IMARX THERAPEUTICS INC
Form 10-Q
November 16, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period ended September 30, 2009

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Transition Period from _____ to _____

Commission File Number 001-33043

ImaRx Therapeutics, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**86-0974730**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
12277 134th Court NE, Suite 202, Redmond, WA	**98052**
(Address of Principal Executive Offices)	**(Zip Code)**

(425) 821-5501
(Registrant s Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES o NO o

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. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

The number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date is as follows:

Class	Outstanding at November 12, 2009
Common Stock $0.0001 par value	**11,665,733**

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements.

ImaRx Therapeutics, Inc.
(A Development-Stage Company)
Consolidated Balance Sheets
(in thousands, except per share data)

	September 30, 2009 (Unaudited)	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 382	$ 757
Accounts receivable	100	
Inventory subject to return		12
Assets held for sale		108
Prepaid expenses and other	16	144
Total current assets	498	1,021
Long-term assets:		
Property and equipment, net		51
Total assets	$ 498	$ 1,072
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 284	$ 117
Accrued expenses	28	82
Deferred revenue		226
Other		154
Total current liabilities	312	579
Stockholders equity:		
Common stock, $.0001 par: 100,000,000 shares authorized, 11,665,733 shares issued and outstanding at September 30, 2009 (unaudited) and 10,165,733 shares issued and outstanding at December 31, 2008	1	1
Additional paid-in capital	91,982	91,808
Accumulated deficit	(91,797)	(91,316)
Total stockholders equity	186	493
Total liabilities and stockholders equity	$ 498	$ 1,072

See accompanying notes.

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ImaRx Therapeutics, Inc.
(A Development-Stage Company)
Statements of Operations
(in thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,		September 23, 2008 (inception) through September 30,
	2009	2008	2009	2008	2009
Revenues:					
Product sales, net	$ 1	$ 1,661	$ 27	$ 5,550	$ 987
Research and development		22		223	
Total revenue	1	1,683	27	5,773	987
Costs and expenses:					
Cost of product sales		717	13	2,476	588
Research and development	10	352	90	2,952	177
General and administrative	432	829	1,189	5,817	1,806
Asset impairment			18	9,978	18
Total cost and expenses	442	1,898	1,310	21,223	2,589
Operating loss	(441)	(215)	(1,283)	(15,450)	(1,602)
Interest and other income, net	296	(1)	356	35	370
Interest expense				(203)	
Gain on settlement of accounts payable and other accrued liabilities			79		266
Gain on sale of assets	367		367		367
Gain on extinguishment of debt				5,602	
Net income (loss)	$ 222	$ (216)	$ (481)	$ (10,016)	$ (599)
Net loss per share:					
Basic and diluted	$ 0.02	$ (0.02)	$ (0.05)	$ (0.99)	
Shares used in computing net loss per share:					
Basic and diluted	10,832,400	10,165,733	10,386,321	10,100,321	

See accompanying notes.

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ImaRx Therapeutics, Inc.
(A Development-Stage Company)
Statements of Cash Flows
(in thousands)

	Nine Months Ended September 30,		September 23, 2008 (inception) through September 30, 2009
	2009	2008	
	(unaudited)		
Operating activities			
Net loss	$ (481)	$ (10,016)	$ (599)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	8	545	26
Stock-based compensation	173	266	330
Gain on extinguishments of debt		(5,602)	
Loss on sale of property and equipment		314	
Gain on sale of assets	(367)		(367)
Asset impairment	18	9,978	19
Gain on settlement of accounts payable and other accrued liabilities	(79)		(266)
Changes in operating assets and liabilities:			
Inventory		937	
Inventory subject to return	13	1,973	587
Accounts receivable		349	
Prepaid expenses and other	128	400	191
Accounts payable	167	96	(902)
Accrued expenses and other liabilities	(129)	(1,562)	(282)
Deferred revenue	(226)	(4,178)	(1,194)
Net cash used in operating activities	(775)	(6,500)	(2,457)
Investing activities			
Purchase of property and equipment		(11)	
Proceeds from asset sale	400		400
Proceeds from sale of urokinase asset		2,000	
Net cash provided by investing activities	400	1,989	400
Financing activities			
Payment on note payable		(6,299)	
Change in restricted cash		388	
Net cash used in financing activities		(5,911)	
Net decrease in cash and cash equivalents	(375)	(10,422)	(2,057)

Cash and cash equivalents at the beginning of the period	757	12,861	2,439
Cash and cash equivalents at the end of the period	$ 382	$ 2,439	$ 382

See accompanying notes.

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ImaRx Therapeutics, Inc.
(A Development-Stage Company)
Notes to Financial Statements
September 30, 2009
(Unaudited)

1. The Company and Significant Accounting Policies

The Company

We are a development stage biopharmaceutical company, whose activities have focused on the research, development and commercialization of therapies for stroke and other vascular disorders. Our development efforts were focused on our SonoLysis program, which involved the administration of our MRX-801 microspheres and ultrasound to break up blood clots and restore blood flow to oxygen deprived tissues. Our commercialization efforts were focused on the promotion and sale of our U.S. Food and Drug Administration, or FDA, approved urokinase product, Abbokinase®, which we had previously acquired from Abbott Laboratories.

In January 2008, we suspended enrollment in our SonoLysis Phase I/II clinical trial designed to evaluate the safety, tolerability and activity of escalating doses of MRX-801 microspheres and ultrasound because the safety data following the second cohort indicated that there were a greater number of intracranial hemorrhage events observed in subjects receiving treatment relative to controls in the second cohort. We concluded the study based on these findings and commenced evaluating strategic alternatives for continued pursuit and financing of the SonoLysis program.

In June 2008, in response to new risks and challenges facing the Company, we announced a restructuring that included a significant workforce reduction in which all of our employees other than Bradford Zakes, our then president and chief executive officer, and one additional employee were terminated. In furtherance of the June 2008 restructuring we discontinued substantially all research and development activity while evaluating strategic alternatives for funding and continuation of our SonoLysis program and for our other Company assets.

On September 23, 2008, we divested our urokinase business to Microbix for an upfront payment of $2.0 million, the assumption by Microbix of up to $0.5 million in chargeback and other liabilities for commercial product then in the distribution channel and an additional $2.5 million payment from Microbix contingent upon release by the FDA of three lots of urokinase that are currently subject to a May 2008 FDA Approvable Letter. On June 15, 2009, we entered into the First Amendment to the Asset Purchase Agreement with Microbix which reduced the size of the contingent payment from $2.5 million to $0.2 million contingent upon receipt by Microbix of written authorization from the FDA for the release of the urokinase lots on or before September 1, 2010.

On September 4, 2009, pursuant to the terms of an Asset Purchase Agreement dated June 15, 2009, we sold to WA 32609, Inc. substantially all of our remaining assets, including but not limited to our clinical-stage SonoLysis product candidate for $0.5 million. At the closing, WA32609 paid to us $0.4 million of the total purchase price. The remaining $0.1 million was deposited into an escrow account to satisfy certain potential claims by WA32609 that may arise post-closing. Following expiration of an approximately five (5) month holdback period and assuming no post-closing claims arise, the remaining proceeds will be released from escrow and distributed to us. The sale was subject to shareholder approval which was obtained at a special meeting of the shareholders held August 31, 2009. Following the closing of the asset sale to WA 32609, the remaining two employees of the Company, including Mr. Zakes, resigned their positions with the Company.

We have sold substantially all of the Company s assets and are now engaged in the orderly settlement and payment of the remaining obligations of the Company while concurrently entertaining proposals from other parties concerning the potential merger and/or acquisition of the remaining assets of the Company. We are also evaluating the potential liquidation and dissolution of the Company. We have no employees and we are carrying out these activities through the use of consultants and other outside service providers. Mr. Love, our Chairman of the Board is now acting as our principal executive officer and principal financial officer.

Basis of Presentation

The accompanying interim consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles, consistent in all material respects with those applied in our Annual Report on Form 10-K for the year ended December 31, 2008. The financial information is unaudited, but reflects all adjustments which

are, in the opinion of management, necessary to reflect a fair statement of results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2008.

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On September 23, 2008, upon the sale of the urokinase assets to Microbix, we returned to the development-stage. We no longer have any commercialized products or licensed technologies that will provide significant revenue in the future. The sale of urokinase assets did not result in discontinued operations reporting as this was not considered a reportable segment. We purchased the urokinase inventory and related assets because it provided us with a source of cash to offset the development expenses associated with our SonoLysis program as well as afforded us the advantage of establishing key contacts within the medical community that would be beneficial to our development stage programs. At the time we purchased the urokinase assets from Abbott Laboratories, there were limited manufacturing facilities that had the capabilities to manufacture additional supplies of urokinase for commercialization. We purchased urokinase with the intention of selling the purchased inventory for cash. Due to the amount of time and resources that it would require to remanufacture a new supply of urokinase at a new manufacturing facility, it was not our intention to reproduce additional commercial supplies of inventory once the existing supplies had been sold. Since discontinued operations reporting was not appropriate, the urokinase assets were written off and we will continue to record revenue until the product at our wholesale distributors is completely sold through to a third party.

Our ability to continue as a going concern and to continue operating for a period of time that is sufficient for us to satisfy our remaining obligations and commitments, and, to either complete a strategic transaction for our remaining assets or to formally wind down operations and dissolve the Company depends on our receipt of the final $0.1 million currently held in escrow pursuant to the terms of the Asset Purchase Agreement with WA 32609. We have had recurring losses, which have resulted in an accumulated deficit of $91.8 million at September 30, 2009. These conditions, among others, raise substantial doubt about our ability to continue as a going concern. The financial statements include adjustments to reduce the value of certain assets to fair value, but do not include any other adjustments relating to the recoverability and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event we cannot obtain additional financing or execute the strategic alternatives being considered.

2. Restructuring

Our board of directors authorized a restructuring that was implemented on June 11, 2008, that included a workforce reduction in which the employment of all of our employees other than Bradford Zakes, our president and chief executive officer, and one additional employee were terminated. The costs associated with these actions were $0.8 million, of which $0.5 million represented severance payments for the affected employees, all of which were paid prior to June 30, 2008. We also incurred a $0.5 million asset impairment for long-lived assets. All expenses incurred due to the restructuring, other than assets impaired, were included in the statement of operations under general and administrative in the year ended December 31, 2008.

The following table presents the activity and balances of the restructuring (in thousands):

		Facility Closing
Liability, January 1, 2009	$	154
Cash payments		(75)
Adjustments to expense		(79)
Liability, September 30, 2009	$	

3. Assets Held for Sale

In connection with the June 11, 2008 restructuring, we discontinued substantially all research and development activity. As such, we initiated a process to sell certain items of laboratory equipment that would not be required for a future strategic transaction associated with our SonoLysis program. We determined that the plan of sale criteria in the FASB guidance for accounting for the impairment or disposal of long-lived assets had been met. Accordingly, the carrying value of the laboratory equipment was adjusted to its fair value less costs to sell.

On September 4, 2009, pursuant to the terms of an Asset Purchase Agreement dated June 15, 2009, we sold to WA 32609, Inc. substantially all of our remaining assets, including but not limited to our clinical-stage SonoLysis product

candidate for $0.5 million. At the closing, WA32609 paid to us $0.4 million of the total purchase price. The remaining $0.1 million was deposited into an escrow account to satisfy certain potential claims by WA32609 that may arise post-closing. Following expiration of an approximately five (5) month holdback period and assuming no post-closing claims arise, the remaining proceeds will be released from escrow and distributed to us. The carrying value of the IT related equipment was adjusted to its fair value less costs to sell in June 2009 resulting in an impairment charge of $18,000. As of September 30, 2009, the assets held for sale were netted with the proceeds received and the $0.1 million receivable from the sale resulting in a gain on sale of assets recorded in the statement of operations of $0.3 million.

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4. Stockholders Equity

Reverse Stock Split

At the special meeting of stockholders held on August 31, 2009, our stockholders approved an amendment to our fifth amended and restated certificate of incorporation effecting a reverse stock split of the issued and outstanding shares of our common stock. It is anticipated that when and if effectuated, the reverse stock split ratio will be one share for every ten shares of our common stock outstanding. Upon effecting the reverse stock split, or the split effective time, the issued and outstanding shares of our common stock immediately prior to the split effective time will be reclassified into a smaller number of shares such that a current stockholder will own one new share of our common stock for each ten shares of issued common stock held by that stockholder immediately prior to the split effective time. The Company is evaluating whether to effect the reverse stock split.

Stock Options

We have two equity incentive plans; the 2000 Stock Plan (2000 Plan) and the 2007 Performance Incentive Plan (2007 Plan). The 2000 Plan was terminated immediately following the closing of the initial public offering on July 31, 2007. No additional grants will be issued from the 2000 Plan; however, there are grants currently outstanding under this plan. The 2007 Plan became effective July 25, 2007, the effective date of the Company s initial public offering. As of September 30, 2009, there is no compensation cost related to non-vested options not yet recognized as we no longer have any employees an all other options are fully vested.

A summary of activity under our stock plans is as follows:

	Options	Exercise Price Per Share	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term
Outstanding at December 31, 2008	732,079	$ 0.63-27.50	$ 6.93	
Granted				
Exercised				
Canceled	300,550	2.10-25.00	5.59	
Outstanding and exercisable at September 30, 2009 (unaudited)	431,529	$ 0.63-20.00	$ 7.86	$ 2.83

Option Modifications

On September 18, 2009, in connection with his resignation, stock options granted to Bradford A. Zakes were modified to accelerate the vesting for certain non-vested options by 12 months from the date of termination and the option exercise period was extended for 12 months. Options to purchase 164,560 shares of common stock were subject to this acceleration, which resulted in 75,249 shares vesting and an increase in compensation expense of $1,250 in the three and nine months ended September 30, 2009.

5. Net Loss per Share

Basic and diluted net loss attributable to common stockholders per share is calculated by dividing the net loss applicable to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net loss per common share is the same as basic net loss per common share for all periods presented. The effects of potentially dilutive securities are antidilutive in the loss periods. At September 30, 2009, there were no options and warrants outstanding that would have had a dilutive effect should the Company have had net income during the periods reported.

6. Asset Acquisition and Sale

Abbokinase

In April 2006, we acquired from Abbott Laboratories the assets related to Abbokinase, including the remaining inventory of finished product, all regulatory and clinical documentation, validated cell lines, and intellectual property rights for a total purchase price of $20.0 million. The total purchase price was comprised of $5.0 million in cash and a

$15.0 million secured promissory note. In April 2008, we entered into a satisfaction, waiver and release agreement with Abbott Laboratories under which we paid Abbott Laboratories $5.2 million in cash and upon payment of the funds, the debt obligation was deemed to be indefeasibly paid in full by us and the note was cancelled and returned to us.

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On September 23, 2008, we divested our urokinase business to Microbix. Under the terms of the agreement, Microbix purchased all remaining urokinase inventory and related assets and assumed full responsibility for ongoing commercial and regulatory activities associated with the product for an upfront payment of $2.0 million in cash and the assumption of up to $0.5 million of chargeback liabilities for commercial product in the distribution channel. If the assumed chargeback liabilities paid by Microbix are less than the $0.5 million assumed, Microbix will issue payment to us for the difference. Microbix also agreed to make an additional payment of $2.5 million upon release by the FDA of the three lots of urokinase that are currently subject to a May 2008 Approvable Letter. Microbix is presently working with the FDA to secure the release of the three lots of urokinase. On June 15, 2009, we entered into the First Amendment with Microbix. The Amendment provides that Microbix shall not be obligated to pay the $2.5 million bonus due under the Original Agreement on release by the FDA of certain lots of urokinase to us. Instead, Microbix shall pay to us a sum of $0.2 million within 90 calendar days of the date of receipt by Microbix of written authorization from the FDA for the release of the urokinase lots should such authorization be received on or before September 1, 2010. As of November 12, 2009, Microbix has not secured the release of the three lots from the FDA. There can be no assurances that Microbix will be successful in securing such release. If Microbix is unable to secure the release of the three lots we will not be entitled to the additional $0.2 million payment.

WA 32609 Inc.

On September 4, 2009, pursuant to the terms of an Asset Purchase Agreement dated June 15, 2009, we sold to WA 32609, Inc. substantially all of our remaining assets, including but not limited to our clinical-stage SonoLysis product candidate for $0.5 million. At the closing, WA32609 paid to us $0.4 million of the total purchase price. The remaining $0.1 million was deposited into an escrow account to satisfy certain potential claims by WA3 2609 that may arise post-closing. Following expiration of an approximately five (5) month holdback period and assuming no post-closing claims arise, the remaining proceeds will be released from escrow and distributed to us. The sale was subject to shareholder approval which was obtained at a special meeting of the shareholders held August 31, 2009. Following the closing of the asset sale to WA 32609, the remaining two employees of the Company, including Mr. Zakes, resigned their positions with the Company. The sale resulted in a gain of $0.3 million recorded in our statement of operations for the three and nine months ended September 30, 2009.

7. Commitments and Contingencies

We do not currently have a returns reserve recorded in our financial statements for any potential product returns for expired product. There is a large amount of inventory that was sold to the wholesale distributors with expiry dates of November 2008, December 2008, and September 2009. When the product was sold to Microbix on September 23, 2008, they assumed all liabilities up to $0.5 million. We believe that we have settled all liabilities; however, we cannot be certain whether or not future liabilities will arise.

We responded to an Internal Revenue Service (IRS) inquiry regarding our calendar year 2005 payroll tax reporting. The IRS did not allow our initial response and did not initially abate the penalty that was assessed of $70,000. In the second quarter ended June 30, 2009, we appealed this position with the IRS. At this time, we are awaiting a response to our appeal. At this time, we estimate that it is probable that the IRS will accept the appeal and abate the penalty.

8. Subsequent Events

Evaluated through November 16, 2009 and we have disclosed the events identified in this filing on Form 10-Q.

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

Cautionary Statement Regarding Forward-Looking Statements

The following discussion should be read in conjunction with the accompanying unaudited Consolidated Financial Statements and related notes appearing elsewhere in this report. This Quarterly Report on Form 10-Q contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We cannot guarantee the accuracy of the forward-looking statements, and you should be aware that results and events could differ materially and adversely from those contained in the forward-looking statements. You should also consider carefully the statements set forth in Item 1A of Part II of this Quarterly Report entitled Risk Factors which address these and additional factors that could cause results or events to differ materially from those set forth in the forward-looking statements.

Our Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and amendments to all such reports are available, free of charge, on our Internet website under Investors-Financial Information, as soon as reasonably practicable after we file electronically such reports with, or furnish such reports to, the SEC. Our Internet website address is http://www.imarx.com. Information on our website does not constitute a part of this Quarterly Report on Form 10-Q. As used in this quarterly report on Form 10-Q, unless the context otherwise requires, the terms we, us, our, the Company, and ImaRx refer to ImaRx Therapeutics, Inc., a Delaware corporation.

Overview

We are a development stage biopharmaceutical company, whose activities have focused on the research, development and commercialization of therapies for stroke and other vascular disorders. Our development efforts were focused on our SonoLysis program, which involved the administration of our MRX-801 microspheres and ultrasound to break up blood clots and restore blood flow to oxygen deprived tissues. Our commercialization efforts were focused on the promotion and sale of our U.S. Food and Drug Administration, or FDA, approved urokinase product, Abbokinase®, which we had previously acquired from Abbott Laboratories.

In January 2008, we suspended enrollment in our SonoLysis Phase I/II clinical trial designed to evaluate the safety, tolerability and activity of escalating doses of MRX-801 microspheres and ultrasound because the safety data following the second cohort indicated that there were a greater number of intracranial hemorrhage events observed in subjects receiving treatment relative to controls in the second cohort. We concluded the study based on these findings and commenced evaluating strategic alternatives for continued pursuit and financing of the SonoLysis program.

In June 2008, in response to new risks and challenges facing the Company, we announced a restructuring that included a significant workforce reduction in which all of our employees other than Bradford Zakes, our then president and chief executive officer, and one additional employee were terminated. In furtherance of the June 2008 restructuring we discontinued substantially all research and development activity while evaluating strategic alternatives for funding and continuation of our SonoLysis program and for our other Company assets.

On September 23, 2008, we divested our urokinase business to Microbix for an upfront payment of $2.0 million, the assumption by Microbix of up to $0.5 million in chargeback and other liabilities for commercial product then in the distribution channel and an additional $2.5 million payment from Microbix contingent upon release by the FDA of three lots of urokinase that are currently subject to a May 2008 FDA Approvable Letter. On June 15, 2009, we entered into the First Amendment to the Asset Purchase Agreement with Microbix which reduced the size of the contingent payment from $2.5 million to $0.2 million contingent upon receipt by Microbix of written authorization from the FDA for the release of the urokinase lots on or before September 1, 2010.

On September 4, 2009, pursuant to the terms of an Asset Purchase Agreement dated June 15, 2009, we sold to WA 32609, Inc. substantially all of our remaining assets, including but not limited to our clinical-stage SonoLysis product candidate for $500,000. At the closing, WA32609 paid to us $0.4 million of the total purchase price. The remaining $0.1 million was deposited into an escrow account to satisfy certain potential claims by WA32609 that may arise post-closing. Following expiration of an approximately five (5) month holdback period and assuming no post-closing claims arise, the remaining proceeds will be released from escrow and distributed to us. The sale was subject to shareholder approval which was obtained at a special meeting of the shareholders held August 31, 2009. Following the closing of the asset sale to WA 32609, the remaining two employees of the Company, including Mr. Zakes, resigned their positions with the Company.

We have sold substantially all of the Company s assets and are now engaged in the orderly settlement and payment of the remaining obligations of the Company while concurrently entertaining proposals from other parties concerning the potential merger and/or acquisition of the remaining assets of the Company. We are also evaluating the potential liquidation and dissolution of the Company. We have no employees and we are carrying out these activities through the use of consultants and other outside service providers. Mr. Love, our Chairman of the Board is now acting as our principal executive officer and principal financial officer.

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Product Sales, Research and Development Revenue

Our primary source of revenue was derived from sales of urokinase product which commenced in October 2006 following our purchase of the product from Abbott Laboratories. Future revenue has been eliminated as the product and related assets were sold to Microbix on September 23, 2008. As a result of the sale of the urokinase assets and inventory to Microbix, revenues will no longer be recognized. In addition to our commercial product sales, we also generated a limited amount of revenue by providing research services for projects funded under various government grants. We currently have no outstanding grants under which we are receiving revenue.

Cost of Product Sales

Cost of product sales had been determined using a weighted-average method and includes the acquisition cost of the inventory as well as additional labeling costs we incurred to bring the product to market. Our product pricing was fixed, but had the potential to include a variable sales or cash discount depending on the nature of the sale. Our gross margins were affected by chargebacks, discounts and administrative fees paid to the wholesale distributors and GPOs. Due to the divestiture of our urokinase product, we will cease to have cost of product sales once all vials at the wholesale distributors have been sold to a hospital or other end user or have expired.

Research and Development Expenses

We classify our research and development expenses into four categories of activity, namely; research, development, clinical and regulatory. Our research and development efforts were focused primarily on product candidates from our SonoLysis program. As part of our restructuring effort announced in June 2008, we have ceased substantially all research related activities.

General and Administrative Expenses

General and administrative expenses consist primarily of personnel-related expenses and other costs and fees associated with our general corporate activities, such as sales and marketing, administrative support, business development, intellectual property protection, public reporting and corporate compliance, as well as a portion of our overhead expenses. Although these expenses will be at reduced levels, we have incurred and will continue to incur expenses in the areas of legal compliance, accounting and corporate governance as a public company.

Critical Accounting Policies and Significant Judgments and Estimates

Our management s discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosed amounts of contingent assets and liabilities and our reported revenue and expenses. Significant management judgment was previously required to make estimates in relation to inventory and intangible asset valuation, chargebacks and administrative fee accruals, clinical trial costs and costs associated with transitioning to a public reporting company. We evaluate our estimates, and judgments related to these estimates, on an ongoing basis. We base our estimates of the carrying values of assets and liabilities that are not readily apparent from other sources on historical experience and on various other factors that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. There has been no significant change in our critical accounting policies or estimates from those policies or estimates disclosed under the heading Critical Accounting Policies and Significant Judgments and Estimates in our Annual Report on form 10-K, filed with the Securities and Exchange Commission on March 6, 2009.

Long-lived and Intangible Assets

We account for long-lived assets in accordance with the FASB guidance for the impairment or disposal of long-lived assets. This guidance addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by comparing the carrying amount of an asset to the expected future net cash flows generated by the asset. If it is determined that the asset may not be recoverable and if the carrying amount of an asset exceeds its estimated fair value, an impairment charge is recognized to the extent of the difference. The FASB guidance requires companies to separately report discontinued operations, including components of an entity that either have been disposed of (by sale, abandonment or in a distribution to owners) or classified as held for sale. Assets to be disposed of are reported at

the lower of the carrying amount or fair value less costs to sell.

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On September 4, 2009, pursuant to the terms of an Asset Purchase Agreement dated June 15, 2009, we sold to WA 32609, Inc. substantially all of our remaining assets, including but not limited to our clinical-stage SonoLysis product candidate for $0.5 million. At the closing, WA32609 paid to us $0.4 million of the total purchase price. The remaining $0.1 million was deposited into an escrow account to satisfy certain potential claims by WA32609 that may arise post-closing. Following expiration of an approximately five (5) month holdback period and assuming no post-closing claims arise, the remaining proceeds will be released from escrow and distributed to us. The carrying value of the IT related equipment was adjusted to its fair value less costs to sell in June 2009 resulting in an impairment charge of $18,000. As of September 30, 2009, the assets held for sale were netted with the proceeds received and the $0.1 million receivable from the sale resulting in a gain on sale of assets recorded in the statement of operations of $0.3 million.

Deferred Tax Asset Valuation Allowance

Our estimate of the valuation allowance for deferred tax assets requires us to make significant estimates and judgments about our future operating results. Our ability to realize the deferred tax assets depends on our future taxable income as well as limitations on utilization. A deferred tax asset must be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized prior to its expiration. The projections of our operating results on which the establishment of a valuation allowance are based involve significant estimates regarding future demand for our products, competitive conditions, product development efforts, approvals of regulatory agencies and product cost. We have recorded a full valuation allowance on our net deferred tax assets due to uncertainties related to our ability to utilize our deferred tax assets in the foreseeable future. These deferred tax assets primarily consist of net operating loss carry forwards and research and development tax credits. Under Section 382 of the Internal Revenue Code of 1986, as amended, substantial changes in our ownership may limit the amount of net operating loss carry-forwards that could be utilized annually in the future to offset taxable income.

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Results of Operations

Three Months Ended September 30, 2008 Compared to 2009

Product Sales, Research and Development Revenue. Our total revenues decreased from $1.7 million in the third quarter of 2008 to $1,000 in the third quarter of 2009. The decrease resulted from the elimination of urokinase channel inventory due to divesting the urokinase assets to Microbix in September 2008.

Cost of Product Sales. Cost of product sales was $0.7 million in the third quarter of 2008 compared to zero for the third quarter of 2008. The decrease in cost of product sales was due to the elimination of urokinase inventory in the channel as a result of divesting the urokinase assets to Microbix in September 2008.

Research and Development Expenses. Research and development expenses decreased from $0.4 million in the third quarter of 2008 to $10,000 in the third quarter of 2009. This decrease is related to the elimination of clinical trial costs associated with the wind down of our SonoLysis Phase I/II clinical trial and the elimination of salaries as a result of our restructuring activities initiated in June 20008.

General and Administrative Expenses. General and administrative expenses decreased from $0.8 million in the third quarter of 2008 to $0.4 million in the third quarter 2009. This decrease was principally a result of reduced salaries associated with our restructuring activities, reduction of amortization expense due to intangible assets written off in the second quarter of 2008 offset partially by the costs associated with the purchase of executive and organization liability insurance.

Interest and Other Income, net. Interest and other expense of $1,000 in the third quarter of 2008 was related to loss on the sale of equipment. Interest and other income of $0.3 million in the third quarter of 2009 was related to the refund of previously paid Delaware franchise taxes, the recognition of the remaining deferred revenue related to the urokinase product as we have settled all remaining liabilities and payments received from Reflow Biomedical in connection with the supply of microspheres under the terms of a license agreement entered into with Reflow Biomedical in April 2009 which was subsequently assigned to WA32609 in connection with the September 2009 asset sale.

Gain on asset sale. The gain on asset sale of $0.4 million in the three months ended September 20, 2009 is related to the asset sale to WA 32609 that was closed on September 4, 2009 for proceeds of $0.5 million.

Nine Months Ended September 30, 2008 Compared to 2009

Product Sales, Research and Development Revenue. Our total revenues decreased from $5.8 million for the nine month period ended September 30, 2008 to $27,000 for the same period in 2009, primarily as a result of the decline in revenue recognized on product sales as a result of an ongoing reduction in channel inventory since divesting the urokinase assets to Microbix in September 2008.

Cost of Product Sales. Cost of product sales decreased from $2.5 million for the nine month period ended September 30, 2008 to $13,000 for the same period in 2009. The decrease in cost of product sales was due to the decrease in urokinase inventory in the channel and the lack of current dated inventory to replenish the channel.

Research and Development Expenses. Research and development expenses decreased from $3.0 million for the nine month period ended September 30, 2008 to $0.1 million for the same period in 2009. This decrease was a result of the wind down of substantially all research and development activities associated with restructuring activities initiated in June 2008.

General and Administrative Expenses. General and administrative expenses decreased from $5.8 million for the nine month period ended September 30, 2008 to $1.2 million for the same period in 2009. This decrease was a result of reduced salaries, accounting fees and consulting fees associated with the restructuring activities that were initiated in June 2008 as well as the elimination of selling and marketing costs and amortization of intangibles due to the sale of the urokinase assets to Microbix in September 2008.

Asset Impairment. The asset