant enterococci (VRE) prior to completion of the study. The Company intends to analyze the results of the VRE trial and make a determination at a later date as to any future course of action for this indication.

The Company's preclinical development programs include an oral peptide deformylase inhibitor series for the potential treatment of respiratory tract infections as well as development of a FACTIVE intravenous formulation. We also have six pharmaceutical alliances focused on the discovery and development of novel therapeutics for chronic human diseases and certain infectious diseases. These alliances were formed in previous years based on our genomics drug discovery expertise. It is no longer our focus to pursue gene discovery or additional partnerships of this type.

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The Company's strategic goal is to supplement its existing product and clinical candidates with additional therapeutic opportunities, either through in-licensing or through mergers with, and acquisitions of, appropriate companies. The Company merged with Genesoft not only to supplement our product pipeline, but also to gain access to leading industry experts that will play a critical role in future product and business development efforts.

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

### *(a) Principles of Consolidation*

The accompanying consolidated condensed financial statements include the accounts of the Company and its wholly owned subsidiaries, Collaborative Securities Corp. (a Massachusetts Securities Corporation) and Genesoft. All intercompany accounts and transactions have been eliminated in consolidation.

### *(b) Revenue Recognition*

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Biopharmaceutical revenues consist of government research grants and license fees, contract research and milestone payments from alliances with pharmaceutical companies. Genomics services revenues consist of government sequencing grants, fees and royalties received from custom gene sequencing and analysis services and subscription fees from the PathoGenome Database.

Revenues from contract research, government grants, and custom gene sequencing and analysis services are recognized over the respective contract periods as the services are performed, provided there is persuasive evidence of an arrangement, the fee is fixed or determinable and collection of the related receivable is probable. The percentage of services performed related to contract research, government grants and custom gene sequencing and analysis services is based on the ratio of the number of direct labor hours performed to date to total direct labor hours the Company is obligated to perform under the related contract, as determined on a full-time equivalent basis. Revenues from PathoGenome Database subscription fees are recognized ratably over the term of the subscription agreement.

Amounts received for license fees are deferred and recognized ratably over the performance period in accordance with Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. Milestone payments will be recognized upon achievement of the milestone as long as the milestone is non-refundable, deemed to be substantive and the Company has no other performance obligations related to the milestone. Unbilled costs and fees represent revenue recognized prior to billing. Deferred revenue represents amounts received prior to revenue recognition.

*(c) Clinical Trial Expense Accrual*

The Company's clinical development trials related to Ramoplanin are primarily performed by outside parties. It is not unusual at the end of each accounting period for the Company to estimate both the total cost and time period of the trials and the percent completed as of that accounting date. The Company also adjusts these estimates when final invoices are received. In July 2004, the Company decided to close enrollment on its Phase III clinical trial of Ramoplanin for the prevention of bloodstream infections caused by vancomycin-resistant enterococci (VRE) prior to completion of the study. The Company believes all actual and estimated costs to complete the Phase III trial are reflected in the accrual at June 26, 2004. However, readers should be cautioned that the possibility exists that the timing or cost of the Ramoplanin clinical trials might be longer or shorter and cost more or less than we have estimated and that the associated financial adjustments would be reflected in future periods.

For the clinical development of Ramoplanin, the Company recorded expenses of approximately \$4,073,000, and \$6,688,000 for the twenty-six week periods ended June 28, 2003 and June 26, 2004, respectively.

*(d) Property and Equipment*

The Company records property, plant and equipment at cost. The Company depreciates its property over its estimated useful life using the straight-line method. The estimated useful life for leasehold improvements is the lesser of the term of the lease or the estimated useful life of the assets.

	<u>Estimated Useful Life</u>
Laboratory Equipment	5 Years
Computer Equipment & Licenses	3 Years

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Office Equipment	5 Years
Furniture & Fixtures	5 Years

Depreciation expense was approximately \$1,640,000 and \$640,000 for the twenty-six week periods ended June 28, 2003 and June 26, 2004, respectively.

### *(e) Inventory*

Inventory is stated at the lower of cost (first in, first out) or market (net realizable value). As of June 26, 2004, inventory consists entirely of finished FACTIVE tablets for sample and commercial sale related to the anticipated product launch of FACTIVE in September 2004.

### *(f) Net Loss Per Share*

Basic and diluted net loss per share was determined by dividing net loss by the weighted average shares outstanding during the period. Diluted loss per share is the same as basic loss per share for all periods presented, as the effect of the potential common stock is antidilutive. Antidilutive securities which consist of stock options, securities sold under the Company's employee stock purchase plan, directors' deferred stock, convertible notes, warrants and unvested restricted stock that are not included in diluted net loss per

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share totaled 5,055,045 and 38,005,371 shares of the Company's common stock during twenty-six week periods ended June 28, 2003 and June 26, 2004, respectively.

*(g) Concentration of Credit Risk*

SFAS No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk, requires disclosure of any significant off-balance-sheet and credit risk concentrations. The Company has no off-balance-sheet or concentrations of credit risk such as foreign exchange contracts, options contracts or other foreign hedging arrangements. The Company maintains its cash and cash equivalents and investment balances with several nonaffiliated institutions.

The Company maintains reserves for the potential write-off of accounts receivable. To date, the Company has not written off any significant accounts.

The following table summarizes the number of customers that individually comprise greater than 10% of total revenues and their aggregate percentage of the Company's total revenues:

	Number of Significant Customers	Percentage of Total Revenues				
		A	B	C	D	E
Thirteen-week period ended:						
June 28, 2003	4		11%	20%	16%	51%
June 26, 2004	1	88%				
Twenty-six week period ended:						
June 28, 2003	4	22%		16%	12%	37%
June 26, 2004	2	52%				41%

The following table summarizes the number of customers that individually comprise greater than 10% of total accounts receivable and their aggregate percentage of the Company's total accounts receivable:

	Percentage of Total Accounts Receivable				
	A	B	C	D	E
As of:					
December 31, 2003	21%	64%			

*(h) Use of Estimates*

The preparation of consolidated condensed financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated condensed financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*(i) Financial Instruments*

The estimated fair value of the Company's financial instruments, which includes cash and cash equivalents, short-term and long-term marketable securities, accounts receivable, accounts payable and long-term debt, approximates the carrying values of these instruments.

*(j) Reclassifications*

The Company has reclassified certain prior-year information to conform with the current year's presentation.

*(k) Comprehensive Income (Loss)*

The Company follows the provisions of SFAS No. 130, Reporting Comprehensive Income. SFAS No. 130 requires disclosure of all components of comprehensive income (loss) on an annual and interim basis. 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. Historically, other comprehensive income had included net loss and change in unrealized gains and losses in marketable securities. For the twenty-six week period ended June 28, 2003, the Company recorded approximately \$153,000 to comprehensive income related to the increase in fair market value of common shares. For the period ended June 26, 2004, net loss equaled comprehensive loss.

*(l) Segment Reporting*

The Company follows the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. SFAS No. 131 establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to stockholders. SFAS No. 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision-making group, in making decisions as to how to allocate resources and assess performance. The Company's chief decision makers, as defined under SFAS No. 131, are the chief executive officer and chief financial officer. To date, the Company has viewed its operations and manages its business as principally two operating segments: genomics services and biopharmaceutical. As a result, the financial information disclosed herein represents all of the material financial information related to the Company's two operating segments. All of the Company's revenues are generated in the United States and all assets are located in the United States. (See Note 4).

	<u>Genomics Services</u>	<u>Biopharmaceutical</u>	<u>Total</u>
Twenty-six week period ended June 28, 2003			
Revenues	\$ 1,537,667	\$ 2,911,414	\$ 4,449,081
Gross profit (loss)	(364,894)	552,809	187,915
Company-funded research & development costs		8,694,746	8,694,746
Twenty-six week period ended June 26, 2004			
Revenues	\$ 100,000	\$ 2,370,920	\$ 2,470,920
Gross profit	100,000	364,186	464,186
Company-funded research & development costs		9,354,047	9,354,047

Prior to the sale in 2003, the measure of gross profit for the Genomics Services segment is the total segment revenues less cost of services. After March 2003, we only receive royalties from such business. The measure of gross profit for the Biopharmaceutical segment is equal to total segment revenues less externally funded research and development costs related to the Company's alliance arrangements and government research grants. The Company does not allocate assets by operating segment.

*(m) Long-Lived Assets*

The Company follows the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144). SFAS No. 144 requires that long-lived assets be reviewed for impairment by comparing the future undiscounted cash flows from the assets with the carrying amount. Any write-downs are to be treated as permanent reductions in the carrying amount of the assets.

The Company also follows the provisions of SFAS No. 142, Goodwill and Other Intangible Assets, (SFAS No. 142). Under SFAS 142, goodwill and purchased intangibles with indefinite lives acquired after June 30, 2001 are not amortized but are reviewed periodically for impairment. As of June 26, 2004, the Company does not believe that any of its long-lived assets, goodwill, and other intangible assets are impaired.



*(n) Pro Forma Disclosure of Stock-based Compensation*

The Company follows Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations, in accounting for its stock-based compensation plans, rather than the alternative fair value accounting method provided for under SFAS No. 123, Accounting for Stock-Based Compensation. Under APB 25, when the exercise price of options granted under these plans equals the market price of the underlying stock on the date of grant, no compensation expense is required. In accordance with Emerging Issues Task Force (EITF) 96-18, the Company records compensation expense equal to the fair value of options granted to non-employees over the vesting period, which is generally the period of service.

The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to employee stock-based compensation. The Company has computed the pro forma disclosures required under SFAS No. 123 and SFAS No. 148, Accounting for Stock-Based Compensation-Transaction and Disclosure, for all employee stock options granted using the Black-Scholes option pricing model prescribed by SFAS No. 123.

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	Twenty-Six Week Period Ended	
	June 28,	June 26,
	2003	2004
Net loss as reported	\$ (22,643,394)	\$ (36,745,660)
Add: Stock-based employee compensation cost, included in the determination of net loss as reported	226,685	2,446,296
Less: Total stock-based compensation expense determined under the fair value method for all employee awards	(1,300,049)	(2,463,967)
<b>Pro forma net loss</b>	<b>\$ (23,716,758)</b>	<b>\$ (36,763,331)</b>
<b>Basis and diluted net loss per share</b>		
As reported	\$ (0.95)	\$ (0.56)
<b>Pro forma</b>	<b>\$ (0.99)</b>	<b>\$ (0.56)</b>

The Company's stock option grants vest over several years and the Company intends to grant varying levels of stock options in the future periods. Therefore, the pro forma effects on 2003 and 2004 net loss and net loss per common share of expensing the estimated fair value of stock options and common shares issued pursuant to the stock option plan are not necessarily representative of the effects on reported results from operations for future years.

**(3) MERGER WITH GENESOFT PHARMACEUTICALS, INC. AND SALE OF COMMON STOCK**

On February 6, 2004, the Company completed its acquisition of Genesoft, a privately-held company located in South San Francisco. The purchase price of approximately \$108 million was paid by the issuance of approximately 25.2 million shares of the Company's common stock to existing Genesoft common stockholders and promissory note holders and the issuance of options to purchase approximately 3.4 million shares for Genesoft stock options and warrants assumed in the merger. In connection with the merger, the Company assumed approximately \$22 million in Genesoft debt, through the issuance of 5% convertible promissory notes. Such notes are convertible, at the option of the holder, into shares of the Company's common stock at a price of \$6.6418 per share.

Concurrent with the merger, the Company sold 16.8 million shares of its common stock at \$5.25 per share resulting in net proceeds received of approximately \$81 million.

The following is a summary of the Company's estimate of the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The Company engaged a third party to appraise the fair value of the acquired tangible and intangible assets, which has completed its report. The Company is currently completing its analysis of the fair values of the liabilities assumed in connection with the acquisition, including certain liabilities that qualify for recognition under Emerging Issues Task Force 95-3 Recognition of Liabilities in connection with a Purchase Business Combination. The Company will finalize the purchase price allocation after it completes its analysis of assumed liabilities, and receives other relevant information relating to the acquisition. The final purchase price allocation may be significantly different than the Company's preliminary estimate as presented below:

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Assets:	
Current Assets	\$ 6,683
Property & Equipment	263
Intangible Assets Subject to Amortization	74,675
Restricted Cash	3,697
In-Process Research & Development	11,704
Goodwill	55,610
	<hr/>
Total assets acquired	\$ 152,632
	<hr/>
Liabilities:	
Current Liabilities	\$ 5,199
Long Term Liabilities	22,310
Accrued Facility Costs	16,887
	<hr/>
Total Liabilities acquired	\$ 44,396
Net Assets acquired	\$ 108,236
	<hr/>

The valuation of the purchased intangible assets of \$74.7 million was based on the result of a valuation using the income approach and applying a risk adjusted discount rate of between 15% to 22%. The valuation of purchased intangible assets include Genesoft's lead product and developed technology, FACTIVE, valued at \$69.5 million, an orally administered, broad-spectrum fluoroquinolone antibiotic which was approved by the FDA for the treatment of acute bacterial exacerbation of chronic bronchitis (ABECB) and community-acquired pneumonia (CAP) of mild to moderate severity. The valuation of purchased intangible assets also includes the value of a manufacturing and supply agreement for FACTIVE with a third party of \$5.2 million. Both intangibles will be

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amortized over the life of the patent which is approximately 16 years, resulting in approximately \$4.6 million of amortization expense on an annual basis.

At the time of acquisition, management approved a plan to integrate certain Genesoft facilities into existing operations. Included in the purchase price allocation is a restructuring liability of approximately \$18,328,000, which includes \$1,441,000 in severance-related costs and \$16,887,000 in facility lease impairment costs. Through June 26, 2004, the Company paid \$688,000 against the accrual for severance-related costs and \$993,000 against the facility lease costs.

Additionally, the Company recorded approximately \$7,701,000 of deferred compensation related to the intrinsic value of unvested options issued in exchange for options assumed in the merger. The Company recorded approximately \$2,320,000 in amortization of deferred compensation through June 26, 2004 in connection with the merger.

*Supplemental Pro Forma Information:*

The unaudited pro forma combined condensed statements of operations for the twenty-six week period ended June 26, 2004 and June 28, 2003 gives effect to the acquisition of Genesoft as if the acquisition of Genesoft had occurred on January 1, 2004 and 2003, respectively.

The unaudited pro forma combined condensed statements of operations are not necessarily indicative of the financial results that would have occurred if the Genesoft acquisition had been consummated on January 1, 2003 nor are they necessarily indicative of the financial results which may be attained in the future.

The pro forma statements of operations are based upon available information and upon certain assumptions that the Company's management believes are reasonable. The Genesoft acquisition is being accounted for using the purchase method of accounting. The allocation of the purchase price is preliminary. Final amounts could differ from those reflected in the pro forma statements of operations.

	Twenty-Six Weeks Ended			
	(In thousands, except per share data)			
	June 26, 2004 (Actual)	June 26, 2004 (Pro forma)	June 28, 2003 (Actual)	June 28, 2003 (Pro forma)
Revenue	\$ 2,471	\$ 2,904	\$ 4,449	\$ 7,354
Total costs and expenses	39,217	42,110	27,092	50,683
Net loss	\$ (36,746)	\$ (39,206)	\$ (22,643)	\$ (43,329)
Weighted average number of shares basic and diluted	65,238	65,238	23,894	35,289
Net loss per share	\$ (0.56)	\$ (0.60)	\$ (0.95)	\$ (1.23)

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The pro-forma adjustments include additional amortization expense of \$623 for the twenty-six week period ended June 26, 2004 and \$3,738 for the twenty-six week period ended June 28, 2003 related to deferred compensation and intangible assets.

### **(4) RESTRUCTURING PLAN**

As part of our effort to reduce costs and expenses, the Company adopted a plan in 2003 to substantially reduce its research effort in internally funded early-stage drug discovery programs under its biopharmaceutical operating segment. Under this plan, the Company eliminated 44 full-time positions and recorded a restructuring charge of approximately \$5.3 million in 2003 and \$99,000 for the twenty-six week period ended June 26, 2004. The following table displays the restructuring activity and liability balance included in accrued expenses.