JUNIATA VALLEY FINANCIAL CORP
Form 10-Q
May 08, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended March 31, 2009

OR

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 000-13232

Juniata Valley Financial Corp.

(Exact name of registrant as specified in its charter)

Pennsylvania	23-2235254
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Bridge and Main Streets, Mifflintown, Pennsylvania	17059
(Address of principal executive offices)	(Zip Code)

(717) 436-8211

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “accelerated filer”,” large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

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

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

Class	Outstanding as of May 8, 2009
Common Stock ($1.00 par value)	4,336,129 shares

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PART I - FINANCIAL INFORMATION
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Juniata Valley Financial Corp. and Subsidiary
Consolidated Statements of Financial Condition
(Unaudited, Dollar amounts in thousands, except share data)

	March 31, 2009	December 31, 2008
ASSETS		
Cash and due from banks	$ 8,951	$ 12,264
Interest bearing deposits with banks	157	193
Federal funds sold	4,000	-
Cash and cash equivalents	13,108	12,457
Interest bearing time deposits with banks	5,325	5,325
Securities available for sale	69,656	64,321
Restricted investment in Federal Home Loan Bank (FHLB) stock	2,197	2,197
Investment in unconsolidated subsidiary	3,224	3,176
Total loans, net of unearned interest	309,642	315,132
Less: Allowance for loan losses	(2,532)	(2,610)
Total loans, net of allowance for loan losses	307,110	312,522
Premises and equipment, net	7,265	7,374
Bank owned life insurance and annuities	12,696	12,582
Core deposit intangible	333	344
Goodwill	2,046	2,046
Accrued interest receivable and other assets	6,582	5,740
Total assets	$ 429,542	$ 428,084
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing	$ 49,685	$ 54,200
Interest bearing	316,446	302,831
Total deposits	366,131	357,031
Securities sold under agreements to repurchase	2,307	1,944
Short-term borrowings	-	8,635
Long-term debt	5,000	5,000
Other interest bearing liabilities	1,102	1,096
Accrued interest payable and other liabilities	6,201	5,893
Total liabilities	380,741	379,599
Stockholders' Equity:		
Preferred stock, no par value:		
Authorized - 500,000 shares, none issued		
Common stock, par value $1.00 per share:		
Authorized - 20,000,000 shares		
Issued - 4,745,826 shares		
Outstanding -		

4,333,455 shares at March 31, 2009;		
4,341,055 shares at December 31, 2008	4,746	4,746
Surplus	18,334	18,324
Retained earnings	35,343	34,758
Accumulated other comprehensive loss	(1,398)	(1,247)
Cost of common stock in Treasury:		
412,371 shares at March 31, 2009;		
404,771 shares at December 31, 2008	(8,224)	(8,096)
Total stockholders' equity	48,801	48,485
Total liabilities and stockholders' equity	$ 429,542	$ 428,084

See accompanying notes to consolidated financial statements.

Juniata Valley Financial Corp. and Subsidiary
Consolidated Statements of Income
(Unaudited)
(Dollar amounts in thousands, except share data)

	Three Months Ended March 31,	
	2009	2008
Interest income:		
Loans, including fees	$ 5,289	$ 5,526
Taxable securities	308	446
Tax-exempt securities	281	246
Federal funds sold	56	70
Other interest income	2	75
Total interest income	5,936	6,363
Interest expense:		
Deposits	1,878	2,446
Securities sold under agreements to repurchase	1	26
Short-term borrowings	1	-
Long-term debt	34	-
Other interest bearing liabilities	5	9
Total interest expense	1,919	2,481
Net interest income	4,017	3,882
Provision for loan losses	135	32
Net interest income after provision for loan losses	3,882	3,850
Noninterest income:		
Trust fees	84	123
Customer service fees	372	392
Earnings on bank-owned life insurance and annuities	106	124
Commissions from sales of non-deposit products	108	211
Income from unconsolidated subsidiary	48	42
Gain on sale of securities	-	13
Gain (loss) on sales of other assets	6	(6)
Prior period income from insurance sales	323	-
Other noninterest income	195	233
Total noninterest income	1,242	1,132
Noninterest expense:		
Employee compensation expense	1,286	1,255
Employee benefits	444	437
Occupancy	239	232
Equipment	162	179
Data processing expense	333	334
Director compensation	110	114
Professional fees	121	84
Taxes, other than income	128	131
FDIC Insurance premiums	88	10
Amortization of intangibles	11	11
Other noninterest expense	269	254
Total noninterest expense	3,191	3,041
Income before income taxes	1,933	1,941

Provision for income taxes		523		539
Net income	$	1,410	$	1,402
Earnings per share				
Basic	$	0.32	$	0.32
Diluted	$	0.32	$	0.32
Cash dividends declared per share	$	0.19	$	0.18
Weighted average basic shares outstanding		4,340,633		4,403,132
Weighted average diluted shares outstanding		4,345,622		4,412,846

See accompanying notes to consolidated financial statements.

Juniata Valley Financial Corp. and Subsidiary
Consolidated Statements of Changes in Stockholders' Equity
(Unaudited)
(Amounts in thousands, except share data)

Three Months Ended March 31, 2009

	Number of Shares Outstanding	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders' Equity
Balance at December 31, 2008	4,341,055	$ 4,746	$ 18,324	$ 34,758	$ (1,247)	$ (8,096)	$ 48,485
Comprehensive income:							
Net income				1,410			1,410
Change in unrealized losses on securities available for sale, net of reclassification adjustment and tax effects					(151)		(151)
Total comprehensive income							1,259
Cash dividends at $0.19 per share				(825)			(825)
Stock-based compensation activity			10				10
Purchase of treasury stock, at cost	(7,600)					(128)	(128)
Balance at March 31, 2009	4,333,455	$ 4,746	$ 18,334	$ 35,343	$ (1,398)	$ (8,224)	$ 48,801

Three Months Ended March 31, 2008

	Number of Shares Outstanding	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders' Equity
Balance at December 31, 2007	4,409,445	$ 4,746	$ 18,297	$ 32,755	$ (557)	$ (6,669)	$ 48,572

Comprehensive income:							
Net income				1,402			1,402
Change in unrealized losses on securities available for sale, net of reclassification adjustment and tax effects					414		414
Total comprehensive income							1,816
Implementation of EITF 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements"				(480)			(480)
Cash dividends at $0.18 per share				(793)			(793)
Stock-based compensation activity			12				12
Purchase of treasury stock, at cost	(14,525)					(302)	(302)
Balance at March 31, 2008	4,394,920	$ 4,746	$ 18,309	$ 32,884	$ (143)	$ (6,971)	$ 48,825

See accompanying notes to consolidated financial statements.

Juniata Valley Financial Corp. and Subsidiary
Consolidated Statements of Cash Flows
(Unaudited)
(Amounts in thousands)

	Three Months Ended March 31,	
	2009	2008
Operating activities:		
Net income	$ 1,410	$ 1,402
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	135	32
Provision for depreciation	154	170
Net (accretion) amortization of securities premiums (discounts)	47	(18)
Amortization of core deposit intangible	11	11
Amortization of deferred net loan costs	12	1
Deferral of net loan costs	(10)	(10)
Net realized gains on sales of securities	-	(13)
Losses (gains) on sales of other assets	(6)	6
Earnings on bank owned life insurance and annuities	(106)	(124)
Deferred income tax expense	6	3
Equity in earnings of unconsolidated subsidiary, net of dividends of $8 and $0	(40)	(42)
Stock-based compensation expense	10	12
Increase in accrued interest receivable and other assets	(447)	(891)
(Decrease) increase in accrued interest payable and other liabilities	317	(3)
Net cash provided by operating activities	1,493	536
Investing activities:		
Purchases of:		
Securities available for sale	(15,339)	(10,176)
FHLB stock	-	(166)
Premises and equipment	(45)	(384)
Bank owned life insurance and annuities	(29)	(28)
Proceeds from:		
Maturities of and principal repayments on securities available for sale	9,728	17,949
Bank owned life insurance and annuities	18	19
Sale of other real estate owned	62	45
Sale of other assets	4	-
Net (increase) decrease in loans receivable	4,884	(2,769)
Net cash provided by (used in) investing activities	(717)	4,490
Financing activities:		
Net increase in deposits	9,100	4,200
Net decrease in short-term borrowings and securities sold under agreements to repurchase	(8,272)	(135)
Cash dividends	(825)	(793)
Purchase of treasury stock	(128)	(302)
Net cash provided by (used in) financing activities	(125)	2,970

Net increase in cash and cash equivalents		651		7,996
Cash and cash equivalents at beginning of period		12,457		20,524
Cash and cash equivalents at end of period	$	13,108	$	28,520
Supplemental information:				
Interest paid	$	1,944	$	2,531
Income taxes paid	$	-	$	75
Supplemental schedule of noncash investing and financing activities:				
Transfer of loans to other real estate owned and repossessed assets	$	391	$	-

See accompanying notes to consolidated financial statements.

Juniata Valley Financial Corp. and Subsidiary

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A – Basis of Presentation and Accounting Policies

The financial information includes the accounts of Juniata Valley Financial Corp. (the "Corporation") and its wholly owned subsidiary, The Juniata Valley Bank (the "Bank"). All significant intercompany accounts and transactions have been eliminated.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for fair presentation have been included. For comparative purposes, the March 31, 2008 balances have been reclassified to conform to the 2009 presentation. Such reclassifications had no impact on net income. Operating results for the three-month period ended March 31, 2009, are not necessarily indicative of the results for the year ended December 31, 2009. For further information, refer to the consolidated financial statements and footnotes thereto included in Juniata Valley Financial Corp.'s Annual Report on Form 10-K for the year ended December 31, 2008.

NOTE B – Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP FAS 157-4). FASB Statement 157, Fair Value Measurements, defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP FAS 157-4 provides additional guidance on determining when the volume and level of activity for the asset or liability has significantly decreased. The FSP also includes guidance on identifying circumstances when a transaction may not be considered orderly.

FSP FAS 157-4 provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with Statement 157.

This FSP clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The FSP provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity early adopting FSP FAS 157-4 must also early adopt FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. The Corporation is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2 and FAS 124-2). FSP FAS 115-2 and FAS 124-2 clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment. Previously, this assessment required management to assert it has both the intent and the ability to hold a security for a period of time sufficient to allow for an anticipated recovery in fair value to avoid recognizing an other-than-temporary impairment. This change does not affect the need to forecast recovery of the value of the security through either cash flows or market price.

In instances when a determination is made that an other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to its anticipated recovery, FSP FAS 115-2 and FAS 124-2 changes the presentation and amount of the other-than-temporary impairment recognized in the income statement. The other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity early adopting FSP FAS 115-2 and FAS 124-2 must also early adopt FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. The Corporation is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1). FSP FAS 107-1 and APB 28-1 amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods.

This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity early adopting FSP FAS 107-1 and APB 28-1 must also early adopt FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly and FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. The Corporation is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

FASB Statement No. 141 (R) Business Combinations was issued in December of 2007. This Statement establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The Statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The guidance became effective as of January 1, 2009, and to date, has had no effect on the Corporation’s consolidated financial statements.

FASB Statement No. 160 Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51 was issued in December of 2007. This Statement establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The guidance became effective as of January 1, 2009 and will not have a material impact on the Corporation’s consolidated financial statements.

In March 2008, the FASB issued Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities—an amendment of Statement No. 133 (Statement 161). Statement 161 requires entities that utilize derivative instruments to provide qualitative disclosures about their objectives and strategies for using such instruments, as well as any details of credit-risk-related contingent features contained within derivatives. Statement 161 also requires entities to disclose additional information about the amounts and location of derivatives located within the financial statements, how the provisions of SFAS 133 have been applied, and the impact that hedges have on an entity’s financial position, financial performance, and cash flows. Statement 161 was effective on January 1, 2009. The

Corporation is currently not using derivative instruments and does not engage in hedging activities.

In February 2008, the FASB issued a FASB Staff Position (FSP) FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions. This FSP addresses the issue of whether or not these transactions should be viewed as two separate transactions or as one "linked" transaction. The FSP includes a "rebuttable presumption" that presumes linkage of the two transactions unless the presumption can be overcome by meeting certain criteria. The FSP was effective on January 1, 2009. The Corporation does not believe that the new pronouncement will impact its consolidated financial statements.

NOTE C – Comprehensive Income

U.S. generally accepted accounting principles require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the consolidated statements of financial condition, such items, along with net income, are components of comprehensive income.

The components of comprehensive income and related tax effects are as follows (in thousands):

	Three Months Ended March 31, 2009			Three Months Ended March 31, 2008		
	Before Tax Amount	Tax Expense or (Benefit)	Net-of-Tax Amount	Before Tax Amount	Tax Expense or (Benefit)	Net-of-Tax Amount
Net income	$ 1,933	$ 523	$ 1,410	$ 1,941	$ 539	$ 1,402
Other comprehensive income (loss):						
Unrealized gains (losses) on available for sale securities:						
Unrealized gains (losses) arising during the period	(229)	(78)	(151)	621	211	410
Unrealized gains from unconsolidated subsidiary	-	-	-	13	-	13
Less reclassification adjustment for:						
(gains) losses included in net income	-	-	-	(13)	(4)	(9)
Other comprehensive income (loss)	(229)	(78)	(151)	621	207	414
Total comprehensive income	$ 1,704	$ 445	$ 1,259	$ 2,562	$ 746	$ 1,816

NOTE D – Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

(Amounts, except earnings per share, in thousands)

	Three Months Ended	Three Months Ended

	March 31, 2009	March 31, 2008
Net income	$ 1,410	$ 1,402
Weighted-average common shares outstanding	4,341	4,403
Basic earnings per share	$ 0.32	$ 0.32
Weighted-average common shares outstanding	4,341	4,403
Common stock equivalents due to effect of stock options	5	10
Total weighted-average common shares and equivalents	4,346	4,413
Diluted earnings per share	$ 0.32	$ 0.32

NOTE E – Commitments, Contingent Liabilities and Guarantees

In the ordinary course of business, the Corporation makes commitments to extend credit to its customers through letters of credit, loan commitments and lines of credit. At March 31, 2009, the Corporation had $47,027,000 outstanding in loan commitments and other unused lines of credit extended to its customers as compared to $47,738,000 at December 31, 2008.

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its letters of credit. Letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Generally, all letters of credit have expiration dates within one year of issuance. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $624,000 and $639,000 of letters of credit commitments as of March 31, 2009 and December 31, 2008, respectively. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of March 31, 2009 for payments under letters of credit issued was not material.

NOTE F – Defined Benefit Retirement Plan

The Corporation has a defined benefit retirement plan covering substantially all of its employees, prior to January 1, 2008. Effective January 1, 2008, the plan was amended to close the plan to new entrants. The benefits are based on years of service and the employees' compensation. The Corporation's funding policy is to contribute annually the maximum amount that can be deducted for federal income taxes purposes. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The Corporation has made no contributions in the first three months of 2009 and does not expect to contribute to the defined benefit plan in the remainder of 2009.

Pension expense included the following components for the three month periods ended March 31, 2009 and 2008:

(Dollar amounts in thousands)

	Three Months Ended March 31,	
	2009	2008
Components of net periodic pension cost		
Service cost	$ 47	$ 45
Interest cost	112	110
Expected return on plan assets	(115)	(106)
Additional recognized amounts	40	9
Net periodic pension cost	$ 84	$ 58

NOTE G– Acquisition

In 2006, the Corporation acquired a branch office in Richfield, PA. The acquisition included real estate, deposits and loans. The assets and liabilities of the acquired business were recorded on the consolidated statement of financial condition at their estimated fair values as of September 8, 2006, and their results of operations have been included in the consolidated statements of income since such date.

Included in the purchase price of the branch was goodwill and core deposit intangible of $2,046,000 and $449,000, respectively. The core deposit intangible is being amortized over a ten-year period on a straight line basis. During the first three months of 2009 and 2008, amortization expense was $11,000. Accumulated amortization of core deposit intangible through March 31, 2009 was $116,000. The goodwill is not amortized, but is measured annually for

impairment.

NOTE H – Investment in Unconsolidated Subsidiary

The Corporation owns 39.16% of the outstanding common stock of The First National Bank of Liverpool (FNBL), Liverpool, PA. This investment is accounted for under the equity method of accounting, as defined in Accounting Principles Board Opinion No. 18. The investment is being carried at $3,224,000 as of March 31, 2009. The Corporation increases its investment in FNBL for its share of earnings and decreases its investment by any dividends received from FNBL. A loss in value of the investment which is other than a temporary decline will be recognized. Evidence of a loss in value might include, but would not necessarily be limited to, absence of an ability to recover the carrying amount of the investment or inability of FNBL to sustain an earnings capacity which would justify the carrying amount of the investment.

NOTE I – Fair Value Measurements

Effective January 1, 2008, the Corporation adopted the provisions of SFAS No 157, Fair Value Measurements for financial assets and financial liabilities and on January 1, 2009, adopted the provision for non-financial assets and non-financial liabilities. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not to be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

SFAS 157 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, SFAS 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs – Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 Inputs – Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Corporation's financial assets and financial liabilities carried at fair value effective January 1, 2008.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, the Corporation's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Corporation's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Corporation's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Securities Available for Sale. Debt securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Corporation obtains fair value measurement from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Equity securities classified as available for sale are reported at fair value using Level 1 inputs.

Impaired Loans. Certain impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on customized discounting criteria.

Other Real Estate Owned. Assets included in other real estate owned are reported at fair value on a non-recurring basis. Values are estimated using Level 3 inputs, based on appraisals that consider the sales prices of similar properties in the proximate vicinity.

The following table summarizes financial assets and financial liabilities measured at fair value as of March 31, 2009 and December 31, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands).

	March 31, 2009	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Other Unobservable Inputs
Measured at fair value on a recurring basis:				
Equity securities available-for-sale	$ 654	$ 654	$ -	$ -
Debt securities available-for-sale	69,002		69,002	-
Measured at fair value on a non-recurring basis:				
Impaired loans	867	-	-	867
Other real estate owned	627	-	-	627

		(Level 1)	(Level 2)	(Level 3)

	December 31, 2008	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Other Unobservable Inputs
Measured at fair value on a recurring basis:				
Equity securities available-for-sale	$ 1,014	$ 1,014	$ -	$ -
Debt securities available-for-sale	63,307		63,307	-
Measured at fair value on a non-recurring basis:				
Impaired loans	-	-	-	-
Other real estate owned	305	-	-	305

Certain non-financial assets and non-financial liabilities measured at fair value on a recurring basis include reporting units measured at fair value in the first step of a goodwill impairment test. Certain non-financial assets measured at fair value on a non-recurring basis include non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, as well as intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. As stated above, SFAS 157 was applicable to these fair value measurements beginning January 1, 2009 and were not significant at March 31, 2009.

NOTE J – Subsequent Events

On April 21, 2009, the Board of Directors declared a regular cash dividend for the second quarter of 2009 of $0.19 per share to shareholders of record on May 15, 2009, payable on June 1, 2009.

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

Forward Looking Statements:

The Private Securities Litigation Reform Act of 1995 contains safe harbor provisions regarding forward-looking statements. When used in this discussion, the words "believes," "anticipates," "contemplates," "expects," and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results, performance or achievements expressed or implied by such forward-looking statements to differ materially from those projected. Those risks and uncertainties include changes in interest rates and their impact on the level of deposits, loan demand and value of loan collateral, changes in the market value of the securities portfolio, increased competition from other financial institutions, governmental monetary policy, legislation and changes in banking regulations, changes in levels of FDIC deposit insurance premiums and assessments, risks associated with the effect of opening a new branch, the ability to control costs and expenses, and general economic conditions. The Corporation undertakes no obligation to update such forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Critical Accounting Policies:

Disclosure of the Corporation’s significant accounting policies is included in the notes to the consolidated financial statements of the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2008. Some of these policies require significant judgments, estimates, and assumptions to be made by management, most particularly in connection with determining the provision for loan losses and the appropriate level of the allowance for loan losses, as well as management’s evaluation of the investment portfolio for other-than-temporary impairment.

General:

The following discusses the consolidated financial condition of the Corporation as of March 31, 2009, as compared to December 31, 2008, and the consolidated results of operations for the three months ended March 31, 2009, compared to the same period in 2008. This discussion should be read in conjunction with the interim consolidated financial statements and related footnotes included herein.

Introduction:

Juniata Valley Financial Corp. is a Pennsylvania corporation organized in 1983 to become the holding company of The Juniata Valley Bank ("Bank"). The Bank is a state-chartered bank headquartered in Mifflintown, Pennsylvania. Juniata Valley Financial Corp. and its subsidiary bank derive substantially all of their income from banking and bank-related services, including interest earned on residential real estate, commercial mortgage, commercial and consumer loans, interest earned on investment securities and fee income from deposit services and other financial services to its customers through 12 locations in central Pennsylvania. Juniata Valley Financial Corp. also owns 39.16% of the First National Bank of Liverpool, located in Liverpool, Pennsylvania. Juniata accounts for Liverpool as an unconsolidated subsidiary using the equity method of accounting.

Financial Condition:

As of March 31, 2009, total assets increased by $1,458,000, or 0.3%, as compared to December 31, 2008. Deposits increased $9.1 million, $8.6 million of which was used to repay short-term debt. Interest-bearing deposits grew by $13.6 million, while non-interest bearing deposits declined by $4.5 million.

The table below shows changes in deposit volumes by type of deposit (in thousands of dollars) between December 31, 2008 and March 31, 2009.

	March 31, 2009	December 31, 2008	Change $	Change %
Deposits:				
Demand, non-interest bearing	$ 49,685	$ 54,200	$ (4,515)	(8.3%)
NOW and money market	66,067	62,099	3,968	6.4%
Savings	39,854	37,114	2,740	7.4%
Time deposits, $100,000 and more	40,232	39,059	1,173	3.0%
Other time deposits	170,293	164,559	5,734	3.5%
Total deposits	$ 366,131	$ 357,031	$ 9,100	2.5%

Overall, loans, net of unearned interest, decreased by $5,490,000, or 1.7%, between December 31, 2008 and March 31, 2009. As shown in the table below (in thousands of dollars), the decrease in outstanding loans since December 31, 2008 has been related primarily to commercial, home equity and personal installment loan activity.

	March 31, 2009	December 31, 2008	Change $	Change %
Loans:				
Commercial, financial and agricultural	$ 35,373	$ 38,755	$ (3,382)	(8.7%)
Real estate - commercial	32,142	32,171	(29)	(0.1%)
Real estate - construction	24,112	22,144	1,968	8.9%
Real estate - mortgage	139,068	140,016	(948)	(0.7%)
Home equity	58,338	60,949	(2,611)	(4.3%)
Obligations of states and political subdivisions	8,048	7,177	871	12.1%
Personal	12,561	13,920	(1,359)	(9.8%)
Total loans	$ 309,642	$ 315,132	$ (5,490)	(1.7%)

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A summary of the transactions in the allowance for loan losses for each of the three months ended March 31, 2009 and 2008 (in thousands) are presented below.

	Periods Ended March 31,	
	2009	2008
Balance of allowance - January 1	$ 2,610	$ 2,322
Loans charged off	(215)	(25)
Recoveries of loans previously charged off	2	11
Net charge-offs	(213)	(14)
Provision for loan losses	135	32
Balance of allowance - end of period	$ 2,532	$ 2,340
Ratio of net charge-offs during period to average loans outstanding	0.07%	0.00%

As of March 31, 2009, the Corporation had several loan relationships, with an aggregate carrying balance of $618,000, deemed to be impaired that have been placed in nonaccrual status. Specific allocations totaling $28,000 have been included within the loan loss reserve for these loans. Management believes that the specific reserve is adequate to cover potential future losses related to these relationships. There are five other significant loan relationships considered to be impaired, with outstanding balances totaling $2,575,000, on which interest continues to accrue. Specific allocations within the allowance for loan losses for these loans total $113,000. Otherwise, there are no material loans classified for regulatory purposes as loss, doubtful, substandard, or special mention which management expects to significantly impact future operating results, liquidity or capital resources. Following is a summary of the Bank’s non-performing loans on March 31, 2009 as compared to December 31, 2008.

(Dollar amounts in thousands)

	March 31, 2009	December 31, 2008
Non-performing loans		
Nonaccrual loans	$ 967	$ 1,255
Accruing loans past due 90 days or more	690	664
Restructured loans	-	-
Total	$ 1,657	$ 1,919
Average loans outstanding	$ 311,525	$ 307,606
Ratio of non-performing loans to average loans outstanding	0.53%	0.62%

Stockholders' equity increased by $316,000, or 0.7%, from December 31, 2008 to March 31, 2009. Net income of $1,410,000 was offset by dividends of $825,000 and net purchases of treasury stock of $128,000. The Corporation repurchased stock into treasury pursuant to its stock repurchase program. During the first three months of 2009, the Corporation purchased 7,600 shares. Securities available for sale decreased in market value, representing a decrease to equity of $151,000, net of taxes.

Recently, the FDIC Board has adopted a restoration plan that raised assessment rates for deposit insurance premiums for 2009, and has also proposed a special emergency assessment; these developments are expected to significantly affect operating results for the Corporation.

Management is not aware of any other current recommendations of applicable regulatory authorities that, if implemented, would have a material effect on the Corporation's liquidity, capital resources, or operations.

Subsequent to March 31, 2009, the following events took place:

On April 21, 2009, the Board of Directors declared a regular cash dividend for the second quarter of 2009 of $0.19 per share to shareholders of record on May 15, 2009, payable on June 1, 2009.

Comparison of the Three Months Ended March 31, 2009 and 2008

Operations Overview:

Net income for the first quarter of 2009 was $1,410,000, an increase of $8,000, or 0.6%, compared to the first quarter of 2008. Basic and diluted earnings per share were $.32 in each of the quarters ended March 31, 2009 and 2008. Annualized return on average equity for the first quarter in 2009 was 11.59%, compared to the prior year's ratio for the same period of 11.60%. For the quarter ended March 31, annualized return on average assets was 1.32% in 2009, versus 1.34% in 2008, reflecting a decrease of 1.5%. The increase in net income was primarily a result of higher net interest income and non-interest income, partially offset by an increase in the loan loss provision and non-interest expense.

Presented below are selected key ratios for the two periods:

	Three Months Ended March 31	
	2009	2008
Return on average assets (annualized)	1.32%	1.34%
Return on average equity (annualized)	11.59%	11.60%
Average equity to average assets	11.42%	11.52%
Non-interest income, excluding securities gains, as a percentage of average assets (annualized)	1.16%	1.07%
Non-interest expense as a percentage of average assets (annualized)	3.00%	2.90%

The discussion that follows further explains changes in the components of net income when comparing the first quarter of 2009 with the first quarter of 2008.

Net Interest Income:

Net interest income was $4,017,000 for the first quarter of 2009, as compared to $3,882,000 in the same quarter in 2008. Average earning assets grew by 1.5%, while the net interest margin on a fully tax equivalent basis increased by 10 basis points.

Interest on loans decreased $237,000, or 4.3%, in the first quarter of 2009 as compared to the same period in 2008. The average weighted interest rate decrease of 58 basis points lowered interest income by approximately $438,000, while an increase in average balances outstanding added approximately $201,000 in interest income.

Interest earned on investment securities and money market investments decreased $190,000 in the first quarter of 2009 as compared to 2008, with average balances decreasing $7.0 million during the period. The yield on money market investments (federal funds and interest bearing deposits) decreased by 116 basis points in the first quarter of 2009 as

compared to the first quarter of 2008, due to the reduction in the federal funds target rate from 2.25% in the first quarter of 2008 to 0.25% as of March 31, 2009. Likewise, the overall pre-tax yield on the investment securities portfolio decreased during that same timeframe by 61 basis points.

Average interest-bearing deposits and securities sold under agreements to repurchase declined by $3,516,000, while average non-interest bearing deposits grew by $4,343,000. This change in the mix of deposits, in addition to the lower general rate environment, contributed to the reduction in the cost to fund earning assets, which was reduced by 61 basis points, to 2.01%, in the first quarter of 2009.

Total average earning assets during the first quarter of 2009 were $387,048,000, compared to $381,477,000 during the first quarter of 2008, yielding 6.18% in 2009 versus 6.69% in 2008. Funding costs for the earning assets were 2.01% and 2.62%, for the first quarters of 2009 and 2008, respectively. Net interest margin on a fully tax-equivalent basis for the first quarter of 2009 was 4.35%. For the same period in 2008, the fully-tax equivalent net interest margin was 4.25%.

Provision for Loan Losses:

In the first quarter of 2009, the provision for loan losses was $135,000. Management regularly reviews the adequacy of the loan loss reserve and makes assessments as to specific loan impairment, historical charge-off expectations, general economic conditions in the Bank's market area, specific loan quality and other factors. In the first quarter of 2008, the recorded loan loss provision was $32,000.

Non-interest Income:

Non-interest income in the first quarter of 2009, exclusive of gains recorded on securities, exceeded non-interest income in the previous year's first quarter by $123,000, or 11.0%. Included in non-interest income in the first quarter of 2009 was an adjustment of $323,000, representing previously unrecorded fees earned in prior periods from the sales of insurance policies on loans. The adjustment was deemed by management to be immaterial to the consolidated financial statements in and all prior periods and therefore required no prior period restatement of earnings. Trust fees earned in the first quarter of 2009 were $39,000 lower than those earned in the first quarter of 2008. Fees for customer service on deposit accounts in the first quarter of 2009 decreased compared to the same period in 2008 by $20,000, or 5.1%, due to reduced activity in the overdraft protection product. At $108,000, commissions from the sale of non-deposit products were 51% of the $211,000 in commissions earned in 2008. Income from bank owned life insurance and annuities decreased in the first quarter of 2009 compared to the first quarter of 2008 by $18,000, or 14.5%, as a result of lower earning rates. Income from our unconsolidated subsidiary was $48,000, representing earnings recorded under the equity method of accounting for the ownership of 39.16% of the First National Bank of Liverpool during the first quarter of 2009, a 14.3% increase over the previous year's first quarter. Other non-interest income decreased by $38,000 in the first quarter of 2009 compared to the same period in 2008. In 2008, the Corporation received funds from VISA for the partial redemption of Class B shares that were created as a result of VISA's IPO. The redemption amount was $38,000 and was recorded as other non-interest income.

The Corporation recognized no gains on securities transactions in the first quarter of 2009 as compared to a gain of $13,000 in the same quarter of 2008.

As a percentage of average assets, annualized non-interest income, exclusive of net gains on the sale of securities, was 1.16% in the first quarter of 2009 as compared to 1.07% in the same period of 2008. Excluding the $323,000 adjustment noted above, the 2009 ratio would have been 0.86%.

Non-interest Expense:

Total non-interest expense increased $150,000, or 4.9%, in the first quarter of 2009 as compared to 2008. Employee compensation and benefits costs increased by $38,000, or 2.2%, in the first quarter of 2009 compared to the first quarter of 2008. Professional fees in the first quarter of 2009 were $37,000, or 44.0% higher than in the first quarter of 2008, due to higher consulting fees. The cost of FDIC insurance rose by $78,000 in the first quarter of 2009 when compared to the first quarter of 2008.

As a percentage of average assets, annualized noninterest expense was 3.00% in the first quarter of 2009 as compared to 2.90% in the same period of 2008.

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Liquidity:

The objective of liquidity management is to ensure that sufficient funding is available, at a reasonable cost, to meet the ongoing operational cash needs of the Corporation and to take advantage of income producing opportunities as they arise. While the desired level of liquidity will vary depending upon a variety of factors, it is the primary goal of the Corporation to maintain a high level of liquidity in all economic environments. Principal sources of asset liquidity are provided by securities maturing in one year or less, other short-term investments such as federal funds sold and cash and due from banks. Liability liquidity, which is more difficult to measure, can be met by attracting deposits and maintaining the core deposit base. The Corporation is a member of the Federal Home Loan Bank of Pittsburgh for the purpose of providing short-term liquidity when other sources are unable to fill these needs. During the first three months of 2009, the average balance of short-term borrowings from the Federal Home Loan Bank was $370,000, with none outstanding on March 31, 2009. As of March 31, 2009, the Corporation had long-term debt of $5,000,000 and had unused borrowing capacity with the Federal Home Loan Bank of $184 million.

Funding derived from securities sold under agreements to repurchase is available through corporate cash management accounts for business customers. This product gives the Corporation the ability to pay interest on corporate checking accounts.

In view of the sources previously mentioned, management believes that the Corporation's liquidity is capable of providing the funds needed to meet loan demand.

Off-Balance Sheet Arrangements:

The Corporation’s consolidated financial statements do not reflect various off-balance sheet arrangements that are made in the normal course of business, which may involve some liquidity risk, credit risk, and interest rate risk. These commitments consist mainly of loans approved but not yet funded, unused lines of credit and letters of credit issued using the same credit standards as on-balance sheet instruments. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Letters of credit are conditional commitments issued to guarantee the financial performance obligation of a customer to a third party. Unused commitments and letters of credit at March 31, 2009, were $47,027,000 and $624,000, respectively. Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Corporation. Management believes that any amounts actually drawn upon can be funded in the normal course of operations. The Corporation has no investment in or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity or the availability of capital resources.

Interest Rate Sensitivity:

Interest rate sensitivity management is the responsibility of the Asset/Liability Management Committee. This process involves the development and implementation of strategies to maximize net interest margin, while minimizing the earnings risk associated with changing interest rates. Traditional gap analysis identifies the maturity and re-pricing terms of all assets and liabilities. A simulation analysis is used to assess earnings and capital at risk from movements in interest rates. See Item 3 for a description of the complete simulation process and results.

Capital Adequacy:

Bank regulatory authorities in the United States issue risk-based capital standards. These capital standards relate a banking company’s capital to the risk profile of its assets and provide the basis by which all banking companies and banks are evaluated in terms of capital adequacy. The risk-based capital standards require all banks to have Tier 1 capital of at least 4% and total capital, including Tier 1 capital, of at least 8% of risk-adjusted assets. Tier 1 capital

includes common stockholders' equity and qualifying perpetual preferred stock together with related surpluses and retained earnings. Total capital is comprised of Tier 1 capital, limited life preferred stock, qualifying debt instruments, and the reserves for possible loan losses. Banking regulators have also issued leverage ratio requirements. The leverage ratio requirement is measured as the ratio of Tier 1 capital to adjusted average assets. At March 31, 2009, the Bank exceeded the regulatory requirements to be considered a "well capitalized" financial institution, i.e., a leverage ratio exceeding 5%, Tier 1 capital exceeding 6% and total capital exceeding 10%.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the exposure to economic loss that arises from changes in the values of certain financial instruments. The types of market risk exposures generally faced by financial institutions include equity market price risk, interest rate risk, foreign currency risk and commodity price risk. Due to the nature of its operations, only equity market price risk and interest rate risk are significant to the Corporation.

Equity market price risk is the risk that changes in the values of equity investments could have a material impact on the financial position or results of operations of the Corporation. The Corporation's equity investments consist of common stocks of publicly traded financial institutions.

Recent declines and volatility in the values of financial institution stocks have significantly reduced the likelihood of realizing significant gains in the near-term. Although the Corporation has realized occasional gains from this portfolio in the past, the primary objective of the portfolio is to achieve value appreciation in the long term while earning consistent attractive after-tax yields from dividends. The carrying value of the financial institutions stocks accounted for less than 0.2% of the Corporation's total assets as of March 31, 2009. Management performs an impairment analysis on the entire investment portfolio, including the financial institutions stocks on a quarterly basis. As of March 31, 2009, there was no impairment that was deemed to be "other-than-temporary". There is no assurance that further declines in market values of the common stock portfolio in the future will not result in "other-than-temporary" impairment charges, depending upon facts and circumstances present.

The equity investments in the Corporation's portfolio had an adjusted cost basis of approximately $1,210,000 and a fair value of $654,000 at March 31, 2009. Net unrealized losses in this portfolio were approximately $556,000 at March 31, 2009.

In addition to its equity portfolio, the Corporation's investment management and trust services revenue could be impacted by fluctuations in the securities markets. A portion of the Corporation's trust revenue is based on the value of the underlying investment portfolios. If securities values decline, the Corporation's trust revenue could be negatively impacted.

Interest rate risk creates exposure in two primary areas. First, changes in rates have an impact on the Corporation's liquidity position and could affect its ability to meet obligations and continue to grow. Second, movements in interest rates can create fluctuations in the Corporation's net interest income and changes in the economic value of equity.

The primary objective of the Corporation's asset-liability management process is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Management recognizes that a certain amount of interest rate risk is inherent, appropriate and necessary to ensure profitability. A simulation analysis is used to assess earnings and capital at risk from movements in interest rates. The model considers three major factors of (1) volume differences, (2) repricing differences, and (3) timing in its income simulation. As of the most recent model run, data was disseminated into appropriate repricing buckets, based upon the static position at that time. The interest-earning assets and interest-bearing liabilities were assigned a multiplier to simulate how much that particular balance sheet item would re-price when interest rates change. Finally, the estimated timing effect of rate changes is applied, and the net interest income effect is determined on a static basis (as if no other factors were present). As the table below indicates, based upon rate shock simulations on a static basis, the Corporation's balance sheet is slightly asset sensitive. Over a one-year period, the effect of a 100, 200 and 300 basis point rate increase would decrease net interest income by $83,000, $167,000 and $250,000, respectively. No rate shock modeling was done for a declining rate environment, as the federal funds target rate currently is between zero and 0.25%. The modeling process is continued by further estimating the impact that imbedded options and probable internal strategies may have in the changing-rate environment. Examples of imbedded options are floor and ceiling features in adjustable rate mortgages and call features on securities in the investment portfolio. Applying the likely

results of all known imbedded options and likely internal pricing strategies to the simulation produces quite different results from the static position assumptions. Over a one-year period, the effect a 100, 200 and 300 basis point rate increase would add about $27,000, $115,000 and $237,000, respectively, to net interest income. As the table below indicates, the net effect of interest rate risk on net interest income is minimal in a rising rate environment. Juniata's rate risk policies provide for maximum limits on net interest income that can be at risk for 100 through 300 basis point changes in interest rates.

Effect of Interest Rate Risk on Net Interest Income
(Dollars in thousands)

Change in Interest Rates (Basis Points)	Change in Net Interest Income Due to Interest Rate Risk (Static)	Change in Net Interest Income Due to Imbedded Options	Total Change in Net Interest Income
300	$ (250)	$ 237	$ (13)
200	(167)	115	(52)
100	(83)	27	(56)
0	-	-	-

The net interest income at risk position remained within the guidelines established by the Corporation's asset/liability policy.

No material change has been noted in the Bank's equity value at risk. Please refer to the Annual Report on Form 10-K as of December 31, 2008 for further discussion of this matter.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As of March 31, 2009, the Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to the Securities Exchange Act of 1934 ("Exchange Act"), Rule 13a-15(e). Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Corporation reports filed or submitted 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. These controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential conditions, regardless of how remote.

Attached as Exhibits 31 and 32 to this quarterly report are certifications of the Chief Executive Officer and the Chief Financial Officer required in accordance with Rule 13a-14(a) of the Exchange Act. This portion of the Corporation's quarterly report includes the information concerning the controls evaluation referred to in the certifications and should be read in conjunction with the certifications for a more complete understanding of the topics presented.

Changes in Internal Control Over Financial Reporting

There were no significant changes in the Corporation’s internal control over financial reporting since December 31, 2008.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

In the opinion of management of the Corporation, there are no legal proceedings pending to which the Corporation or its subsidiary is a party or to which their property is subject, which, if determined adversely to the Corporation or its subsidiary, would be material in relation to the Corporation's or its subsidiary's financial condition. There are no proceedings pending other than ordinary routine litigation incident to the business of the Corporation or its subsidiary. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation or its subsidiary by government authorities.

Item 1A. RISK FACTORS

There have been no material changes in risk factors that were disclosed in the Annual Report on Form 10-K as of December 31, 2008.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information on repurchases by the Corporation of its common stock in each month of the quarter ended March 31, 2009:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
January 1-31, 2009	-	$ -	-	218,536
February 1-28, 2009			-	218,536
March 1-31, 2009	7,600	16.90	7,600	210,936
Totals	7,600		7,600	210,936

(1) On March 23, 2001, the Corporation announced plans to buy back 100,000 (200,000 on a post-split basis) shares of its common stock. There is no expiration date to this buyback plan, but subsequent to the initial plan, the Board of Directors authorized the repurchase of 400,000 additional shares in 2005 and then authorized 200,000 additional shares in September of 2008. As of May 5, 2009, the number of shares that may yet be purchased under the program was 210,936. No repurchase plan or program expired during the period covered by the table. The Corporation has no stock repurchase plan or program that it has determined to terminate prior to expiration or under which it does not intend to make further purchases.

Item 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

Item 5. OTHER INFORMATION

None

Item 6. EXHIBITS

3.1 - Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 4.1 to the Company's Form S-3 Registration Statement No. 333-129023 filed with the SEC on October 14, 2005)

3.2 – Bylaws (incorporated by reference to Exhibit 3.2 to the Company's report on Form 8-K filed with the SEC on December 21, 2007)

31.1 - Rule 13a – 14(a)/15d – 14(a) Certification of President and Chief Executive Officer

31.2 - Rule 13a – 14(a)/15d – 14(a) Certification of Chief Financial Officer

32.1 - Section 1350 Certification of President and Chief Executive Officer (furnished, not filed)

32.2 - Section 1350 Certification of Chief Financial Officer (furnished, not filed)

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

Juniata Valley Financial Corp.
(Registrant)

Date 05-08-2009 By /s/ Francis J.Evanitsky
Francis J. Evanitsky, President and Chief Executive Officer

Date 05-08-2009 By /s/ JoAnn N. McMinn
JoAnn N. McMinn, Chief Financial Officer

>469 $19 $19,873

Sublease contracted income

(2,795) (746) (716) (122) (4,379)

Current sublease forecasts[a]

(500) (563) (96) (1,159) 2,749 4,576 4,735 1,787 469 19 14,335

Convertible promissory notes, including interest[b, c]

7,927 24,952 7,927 228,803 271,265

Term Loan[d]

1,321 1,402 26,625 29,348

Total forecasted contractual obligations

$11,997 $30,930 $39,287 $230,590 $469 $19 $314,948

(a) The current market reflects lower demand and cost for space, as well as shorter term leases.

(b) Upon the closing of the convertible debt exchange in May 2007, we exchanged approximately $9.0 million of GeneSoft promissory notes plus accrued interest of approximately $1.6 million for approximately $13.7 million of 3.5% senior convertible promissory notes due in April 2011. Approximately $13.3 million plus accrued interest of the original GeneSoft promissory notes remain outstanding as of June 30, 2008 and are due February 9, 2009

(c) In the quarter ended June 30, 2007, we issued $60 million in principal amount of 3.5% senior convertible promissory notes due in April 2011 and also refinanced approximately $151.9 in principal amount of 3 1/ 2% senior convertible promissory notes due in April 2011. These notes are convertible into shares of our common stock at the option of the holders at a conversion price of $13.50 per share. In connection with the issuance, we recorded deferred financing costs of approximately $6.1 million which is being amortized to interest expense on a straight-line basis over the period the notes are outstanding.

(d) Pursuant to the financing of our acquisition of ANTARA, our wholly owned subsidiary, Guardian II Acquisition Corporation, entered into a Note Purchase Agreement with Paul Capital pursuant to which Guardian II issued and sold a $20.0 million aggregate principal amount of 12% senior secured note due on the fourth anniversary of the closing date, subject to Guardian II s option to extend the maturity to the sixth anniversary of the closing date. Interest is payable semi-annually in arrears on the last day of each of March and September. Guardian II has the option to pay interest in cash or to have 50% of the interest paid in cash and 50% of the interest added to principal.

(e) The above contractual obligation table excludes amounts payable to Paul Capital in relation to the Revenue Interests Agreement.

In addition to the amounts reflected in the table above, in the future, we may owe royalties and other contingent payments to our collaborators and licensors, based on the achievement of product sales and specified other objectives and milestones, including a minimum annual product purchase commitment to Ethypharm pursuant to the ANTARA license agreement.

For the six-month period ended June 30, 2008, there were no material changes to our contractual obligations outside the ordinary course of business.

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BUSINESS

We are a commercial-stage pharmaceutical company marketing Food and Drug Administration (FDA)-approved products in the United States. Our strategy is to grow the sales of our existing products and to gain access to new products via transactions, including acquisition, in-licensing and co-promotion. We have developed a commercial infrastructure, including a national sales force calling on targeted primary care physicians, cardiologists, endocrinologists and pulmonologists in the United States.

We currently market two products: ANTARA® (fenofibrate) capsules, a cardiovascular product, and FACTIVE® (gemifloxacin mesylate) tablets, a fluoroquinolone antibiotic. ANTARA is approved by the FDA to treat hypercholesterolemia (high blood cholesterol) and hypertriglyceridemia (high triglycerides) in combination with a healthy diet. We license the rights to ANTARA from Ethypharm S.A. of France (Ethypharm) and began promoting ANTARA in late August 2006. In 2007, ANTARA generated approximately $59 million in net revenues. FACTIVE is indicated for the treatment of community-acquired pneumonia (CAP) of mild to moderate severity and acute bacterial exacerbations of chronic bronchitis, or AECB. We license the rights to gemifloxacin, the active ingredient in FACTIVE tablets, from LG Life Sciences of the Republic of Korea (LG Life Sciences) and launched FACTIVE in the U.S. market in September 2004. In fiscal 2007, FACTIVE generated approximately $21 million in net revenues.

Additionally, we have a novel, late-stage antibiotic candidate, Ramoplanin for the treatment of *Clostridium difficile*-associated disease (CDAD). We have made the strategic decision to concentrate our financial resources on building our revenues for products promoted to community-based physicians in the United States and are currently seeking to out-license, co-develop or sell the rights to Ramoplanin to a partner.

Our business growth strategy is to increase the sales of our existing products and to gain access to new primary care products via transactions, including acquisition, in-licensing and co-promotion for the U.S. marketplace in order to leverage our existing sales force and commercial infrastructure. Our review of potential additions to our portfolio of marketed products is focused on those products which are commonly prescribed by those primary care physicians that we currently visit during the marketing of ANTARA and FACTIVE. As we currently direct our sales effort largely at those primary care physicians that treat older patients with co-morbities, a range of therapeutic categories can be considered for our portfolio, including cardiovascular, diabetes, metabolic, anti-infectives among others.

We are currently pursuing privately raising additional capital from investors through equity financing, the incurrence of indebtedness, or a combination of equity and debt. We plan to use the additional capital to repay approximately $17 million of indebtedness which comes due in February 2009, for operating cash and to execute our business strategy.

ANTARA

The Fenofibrate and Cholesterol-Treatment Markets

Nearly 37 million Americans have total cholesterol values above recommended levels and heart disease remains the number one cause of death in the U.S. Abnormal cholesterol and lipid levels, known as dyslipidemia, can lead to the development of atherosclerosis, a dangerous hardening of blood vessels and a primary cause of coronary heart disease. Managing cholesterol levels is a complex undertaking and several therapeutic options are available to treat different types of abnormalities. Statins are the standard of care for lowering high levels of LDL-C (low density lipoprotein cholesterol). Fenofibrate products have demonstrated their utility in managing atherogenic dyslipidemia or mixed dyslipidemia (also known as lipid abnormalities) which are characterized by high triglycerides, low HDL-C (high density lipoprotein cholesterol), high levels of remnant-like particle cholesterol and a high proportion of cholesterol carried by small, dense LDL particles. Other drugs commonly used to treat lipid abnormalities include niacin and omega-3 fatty acids.

In 2007, total U.S. sales of fenofibrate products were approximately $1.7 billion, a 12% increase over 2006 sales. The fenofibrate market has experienced a 25% average annual growth in sales since 2003.

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ANTARA s sales accounted for approximately 5% of the U.S. fenofibrate sales for the three-month period ending June 30, 2008.

Indications and Efficacy

ANTARA is a once-daily formulation of fenofibrate approved for use in combination with a diet restricted in saturated fat and cholesterol to reduce elevated LDL-C (bad cholesterol), triglyceride and apolipoprotein B (free floating fats in the blood) levels and to increase HDL-C (good cholesterol) in adult patients with high cholesterol or an abnormal concentration of lipids in the blood. Fenofibrate products work primarily to lower triglycerides and increase HDL-C. ANTARA received FDA approval in November 2004 and is approved and marketed in 43 mg and 130 mg doses. The predominantly prescribed dose is 130 mg while the 43 mg dose is generally used for titration and in patients with impaired renal function. ANTARA was approved based in part on demonstrating its bioequivalence to Abbott Laboratories fenofibrate product TriCor®, meaning that, under FDA guidelines, the bioequivalence of the two products does not differ significantly when the two products are given under similar conditions. ANTARA was also studied in the Triglyceride Reduction in Metabolic Syndrome study, known as TRIMS, to measure the impact of ANTARA on cholesterol levels in patients with multiple cardiovascular risk factors and to assess the use of ANTARA without regard to meals.

In the treatment of hypercholesterolemia, ANTARA is approved as adjunctive therapy to diet to reduce elevated LDL-C, total cholesterol (total-C), triglycerides and apolipoprotein B (apo B) and to increase HDL-C in adult patients with primary hypercholesterolemia or mixed dyslipidemia. The effects of fenofibrate at a dose equivalent to 130 mg ANTARA per day were assessed in four randomized, placebo-controlled, double-blind, parallel-group studies. Fenofibrate therapy lowered LDL-C, total-C, and the LDL-C/HDL-C ratio. In these studies, fenofibrate therapy also lowered triglycerides, raised HDL-C and significantly reduced apo B as compared with placebo.

ANTARA is also indicated as an adjunctive therapy to diet for the treatment of hypertriglyceridemia, which affects an estimated 10% of American men over the age of 30 and 10% of American women over the age of 55. In clinical studies, the effects of fenofibrate on serum triglycerides were studied in two randomized, double-blind, placebo-controlled clinical trials of 147 hypertriglyceridemic patients for eight weeks. In patients with hypertriglyceridemia, treatment with fenofibrate at dosages equivalent to 130 mg ANTARA per day effectively decreased very low density lipoprotein (VLDL) triglycerides and VLDL cholesterol.

Mechanism of Action: ANTARA increases lipolysis and elimination of triglyceride-rich particles from plasma by activating lipoprotein lipase and reducing production of apoprotein C-III (an inhibitor of lipoprotein lipase activity). The resulting decrease in triglycerides produces an alteration in the size and composition of LDL from small, dense particles (which are thought to be atherogenic due to their susceptibility to oxidation), to large, buoyant particles. These larger particles have a greater affinity for cholesterol receptors and are catabolized rapidly. ANTARA also activates PPAR-alpha, which induces an increase in the synthesis of apoproteins A-I, A-II and HDL-cholesterol.

Competitive Advantages: The TRIMS study produced exclusive clinical data for ANTARA. In the study, ANTARA was evaluated in patients with elevated triglyceride levels and multiple cardiovascular risk factors. Of the 146 patients studied, 70% had hypertension and 32% had diabetes. The double-blind, placebo-controlled trial measured levels of total cholesterol, triglycerides, HDLs and LDLs, as well as other types of cholesterol, during eight weeks of therapy. In the study, ANTARA demonstrated the ability to reduce triglyceride and increase HDL-C levels after two weeks of therapy. At the end of therapy, patients treated with ANTARA had a statistically significant 37% reduction in their triglyceride levels and a statistically significant 14% increase in their HDL levels. ANTARA is distributed in 130 mg and 43 mg capsule formulations, as compared to the 145 mg and 48 mg tablet formulations of TriCor, which is marketed by Abbott Laboratories.

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License Agreement

On August 18, 2006, we acquired rights to ANTARA in the United States from Reliant Pharmaceuticals Inc. (Reliant) for $78.0 million plus approximately $4.3 million for ANTARA inventory, excluding estimated transaction costs. Under the terms of our acquisition of ANTARA, we assumed certain of Reliant s liabilities related to ANTARA, including obligations to make certain royalty and milestone payments on sales of ANTARA. Under the terms of one of the licenses we assumed related to ANTARA, we are obligated to make certain royalty payments on sales of ANTARA, which royalty payments are subject to a low single digit increase in the event of a change in control of the Company. The license also limits our ability to co-promote ANTARA with companies other than contract sales organizations or similar companies. Under the terms of our acquisition of ANTARA we were also assigned rights to an exclusive license from Ethypharm S.A. (Ethypharm). Pursuant to the Ethypharm license, in order to maintain the exclusivity of our rights, we must achieve minimum annual sales in the United States until February 2012 or alternatively Ethypharm may elect to convert our exclusive license to a non-exclusive; however we would then have the option to compensate Ethypharm for any shortfall to maintain the exclusive license. As of June 30, 2008, we have recorded approximately $605,000 related to the potential minimum royalty obligation to Ethypharm. During the term of the agreement with Ethypharm, we are obligated to pay a royalty on net sales of ANTARA in the U.S., including a royalty on other fenofibrate monotherapy products in formulations and dosage forms that may be substantially similar or identical to ANTARA developed by us. The license term expires in February 2020 and, absent notice of termination by either party, automatically renews for consecutive periods of two (2) years each. Under the terms of the agreement, at our option, Ethypharm is obligated to either manufacture and deliver to us finished fenofibrate product or deliver active pharmaceutical ingredient (API) to us for encapsulation and packaging. Ethypharm also has a right of first refusal on any divestiture of the ANTARA rights by us. Additional Oscient obligations under the Ethypharm agreement include funding a portion of the active pharmaceutical ingredient safety stock that Ethypharm is required to maintain.

Pursuant to the terms of our acquisition of ANTARA from Reliant, we also acquired the New Drug Application, or NDA and the Investigational New Drug application, or IND, covering the ANTARA products in the United States, clinical data, inventory, the ANTARA® trademark in the United States and certain related contracts and licenses covering intellectual property rights related to the ANTARA products. We also assumed certain of Reliant s liabilities relating to the ANTARA products.

We are not required to pay Reliant a royalty on the sale of the ANTARA products; however, we are required to pay a low single-digit royalty to Reliant for a specified time period on net sales of any line extensions and improvements to the ANTARA products that we develop, which include any product containing fenofibrate as the API. We currently do not pay royalties to Reliant. We also agreed that we would not, at any time prior to August 2016, develop or sell any product in the United States that is a combination of fenofibrate and an omega-3 compound without the prior written consent of Reliant. On December 19, 2007, Reliant was acquired by GlaxoSmithKline.

FACTIVE

Infectious Diseases Market

Infectious diseases represent the second leading cause of death worldwide accounting for over 14 million deaths each year, with lower respiratory tract infections alone causing 3.9 million deaths annually. Bacterial infections are the ninth leading cause of death in the U.S. Sales of antibiotics in the U.S. totaled $14 billion in 2007. Within the antibiotic market, fluoroquinolones, a product class with close to $3.9 billion in annual sales in the U.S. in 2007, have been gaining market share at the expense of older classes of antibiotics, according to Wolters Kluwer, a leading provider of pharmaceutical market data. This is a trend that is expected to continue as resistance to older antibiotic classes increases.

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The principal classes of antibiotics include beta-lactams, fluoroquinolones, macrolides, tetracyclines, aminoglycosides, glycopeptides and trimethoprim combinations. Bacterial resistance to existing antibiotics has increased in recent years, leading to bacterial infection recurrences, treatment failures and higher costs. These factors have fueled a growing need for more effective products in existing antibiotic classes, as well as for products with new mechanisms of action.

Acute Bacterial Exacerbations of Chronic Bronchitis: Chronic bronchitis is a health problem associated with significant morbidity and mortality. It is estimated that chronic bronchitis affects approximately 9 million adults in the United States. Patients with chronic bronchitis are prone to frequent exacerbations, characterized by increased cough and other symptoms of respiratory distress. Longitudinal studies have estimated that 1 to 4 exacerbations occur each year in patients with chronic bronchitis; studies estimate that two-thirds are caused by bacteria. Exacerbations are estimated to account for approximately 12 million physician visits per year in the U.S. Antibiotic therapy, the standard treatment for acute bacterial exacerbations of chronic bronchitis, or AECB, is typically effective in reducing the course of illness for patients. Fluoroquinolones are frequently used to treat AECB due to their activity versus *Haemophilus influenzae* and *Moraxella catarrhalis,* two of the most common causes of these infections. Newer fluoroquinolones have enhanced activity versus *Streptococcus pneumoniae,* or *S. pneumoniae,* another common cause of these infections.

Community-Acquired Pneumonia: Community-acquired pneumonia, or CAP, is a common and serious illness in the United States. Of the estimated 4 to 5 million cases per year of CAP, nearly 1 million cases occur in patients over the age of 65. CAP cases result in approximately 10 million physician visits and as many as 1 million hospitalizations annually. Antibiotics are the mainstay of treatment for most patients with pneumonia, and where possible, antibiotic treatment should be specific to the pathogen responsible for the infection on a case by case basis. However, since the responsible pathogen is not identified in a high proportion of patients with CAP, physicians usually take an empiric approach to treatment in the first instance. Over the last decade, resistance to penicillins and macrolides has increased significantly, and in many cases, fluoroquinolones are now recommended as a first line of therapy due to their efficacy against a wide range of respiratory pathogens, including many antibiotic resistant strains. The most recent treatment guidelines from the Infectious Diseases Society of America and the American Thoracic Society recommend fluoroquinolones as a first-line treatment for certain higher-risk patients with CAP and as therapy for treating patients with pneumonia in geographic regions of the U.S. with high levels of macrolide-resistant *S. pneumoniae*.

Indications and Efficacy

FACTIVE is a member of the fluoroquinolone class of antibiotics. In April 2003, FACTIVE was approved by the FDA for the five-day treatment of AECB and seven-day treatment of CAP of mild to moderate severity. In July 2003, FACTIVE was also approved by the FDA to treat CAP caused by multi-drug resistant *S. pneumoniae*, a growing clinical concern. Multi-drug resistant *S. pneumoniae*, or MDRSP, is defined as *S. pneumoniae* resistant to two or more of the following antibiotics: penicillin, second-generation cephalosporins (such as cefuroxime), macrolides, tetracyclines, and trimethoprim/sulfamethoxazole. In May 2007, FACTIVE was approved by the FDA for the five-day treatment of CAP.

FACTIVE has potent *in vitro* activity against a wide range of Gram-positive, Gram-negative and atypical pathogens, including key respiratory pathogens, such as *S. pneumoniae, H. influenzae* and *M. catarrhalis.* FACTIVE is bactericidal at clinically achievable concentrations. Gemifloxacin, the active ingredient in FACTIVE, has minimum inhibitory concentrations, or MICs, as low as 0.032 µg/ml for *S. pneumoniae*. In clinical trials, FACTIVE has been administered to approximately 8,000 patients and had a good overall safety and tolerability profile. FACTIVE has been the subject of over 200 scientific publications and has been mentioned in nearly 300 scientific articles. Among the research published are data from a study involving 438 subjects indicating that a statistically significant higher percentage of patients treated with FACTIVE (71%) remained free of AECB recurrences than those treated with a comparator agent (58.5%) over a six-month period following treatment.

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Mechanism of Action: FACTIVE tablets act by inhibiting bacterial DNA synthesis through the inhibition of both DNA gyrase and topoisomerase IV, two enzymes essential for bacterial growth and survival. Strains of *S. pneumoniae* showing mutations in both DNA gyrase and topoisomerase IV (double mutants) are resistant to most fluoroquinolones. Since gemifloxacin has the ability to inhibit both target enzymes at therapeutically relevant drug levels, some of these *S. pneumoniae* double mutants remain susceptible to FACTIVE. FACTIVE is also active against many strains of *S. pneumoniae* that are resistant to other classes of antibiotics.

Clinical Efficacy: The clinical development program for FACTIVE included 19 Phase III trials in respiratory tract infections. FACTIVE was studied for the treatment of acute bacterial exacerbations of chronic bronchitis in three pivotal, non-inferiority, double-blind, randomized, active-controlled clinical trials using 320 mg once daily for five-days. In these principal Phase III AECB studies, FACTIVE given once daily for five-days was at least as effective as the comparators given for seven-days, with clinical response rates in the FACTIVE arms ranging from 85.4% to 93.6%. FACTIVE was also studied for the treatment of CAP in three double-blind, randomized, active-controlled clinical studies, one open, active-controlled study, and two uncontrolled studies. The results of these studies showed that gemifloxacin was effective in the treatment of mild to moderate CAP.

Safety and Tolerability: FACTIVE tablets have been studied in approximately 8,000 patients in clinical trials and we estimate that to date, approximately 920,000 prescriptions have been dispensed for FACTIVE since its launch in September 2004. In clinical trials, the incidence of adverse events reported for FACTIVE tablets was low and comparable to comparator drugs, namely beta-lactam antibiotics, macrolides and other fluoroquinolones. Most adverse events were described as mild to moderate. The most common adverse events reported in FACTIVE clinical trials were diarrhea, rash and nausea. In clinical trials across all durations of therapy, rash was reported in 2.8% of patients receiving gemifloxacin and was more commonly observed in patients with treatment durations greater than seven-days and patients less than 40 years of age, particularly females. In clinical trials conducted in 3,696 patients treated with five-days of FACTIVE therapy, the rate of rash reported was 1.1% vs. 0.7% for comparator antibiotics. Since the launch of the drug, the post-marketing adverse events reported have been consistent with those observed in the clinical development program, and with the fluoroquinolone class as a whole.

Competitive Advantages: We believe the competitive advantages of FACTIVE tablets include:

- FACTIVE has been shown in *in vitro* studies to be active against many bacterial isolates resistant to other classes of antibiotics.
- FACTIVE is the most active fluoroquinolone against *S. pneumoniae*, one of the most prevalent pathogens found in lower respiratory tract infections, compared to the currently marketed fluoroquinolones (MIC_{90} 0.032 μg/mL).
- FACTIVE has a dual mechanism of action in bacteria, targeting two enzymes essential for bacterial growth and survival at therapeutically relevant drug levels, and as a result we believe FACTIVE has low potential for generating bacterial resistance.
- FACTIVE can be dosed once daily, with short courses of therapy (five-days) for both AECB and CAP.
- FACTIVE is effective in the treatment of CAP due to penicillin-resistant *S. pneumoniae* and due to MDRSP. In clinical trials, of 22 patients with MDRSP treated with FACTIVE for seven-days, 19 (87%) achieved both clinical and bacteriological success at follow-up.
- FACTIVE achieves high concentration levels in lung and bronchial tissues and in secretions.
- FACTIVE has composition of matter patent protection which extends into 2018, longer than the composition of matter patent protection for any currently marketed fluoroquinolone or other antibiotic widely used to treat respiratory tract infections.

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Post-Marketing Commitments: As a post-marketing commitment to the FDA, we completed a Phase IV trial of FACTIVE. This prospective, randomized study examined the activity of FACTIVE tablets (5,000 patients) versus an active comparator (2,500 patients) in treating patients with mild to moderate CAP or AECB. The study included patients of different ethnicities so that safety information in populations not substantially represented in the existing clinical trial program could be collected, specifically as it relates to rash. This Phase IV trial was initiated in the fall of 2004 and was completed in February 2007. The final report of the utilization study was submitted to the FDA in March of 2008. In the future, we need only to provide the FDA with annual reports containing safety information.

Recent developments: On July 7, 2008, we received notice from the FDA directing that the prescribing information for all fluoroquinolone products, including FACTIVE, be revised to include a Boxed Warning relating to the risk of tendonitis and tendon rupture associated with the use of fluoroquinolone products. Currently, warnings regarding the risk of tendon related adverse events are included in the prescribing information, as part of a class labeling, for all fluoroquinolones. The FDA has cautioned that such risk is increased in patients over the age of 60 and in those on concomitant corticosteroid therapy, as well as kidney, heart and lung transplant recipients. The FDA has also informed us that, along with the other sponsors of all marketed oral fluoroquinolone products, we should submit a proposed Medication Guide along with a proposed REMS to ensure patients safe and effective use of FACTIVE. We continue to work closely with the FDA to implement appropriate label changes that may be required to ensure patient safety and improve physician understanding of the risk-benefit profile for fluoroquinolone products, including FACTIVE.

Additional Development of FACTIVE

Five-Day Treatment of CAP: We completed a clinical trial to demonstrate that a five-day course of FACTIVE for the treatment of mild to moderate CAP is as effective as the previously approved seven-day course of treatment. On September 21, 2006, we received an approvable letter from the FDA for the supplemental New Drug Application (sNDA) seeking approval for the five-day treatment of CAP with FACTIVE tablets. In accordance with the letter, we provided clarification and additional interpretation regarding certain data included in the application to assist the FDA in its evaluation. On May 1, 2007, the FDA approved FACTIVE for the five-day treatment of CAP.

In the five-day CAP clinical trial, a five-day course of therapy with FACTIVE was shown to be as effective as the FDA-approved seven-day course of treatment, with both arms displaying excellent clinical response rates. Further, data showed that the bacteriological and radiologic success rates with five-days of therapy were also non-inferior to the success rates with seven-days of therapy. The multicenter, randomized, double-blind study enrolled 510 patients with CAP, with 469 patients comprising the per protocol group. Investigators measured clinical and bacteriological response at end of therapy as well as clinical, bacteriological and radiologic response at follow-up (two to three weeks post therapy). Clinical response at follow-up, the primary endpoint, in the per protocol group was 95% for the five-day treatment arm and 92% for the seven-day treatment arm (95% CI: -1.48, 7.42), demonstrating non-inferiority between the two groups. Further, clinical response at end of therapy in the per protocol group was 96% for the five-day group and 96% for the seven-day group (95% CI: -3.85, 3.42). The study also yielded encouraging results for bacteriological response. Bacteriological response in the per protocol population was 91% for the five-day and seven-day groups at follow-up (95% CI: -6.89, 7.93) and 94% for the five-day group and 96% for the seven-day group (95% CI: -8.27, 3.25) at end of therapy. The study demonstrated radiologic response at follow-up in the per protocol population of 98% for the five-day arm and 93% for the seven-day arm (95% CI: 0.35, 7.91). FACTIVE was well-tolerated in the study, with a low withdrawal rate due to adverse events: 1.2% for the five-day group and 2.0% for the seven-day group. The most common adverse event reported was a laboratory finding of elevated liver enzymes (increased ALT and increased AST). Analysis of all ALT/AST values demonstrated that the elevations were significantly associated with baseline ALT levels (elevated in many patients) with no significance or association with a particular treatment group. There was also no evidence of symptomatic hepatic events. In addition, the rate of drug-related rash in both treatment groups was low: 0.4% for the five-day arm and 2.8% for the seven-day arm. There were no withdrawals due to rash.

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Acute Bacterial Sinusitis: As part of the FACTIVE development program, several studies relating to acute bacterial sinusitis, or ABS, were completed, and, in November 2005, we filed an sNDA for ABS. In September 2006, the FDA s Anti-Infective Drugs Advisory Committee voted not to recommend approval of this sNDA. In November 2006, we voluntarily withdrew our sNDA seeking approval of the ABS indication.

FACTIVE IV: An intravenous formulation of gemifloxacin has also been studied. If we elect to further pursue such a formulation, additional formulation development will be necessary before initiating a bioequivalence study.

License Agreement with LG Life Sciences

We license the rights to gemifloxacin, the active ingredient in FACTIVE tablets, from LG Life Sciences. We have the rights to commercialize gemifloxacin in North America, France, Germany, the United Kingdom, Luxembourg, Ireland, Italy, Spain, Portugal, Belgium, the Netherlands, Austria, Greece, Sweden, Denmark, Finland, Norway, Iceland, Switzerland, Andorra, Monaco, San Marino, Vatican City, Poland, Czech Republic, Slovakia, Slovenia, Hungary, Estonia, Latvia, Lithuania, Liechtenstein, Malta, Cyprus, Romania, Bulgaria, Croatia, Serbia and Montenegro, Bosnia and Herzegovina, Albania and the Former Yugoslav Republic of Macedonia. The term of the agreement with respect to each country extends at least through the life of the patents covering gemifloxacin in such country. In the United States, the last of the currently issued patents for composition of matter expires in 2018. The patent term could extend further in countries outside of the U.S. depending upon several factors, including whether we obtain patent extensions and the timing of our commercial sale of the product in a particular country.

Under the terms of the agreement, LG Life Sciences has agreed to supply and we are obligated to purchase from LG Life Sciences all of our anticipated commercial requirements for the FACTIVE active pharmaceutical ingredient, or API. LG Life Sciences currently supplies the FACTIVE API from its manufacturing facility in South Korea.

The agreement with LG Life Sciences also requires that we achieve a minimum gross sales level of $30 million from our licensed territories over a 12-month period of time starting in approximately the third quarter of 2007 to the third quarter of 2008 which, if not met, LG Life Sciences could elect to terminate the agreement and have the technology be returned to LG Life Sciences. Based on data available at the time of this filing, including unaudited data from our logistics provider and sublicensees, we believe that we have achieved the minimum gross sales threshold level. Under this agreement, we are responsible, at our expense and through consultation with LG Life Sciences, for the clinical and commercial development of gemifloxacin in the countries covered by the license, including the conduct of clinical trials, the filing of drug approval applications with the FDA and other applicable regulatory authorities and the marketing, distribution and sale of gemifloxacin in our territory.

We are obligated to pay a royalty on sales of FACTIVE in North America and the territories covered by the license in Europe. These royalty obligations expire with respect to each country covered by the agreement on the later of (i) the expiration of the patents covering FACTIVE in such country or (ii) the expiration of data exclusivity in Mexico, Canada or the European Union respectively, or 2014 in the U.S. We are also obligated to make aggregate milestone payments of up to approximately $40 million (not including payments to LG Life Sciences previously made pursuant to up-front obligations or achievements of certain milestones) including milestone payments required by the amendments described below upon achievement of additional regulatory approvals and sales thresholds.

Collaborations and Partnerships for FACTIVE

Pfizer, S.A. de C.V. On February 6, 2006, we entered into a Sublicensing and Distribution Agreement with Pfizer, S.A. de C.V. (Pfizer Mexico), pursuant to which we sublicensed our rights to market FACTIVE tablets in Mexico to Pfizer Mexico. In exchange for those rights, Pfizer Mexico has made an up-front payment and has

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agreed to pay milestone payments upon obtaining certain regulatory approvals and sales goals, as well as royalties on future sales. The up-front payment is being recognized as revenue over the term of our continuing obligations under the agreement. These royalty rates are subject to reduction upon expiration of certain patents in Mexico for FACTIVE or if a generic form of gemifloxacin has a material impact on Pfizer Mexico s sales volumes in Mexico. Pfizer Mexico is obligated to exclusively purchase from us, and we must exclusively supply, all API for FACTIVE. The agreement with Pfizer Mexico may be terminated by either party upon the occurrence of certain termination events, including Pfizer Mexico s right to terminate at any time after August 2007, the first anniversary of launch of FACTIVE tablets in Mexico upon six-months prior written notice. Upon termination, Pfizer Mexico is obligated to assign any and all rights to regulatory approvals in Mexico to us or our designee.

In October 2006, Pfizer Mexico launched its promotion and marketing of FACTIVE-5 in Mexico for the five-day treatment of acute bacterial exacerbations of chronic bronchitis (AECB), acute bacterial sinusitis (ABS) and community-acquired pneumonia (CAP).

Abbott Laboratories Ltd. On August 9, 2006, we granted the commercialization rights to FACTIVE tablets in Canada to Abbott Laboratories, Ltd. (Abbott Canada), the Canadian affiliate of Abbott. In exchange for those rights, Abbott Canada agreed to a transfer price on product purchases and to make certain payments to us upon achievement of certain regulatory and sales milestones. FACTIVE tablets are currently approved in Canada for the five-day treatment of AECB. We subsequently amended the agreement on January 31, 2008 whereby Abbott Canada s development and commercialization obligations were substantially reduced. In accordance with the terms of the amendment, Abbott Canada will continue to maintain FACTIVE tablets in its current product price list and it will continue to pay us a transfer price on FACTIVE tablets purchases. Abbott Canada is not required to pursue the CAP and ABS indications. Additionally, the amendment provides that we can terminate the agreement at any time with prior notice to Abbott Canada and Abbott Canada can terminate with prior notice to us after November 30, 2008.

Menarini International Operation Luxembourg SA. We entered into a License, Supply and Marketing Agreement with Menarini International Operation Luxembourg SA (Menarini), a wholly-owned subsidiary of Menarini Industrie Farmaceutiche Riunite S.r.l. dated December 28, 2006, whereby we sublicensed our rights to sell FACTIVE tablets in the European Union to Menarini. Under the terms of our agreement, Menarini is responsible for obtaining regulatory approval for FACTIVE in the European Union, and Oscient has agreed to reimburse Menarini for expenses associated with such regulatory development up to an agreed limit. Menarini has also paid us an up-front payment which is being recognized over the term of our continuing obligations under the agreement of approximately thirty-three months. Menarini has also agreed to pay us milestone payments upon obtaining certain regulatory and reimbursement approvals and upon achieving certain annual net sales goals, which could total up to $23.0 million, if all the milestones are achieved. Menarini will pay us a transfer price on purchases of the active pharmaceutical ingredient, or API, for FACTIVE, which is determined based on a percentage of quarterly sales of FACTIVE by Menarini in Europe. Menarini is also obligated to exclusively purchase from us, and we must exclusively supply, all API for FACTIVE to be sold in Europe for the earlier of (i) the expiration of the life of certain patents covering the product or (ii) expiration of data exclusivity. Our agreement with Menarini may be terminated by either party upon the occurrence of certain termination events, including Menarini s right to terminate if the European regulatory authorities do not recommend approval of FACTIVE at various stages of the approval process with a package insert, or label, that meets certain requirements as to the safety, dosing and indications for which FACTIVE may be prescribed. Menarini may also terminate the agreement if it does not receive approval for reimbursement from European member countries that is above a certain minimum price per tablet. Upon termination, Menarini is obligated to assign any and all rights to regulatory approvals in the European Union to Oscient or its designee. In the first quarter of 2008, Menarini submitted a regulatory filing seeking approval of FACTIVE in Europe for the treatment of community-acquired pneumonia and acute bacterial exacerbations of chronic bronchitis.

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Ramoplanin

***Clostridium difficile*-Associated Disease (CDAD)**

CDAD, a serious form of colitis caused by toxins produced by the Gram-positive bacterium *Clostridium difficile* (*C. difficile*), is the most commonly recognized microbial cause of diarrhea, resulting from high rates of colonization in hospitalized patients and the frequent use of antimicrobials. About 3% of healthy adults and 16 to 35% of hospital patients are colonized with *C. difficile* either prior to or during admission. Because it is a spore-forming bacterium, *C. difficile* is readily spread from person to person, especially in the hospital and nursing home environment. Under certain conditions, such as extended antibiotic therapy and gastrointestinal surgery, *C. difficile* can colonize the gut and release toxins, leading to bowel inflammation and severe diarrhea. Severe cases can occur and involve the development of fulminant colitis (severe inflammation of the colon); such occurrences can be life threatening, especially in elderly or immunocompromised populations.

Over 400,000 patients are treated in U.S. hospitals each year for CDAD. CDAD is associated with an average increased hospital stay of 3.6 days and an average increase in hospital costs of over $3,600 per patient. It is estimated that the annual increase in hospital costs attributable to CDAD exceeds $1 billion in the U.S.

Two studies published in *The New England Journal of Medicine* in December 2005 describe a new strain of *C. difficile,* one that produces 16 to 23 times more toxins *in vitro* than do other strains, thus potentially contributing to its virulence. The very high incidence and mortality rates are of particular concern with this new strain. Data support the concept that this highly virulent strain is causing epidemic disease at certain locations and is associated with more frequent and more severe disease.

Current therapies for the treatment of CDAD include oral metronidazole and oral vancomycin. However, approximately 15 to 20% of patients will experience a relapse of symptoms. The use of oral vancomycin has been associated with the emergence of vancomycin-resistant organisms, including vancomycin-resistant enterococci, or VRE. Resistance has also been reported for metronidazole.

Ramoplanin Overview

In October 2001, we in-licensed U.S. and Canadian rights to Ramoplanin from Vicuron Pharmaceuticals Inc., or Vicuron, a wholly-owned subsidiary of Pfizer Inc., and on February 3, 2006, acquired worldwide rights from Vicuron, assuming full control of Ramoplanin manufacturing, development and commercialization. Ramoplanin is a novel glycolipodepsipeptide antibiotic produced by fermentation of the bacteria *Actinoplanes*, with activity against Gram-positive aerobic and anaerobic microorganisms. In preclinical studies, Ramoplanin has been shown to be bactericidal against most Gram-positive species, including methicillin-resistant staphylococci, VRE and *C. difficile,* including the recent epidemic strains. Ramoplanin inhibits the bacterial cell wall peptidoglycan biosynthesis with a mechanism different from that of vancomycin, teicoplanin or other cell wall-synthesis inhibitors. No evidence of cross-resistance between Ramoplanin and other glycopeptide antibiotics has been observed *in vitro* to date. Ramoplanin has a unique profile that may make it particularly well-suited for killing bacteria in the GI tract.

In 2004, we completed a Phase II trial to assess the safety and efficacy of Ramoplanin in the treatment of CDAD. The open-label study enrolled 87 patients in 24 U.S. sites. The trial compared two doses of Ramoplanin (200 mg and 400 mg twice daily) to vancomycin (125 mg four times daily). Both agents were administered for ten days, during which data on Ramoplanin was collected to measure safety and efficacy. The primary endpoint of the study was response rate at the test-of-cure visit, 7 to 14 days post-therapy. For this trial, the response rates were 60% for Ramoplanin 200 mg, 71% for Ramoplanin 400 mg, and 78% for vancomycin 125 mg in the clinically evaluable population. While the study did not meet its primary endpoint, non-inferiority at the test-of-cure visit, the response rates for all three arms were comparable. A potentially more clinically relevant endpoint, response at the end of therapy, was also assessed. At the end of therapy, the response rates were 83% for Ramoplanin 200 mg, 85% for Ramoplanin 400 mg and 86% for vancomycin 125 mg.

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In December 2005, we agreed with the FDA to a Special Protocol Assessment regarding the specific components of a Phase III program that, if completed successfully, would support regulatory approval for the indication. Because the Special Protocol Assessment was agreed to by the FDA in 2005, we cannot guarantee that the FDA will continue to regard it as binding on the agency if and when we or a prospective partner re-initiates the Ramoplanin clinical development process. On January 8, 2008, the United States Patent and Trademark Office (USPTO) issued us a patent relating to methods of use of Ramoplanin for the treatment of CDAD.

Potential Benefits:

We believe the potential benefits of Ramoplanin include:

- Ramoplanin belongs to a novel class of antibiotics and there have been no observed cases of bacterial resistance or cross-resistance with other antibiotics to date.
- Ramoplanin is orally administered, but not absorbed into the bloodstream, so it concentrates and exerts its killing effects in the GI tract.
- Its bactericidal effect may result in lower potential for bacteria to develop resistance.
- Ramoplanin has a Gram-positive spectrum of activity and low potency against Gram-negative anaerobes that normally colonize the GI tract making it less likely that its use will result in the overgrowth of other opportunistic organisms or in the elimination of normal, healthy bacteria.
- Along with its activity against *C. difficile,* Ramoplanin has demonstrated *in vitro* activity against methicillin-resistant *Staphylococcus aureus* (MRSA) and VRE. Both organisms are associated with causing serious infections.

Acquisition of Expanded Rights: In exchange for the assignment of the rights for Ramoplanin under the acquisition agreement with Pfizer, we made a one-time, up-front payment to Pfizer and agreed to make additional milestone payments for regulatory filings and approvals in various countries. We will also pay mid-single-digit to low double-digit royalties to Pfizer on net sales of Ramoplanin dependent upon the territory.

With the acquisition of ANTARA, we have made the strategic decision to concentrate our financial resources on building our revenues for products promoted to community-based physicians in the United States and are currently seeking to out-license, co-develop or sell our rights to Ramoplanin to a partner. There can be no assurance that we will be able to license or divest Ramoplanin or to partner the development of Ramoplanin on acceptable terms, or at all.

SALES AND MARKETING

We market ANTARA and FACTIVE through our sales and marketing organization in the U.S, which is currently comprised of approximately 280 field sales personnel, including 250 sales representatives, as well as district managers and regional sales directors. Sales and marketing functions are located at our New Jersey office. Our sales representatives focus on community-based physicians and opinion leaders who are potential high prescribers of fluoroquinolones and/or fenofibrate products. We have also built a team of professionals with experience in insurance and government reimbursement, medical affairs and marketing. Our strategy is to continue to leverage our existing commercial infrastructure through the acquisition, in-license or co-promotion of additional marketed products to market to community-based physicians in the United States. Longer term, we anticipate expanding our commercial infrastructure to reach additional physicians.

Our strategy includes granting commercialization rights to FACTIVE tablets in territories outside of the U.S. to third parties to leverage the additional resources that a pharmaceutical marketing partner with expertise in such countries can provide. Thus, we have partnered with following entities:

On February 6, 2006, we sublicensed our rights to sell FACTIVE tablets in Mexico to Pfizer, S.A. de C.V. (Pfizer Mexico), the largest pharmaceutical company in Mexico. Pfizer Mexico is commercializing FACTIVE for community-acquired pneumonia, acute bacterial exacerbations of chronic bronchitis and acute bacterial sinusitis with three national field sales forces and one specialty field sales force.

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On August 9, 2006, we granted the commercialization rights to FACTIVE tablets in Canada to Abbott Laboratories, Ltd. (Abbott Canada), the Canadian affiliate of Abbott; however, on January 31, 2008, we amended the agreement whereby Abbott Canada s obligations to commercialize FACTIVE tablets were substantially reduced.

On December 27, 2006, we sublicensed our rights to sell FACTIVE tablets in Europe to Menarini International Operation Luxembourg SA (Menarini), the second largest primary care pharmaceutical company in Europe. Menarini is responsible for obtaining regulatory approval for FACTIVE in Europe and will leverage its regulatory and marketing experience to pursue approval and launch of FACTIVE in Europe. In the first quarter of 2008, Menarini submitted a regulatory filing seeking approval of FACTIVE in Europe for the treatment of community-acquired pneumonia and acute bacterial exacerbations of chronic bronchitis.

COMPETITION

The pharmaceutical industry generally is characterized by rapidly evolving technology and intense competition. Our competitors include pharmaceutical and biotechnology companies both in the United States and abroad. Many of our competitors have substantially greater capital resources, facilities and human resources than we do.

Competition with respect to our products and product candidates is and will be based on, among other things:

our sales and marketing expertise,

our clinical trial results and post marketing experience,

our ability to obtain appropriate regulatory approvals for our product candidates in a cost-efficient and timely manner and subsequently remain in regulatory compliance,

our ability to secure adequate reimbursement for our products from public and private healthcare payors,

our ability to attract and retain qualified personnel,

our ability to obtain patent protection and defend our patent challenges,

our ability to in-license product candidates for clinical development,

our ability to gain access to new products via co-promotion or in-license agreements or product acquisitions,

our ability to secure sufficient capital resources to fund our clinical development and sales and marketing operations, and

our ability to secure sufficient capital resources to execute transactions to gain access to new products.

Because we rely primarily on in-licensing, co-promotion and acquisitions of products and product candidates to expand our portfolio, it is important to note that we may also face increasing competition for in-licensing, co-promotion and acquisition opportunities from leading pharmaceutical and biotechnology companies. We cannot be certain that we will be able to in-license product opportunities in the future or acquire new products.

ANTARA

ANTARA is a fenofibrate product approved by the FDA to treat hypercholesterolemia and hypertriglyceridemia in combination with a healthy diet. The marketing of current and additional branded versions of fenofibrate could reduce our net sales of ANTARA and adversely impact our revenues. Currently, the primary competition for ANTARA in the fenofibrate market is TriCor 145 mg, a product manufactured by Abbott Laboratories, which accounted for approximately 90% of U.S. fenofibrate sales for the three-month period ended June 30, 2008. Abbott has announced its development and evaluation of another branded fenofibrate-type product, both as mono and combination therapy.

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In addition to TriCor, there are several other branded fenofibrate products which compete with ANTARA. ANTARA also competes with Triglide, a 160 mg fenofibrate product marketed by Sciele Pharma, Inc., which accounted for approximately 2% of U.S. fenofibrate sales for the three-month period ended June 30, 2008. Additionally, ANTARA competes with Lipofen, a 150 mg fenofibrate product, which was recently launched and is currently being marketed by ProEthic Pharmaceuticals, Inc. ANTARA also competes with Fenoglide, a 120 mg branded fenofibrate product, which the FDA approved in August 2007 referencing ANTARA in accordance with the provisions of section 505(b)(2) of the Federal Food, Drug, and Cosmetic Act. Sciele Pharmaceuticals recently launched Fenoglide in North America.

Additionally, several generic versions of fenofibrate in varying doses are also available for the treatment of dyslipidemias. Revenues from these products accounted for approximately 3% of total U.S. sales of fenofibrate sales in the first quarter of 2008. In May 2005, Teva Pharmaceutical Industries, Ltd. (Teva) obtained FDA approval to market a generic version of Abbott Laboratories 160 mg TriCor tablet (which is no longer marketed or sold) and Par Pharmaceuticals and Impax Labs received FDA approval for similar generic products in October 2007 and March 2008, respectively. In addition, Solvay S.A., Abbott Laboratories partner announced on January 23, 2008, that Teva had filed an Abbreviated New Drug Application (ANDA) with a Paragraph IV certification seeking the approval of a generic version of TriCor 145 mg. Additionally, Biovail Corporation announced on September 3, 2008 that it also has filed an ANDA seeking approval for a generic version of TriCor 145 mg. If a generic version of Abbott Laboratories TriCor 145 mg product is approved by the FDA, the percentage of total revenues attributable to generic fenofibrate products would likely increase. There are also several other FDA-approved products and products in development for similar indications as ANTARA which could compete with ANTARA, including statins, omega-3 fatty acids (including Lovaza® marketed by GlaxoSmithKline), niacin (including Niaspan® marketed by Abbott), ezetimibe and fixed-dose combination products.

The growth of any of these branded products or the marketing of generic fenofibrate products could result in a decrease in ANTARA sales, create pressure on the price at which we are able to sell ANTARA, reduce our profit margins, reduce our net sales of ANTARA and adversely impact our revenues.

FACTIVE

FACTIVE tablets are approved for the treatment of community-acquired pneumonia of mild to moderate severity and acute bacterial exacerbations of chronic bronchitis. There are several classes of antibiotics that are primary competitors for the treatment of these indications, including other fluoroquinolones (levofloxacin, ciprofloxacin and moxifloxacin), macrolides (clarithromycin and azithromycin) and penicillins (amoxicillin/clavulanate potassium).

Many generic antibiotics are also currently prescribed to treat these infections. Moreover, a number of the antibiotic products that are competitors of FACTIVE tablets have composition of matter patents which have gone or will be going off patent at dates ranging from 2003 to 2016. As these competitors lose patent protection, their manufacturers will likely decrease their promotional efforts. However, makers of generic drugs will likely begin to produce some of these competing products and this could result in pressure on the price at which we are able to sell FACTIVE tablets and reduce our profit margins.

In addition, Orchid has recently filed an ANDA seeking approval to market a generic version of FACTIVE. Currently, final approval of Orchid s ANDA may not be granted until 2015, because Orchid has not filed a Paragraph IV certification with respect to U.S. Patent No. 5,633,262, which expires in June 2015. However, Orchid could amend its ANDA filing to include a Paragraph IV certification against all of our FDA Orange Book listed patents and attempt to launch a generic version of FACTIVE before 2015. If Orchid were to amend its ANDA to include a Paragraph IV certification with respect to U.S. Patent No. 5,633,262, and we and/or LG Life Sciences initiate a timely patent infringement lawsuit against Orchid, we believe we will be eligible for an automatic thirty-month stay of FDA approval of Orchid s ANDA.

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Ramoplanin

We have completed Phase II clinical trials studying Ramoplanin for the treatment of CDAD. We are aware of two products currently utilized in the marketplace: Vancocin® pulvules (vancomycin), a product marketed by ViroPharma Inc., and metronidazole, a generic product, for treatment of this indication. We are also aware of several other companies with products in development for the treatment of CDAD. Due to strategic and financial considerations, we have suspended the clinical development of Ramoplanin pending identification of a partner, licensee, or buyer for the product.

GOVERNMENT REGULATION

Regulation by governmental entities in the United States and other countries will be a significant factor in the development, manufacturing, distribution and marketing of any product candidates that we develop or commercialize. The extent to which such regulation may apply to us and our licensees will vary depending on the nature of the product. Virtually all of our pharmaceutical products, including expanded uses of our pharmaceutical products, will require regulatory approval by governmental agencies prior to commercialization. In particular, the FDA in the United States and similar health authorities in foreign countries subject human therapeutic and vaccine products to rigorous preclinical and clinical testing, and require review and approval of extensive data in order to permit commercial marketing.

Virtually all aspects of our activities are regulated by federal and state statutes and regulations, and government agencies. The research, development, manufacturing, processing, packaging, labeling, distribution, sale, advertising, promotion, import and export of our products, and disposal of waste products arising from these activities, are subject to regulation by one or more federal agencies and their state equivalents, including the FDA, the Consumer Product Safety Commission, the Occupational Safety and Health Administration and the Environmental Protection Agency, as well as by state and local governments and governmental authorities in those foreign countries in which we or our partners operate.

Noncompliance with applicable regulatory policies or requirements of the FDA or other governmental authorities could subject us to enforcement actions, such as suspensions of product distribution, seizure of products, product recalls, civil monetary and other penalties, criminal prosecution and penalties, injunctions, whistleblower lawsuits, failure to approve pending drug product applications or total or partial suspension of product marketing approvals. Similar civil or criminal penalties could be imposed by other government agencies or the agencies of the states and localities in which our products are manufactured, sold or distributed, and could have ramifications for our contracts with government agencies. These enforcement actions would detract from management s ability to focus on our daily business and would have an adverse effect on the way we conduct our daily business, which could severely impact future profitability.

Product Approval

For innovative, or non-generic, new drugs, an FDA-approved new drug application, or NDA, is required before the drugs may be marketed in the United States. The NDA must contain data to demonstrate that the drug is safe and effective for its labeled uses, and that it will be manufactured to appropriate quality standards. In order to demonstrate safety and effectiveness, an NDA typically must include or reference preclinical data from animal and laboratory testing and clinical data from controlled trials in humans. For a new chemical entity, this generally means that lengthy, uncertain and rigorous pre-clinical and clinical testing must be conducted. For compounds that have a record of prior or current use, it may be possible to utilize existing data or medical literature and limited new testing to support an NDA. Any preclinical laboratory and animal testing must comply with FDA s good laboratory practice and other requirements. Clinical testing in human subjects must be conducted in accordance with FDA s good clinical practice and other requirements. In order to initiate a clinical trial, the sponsor must submit an investigational new drug application, or IND, to the FDA or meet one of the narrow exemptions that exist from the IND requirement. Clinical research must also be reviewed and approved by

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independent institutional review boards, or IRBs, at the sites where the research will take place, and the study subjects must provide informed consent. The FDA also regulates and typically inspects manufacturing facilities, equipment and processes used in the manufacturing of pharmaceutical products before granting approval to market any drug. Each NDA submission requires a substantial user fee payment, unless a waiver or exemption applies. FDA has committed generally to review and make a decision concerning approval on an NDA within 10 months, and on a new priority drug within six months. However, final FDA action on the NDA can take substantially longer, and where novel issues are presented there may be review and recommendation by an independent FDA advisory committee. The FDA can also refuse to file and review an NDA it deems incomplete or not properly reviewable.

Clinical trial programs in humans generally follow a three-phase process. Typically, Phase I studies are conducted in small numbers of healthy volunteers or, on occasion, in patients afflicted with the target disease, to determine the metabolic and pharmacological action of the product candidate in humans, the side effects associated with increasing doses, and, if possible, to gain early evidence of effectiveness. In Phase II, studies are generally conducted in larger groups of patients having the target disease or condition in order to validate clinical endpoints, and to obtain preliminary data on the effectiveness of the product candidate and optimal dosing. This phase also helps determine further the safety profile of the product candidate. In Phase III, large-scale clinical trials are generally conducted in hundreds of patients having the target disease or condition to provide sufficient data for the statistical proof of effectiveness and safety of the product candidate as required by U.S. and foreign regulatory agencies. Federal law and the state of Maine require that clinical trial sponsors register most Phase II and Phase III studies and post results of such studies on a publicly funded internet website. Failure to comply with these requirements can result in civil and criminal penalties and, at the federal level, can render our products misbranded. We believe we are in compliance in all respects with federal clinical trial registration laws and are in the process of bringing the company into compliance with applicable Maine law.

Before proceeding with a study, sponsors may seek a written agreement from the FDA regarding the design, size, and conduct of a clinical trial. This is known as a Special Protocol Assessment, or SPA. Among other things, Special Protocol Assessments can cover clinical studies for pivotal trials whose data will form the primary basis to establish a product s efficacy. Where the FDA agrees to a Special Protocol Assessment, the agreement may not be changed by either the sponsor or the FDA except if the sponsor and the FDA agree to a change, or a senior FDA official determines that a substantial scientific issue essential to determining the safety or effectiveness of the product was identified after the testing began. Special Protocol Assessments thus help establish up-front agreement with the FDA about the adequacy of the design of a clinical trial to support a regulatory approval, but the agreement is not binding if new circumstances arise. There is no guarantee that a study will ultimately be adequate to support an approval even if the study is subject to a Special Protocol Assessment.

The FDA can, and does, reject new drug applications, require additional clinical trials, grant approvals on only a restricted basis even when product candidates performed well in clinical trials, or require further studies as a condition of approval. In addition, the Food and Drug Administration Amendments Act of 2007 (FDAAA) permits the agency to require new drug applicants to submit a REMS with the NDA if the agency determines that a REMS is necessary to ensure that the benefits of the drug outweigh the risks.

Generic drugs are approved through an abbreviated process based on the submission to FDA of an abbreviated new drug application, or ANDA. The ANDA must seek approval of a drug product that has the same active ingredient(s), dosage form, strength, route of administration, and labeling as a so-called reference listed drug approved under an NDA, although some limited exceptions may be permitted. The ANDA also generally contains limited clinical data to demonstrate that the product covered by the ANDA is absorbed in the body at the same rate and to the same extent as the reference listed drug. This is known as bioequivalence. In addition, the ANDA must contain information regarding the manufacturing processes and facilities that will be used to ensure product quality, and must contain certifications to patents listed with the FDA for the reference listed drug. Special procedures apply when an ANDA contains certifications stating that a listed patent is invalid or not infringed, and if the owner of the patent or the NDA for the reference listed drug brings a patent infringement

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suit within a specified time (45 days), an automatic stay bars FDA approval of the ANDA for a specified period of time pending resolution of the suit or other action by the court. The amount of testing and effort that is required to prepare and submit an ANDA is generally substantially less than that required for an NDA.

In addition to the NDA and ANDA procedures, there is an additional approval mechanism known as a 505(b)(2) application. A 505(b)(2) application is a form of an NDA where the applicant does not have a right to reference all or some of the data being relied upon for approval. Under current regulations and FDA policies, 505(b)(2) applications can be used where the applicant is relying in part on published literature or on findings of safety or effectiveness in another company s NDA. This might be done, for example, where the applicant is seeking approval for a new use for a drug that has already been approved for a different use or for a different formulation of the same drug that is already approved for the same use. FDA s interpretation of the 505(b)(2) pathway is controversial and has not been tested in the courts.

In European Union countries (where our partner, Menarini is currently attempting to gain marketing approval for certain indications of FACTIVE) and in Canada, regulatory requirements and approval processes are similar in principle to those in the United States and can be at least as rigorous, costly and uncertain. Additionally, depending on the type of drug for which an applicant is requesting approval, there are currently two potential tracks for marketing approval in European Union countries: the centralized procedure and a de-centralized process which requires requesting approval on a country-by-country basis. These review mechanisms may ultimately lead to approval in all European Union countries, but each method grants all participating countries some decision making authority in product approval.

Post-Approval Requirements

Products on the market are subject to continual review by the FDA. If previously unknown problems are discovered or if there is a failure to comply with applicable regulatory requirements, the FDA may restrict the marketing of an approved product, cause the withdrawal of the product from the market, or under certain circumstances seek recalls, seizures, injunctions or criminal sanctions. For example, the FDA may require a change in labeling for an approved marketing application or additional studies for any marketed drug product if new information reveals questions about a drug s safety or effectiveness. In addition, changes to the product, the manufacturing methods or locations, or labeling are subject to additional FDA approval, which may or may not be received, and which may be subject to a lengthy FDA review process.

Manufacturing facilities that produce drugs are subject to extensive regulation both by the FDA, state and local governments, and foreign regulatory authorities. These laws and regulations require, among other things, that our facilities and the facilities of third parties, such as LG Life Sciences, Ethypharm S.A., Patheon Pharmaceuticals Inc. (our third party finished-product manufacturer for FACTIVE tablets) and Catalent Pharma Solutions (our third party packager of ANTARA capsules), be registered with the FDA and other regulatory authorities, comply with current good manufacturing practices requirements, and pass periodic inspections by the FDA and other regulators. Facilities in foreign countries may be subject to inspection by the FDA, local regulators or both. Current good manufacturing practices, or cGMP, require extensive recordkeeping, quality control, documentation and auditing to ensure that products meet applicable specifications. Failure to comply with these requirements can result in warning letters, requirements of remedial action, and, in the case of more serious failures, suspension of manufacturing, seizure, injunctions or recall of product and fines and other penalties. Compliance with these requirements can be time consuming, costly and can result in delays in product approval or product sales.

In addition to cGMP requirements, certain of our products must also be packaged with child-resistant and senior friendly packaging under the Poison Prevention Packaging Act and Consumer Product Safety Commission regulations. Products that do not comply with these requirements can be considered misbranded and subject to seizure, recall, monetary fines, and other penalties.

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The distribution of prescription pharmaceutical products is subject to the Prescription Drug Marketing Act, or PDMA, which regulates the distribution of drugs and drug samples at the federal level, and sets minimum standards for the registration and regulation of drug distributors by the states. States require the registration of manufacturers and distributors who provide pharmaceuticals, including in certain states even if these manufacturers or distributors have no place of business within the state but satisfy other nexus requirements, for example, the shipment of products into such state. States also impose requirements on manufacturers and distributors to establish the pedigree of product in the chain of distribution, including some states that are requiring manufacturers and others to adopt new technology capable of tracking and tracing product as it moves through the distribution chain. Both the PDMA and state laws limit the distribution of prescription drug product samples to licensed practitioners and impose other requirements to ensure accountability in the distribution of samples.

Other reporting and recordkeeping requirements also apply for marketed drugs, including for most products requirements to review and report cases of adverse events. Product advertising and promotion are subject to FDA and state regulation, including requirements that promotional claims conform to any applicable FDA approval, and be appropriately balanced and substantiated. We are also subject to various federal and state laws pertaining to health care fraud and abuse, including the anti-kickback provisions of the Social Security Act, the False Claims Act, the Veterans Healthcare Act, and the implementing regulations and policies of the United States Health and Human Services Office of Inspector General and United States Department of Justice, as well as similar state laws. Anti-kickback laws make it illegal for a prescription drug manufacturer or marketer to solicit, offer, receive, or pay any remuneration in exchange for, or to induce, the referral of business, including the purchase, recommendation or prescription of a particular drug, covered by a federal healthcare program, unless one of several narrow safe harbors or other exceptions applies. False claims laws prohibit anyone from knowingly and willingly presenting, or causing to be presented, for payment to third-party government payors, including Medicare and Medicaid, claims for reimbursed drugs or services that are false or fraudulent, claims for items or services not provided as claimed, or claims for medically unnecessary items or services. Many states have their own versions of the False Claims Act, some of which apply regardless of whether the relevant payors are government or private.

Similar laws apply in other countries, including anti-bribery prohibitions in the European Union and member countries of the European Union.

Other Regulatory and Compliance Requirements

Under the laws of the United States, the countries of the European Union and other nations, we and the institutions where we sponsor research are subject to obligations to ensure the protection of personal information of human subjects participating in our clinical trials. In the United States, these laws include the privacy provisions of the Health Insurance Portability and Accountability Act, or HIPAA, the implementing regulations of the United States Department of Health and Human Services, and state medical records privacy laws. We have instituted procedures that we believe will enable us to comply with these requirements and the contractual requirements of our data sources. The laws and regulations in this area are evolving and further regulation, if adopted, could affect the timing and the cost of future clinical development activities.

We are subject to the United States Foreign Corrupt Practices Act, which prohibits corporations and individuals from engaging in specified activities to obtain or retain business or to influence a person working in an official capacity. Under this act, it is illegal to pay, offer to pay, or authorize the payment of anything of value to any foreign government official, government staff member, political party, or political candidate in an attempt to obtain or retain business or to otherwise influence a person working in an official capacity. Our present and future business has been and will continue to be subject to various other laws and regulations.

Pricing and Third-Party Reimbursement

In the United States and elsewhere, sales of therapeutic and other pharmaceutical products are dependent in part on the availability of reimbursement to the consumer from third party payors, such as government and private

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insurance plans. Increasingly, third party payors are challenging the prices charged for medical products and services. As a result, in the future, reimbursement to the consumer could become unavailable or could be insufficient to allow us to sell our products on a competitive and profitable basis, either because our products are deemed to be not cost effective or for some other reason. For example, in some foreign markets, pricing reimbursement or profitability of therapeutic and other pharmaceutical products is subject to governmental control. In Canada this practice has led to lower priced products than in the United States. As a result, importation of products from Canada into the United States may result in reduced product revenues. In the United States there have been, and we expect that there will continue to be, a number of federal and state proposals to implement similar governmental pricing reimbursement controls. For example, Congress may give the federal government authority to negotiate drug prices for the Medicare Part D outpatient prescription drug benefit. Currently under Part D, prices are negotiated by the manufacturer with individual Part D plan sponsors or their administrators. Medicare Part B provides separate reimbursement for a limited universe of prescription drugs (primarily physician administered drugs). Currently, reimbursement for most Part B drugs is set at 106% of average sales price (which a manufacturer must report quarterly). Congress may consider proposals to reduce reimbursement for Part B drugs.

In many foreign markets, including the countries in the European Union, pricing of pharmaceutical products is subject to governmental control. In the United States, there have been, and we expect that there will continue to be, a number of federal and state proposals to implement similar governmental pricing controls. While we cannot predict whether such legislative or regulatory proposals will be adopted, the adoption of such proposals could have a material adverse effect on our business, financial condition and results.

Through the commercialization of ANTARA and FACTIVE, we became a participant in the Medicaid rebate program established by the Omnibus Budget Reconciliation Act of 1990, and most recently amended under the Deficit Reduction Act of 2005. Under the Medicaid rebate program, we pay a rebate for each unit of our product reimbursed by Medicaid. The amount of the rebate for each product is set by law as a minimum of 15.1% of the average manufacturer price, or AMP, of that product, or if it is greater, the difference between AMP and the best price available from us to any commercial customer. The rebate amount also includes an inflation adjustment if AMP increases faster than inflation. The rebate amount is recomputed each quarter based on our reports of our current average manufacturer price and best price for each of our products to the Centers for Medicare & Medicaid Services, or CMS. In order to meet the requirements of the Deficit Reduction Act of 2005, the AMP for each product must now be reported to CMS monthly in addition to quarterly, and CMS will publish the monthly AMP data on its website.

Participation in the Medicaid rebate program requires participation in the Public Health Service, or PHS, pharmaceutical pricing program. The PHS pricing program extends discounts comparable to the Medicaid rebate to a variety of community health clinics and other entities that receive health services grants from the PHS, as well as hospitals that serve a disproportionate share of low-income Medicare and Medicaid beneficiaries.

ANTARA and FACTIVE are available to authorized users of the Federal Supply Schedule of the General Services Administration. Since 1993, as a result of the Veterans Health Care Act of 1992, or VHC Act, federal law has required that product prices for purchases by the Veterans Administration, the Department of Defense, Coast Guard, and the PHS, including the Indian Health Service, be discounted by a minimum of 24% off the non-federal average manufacturer price, or non-FAMP. Our computation and report of non-FAMP is used in establishing the price, and the accuracy of the reported non-FAMP may be audited by the government under applicable federal procurement laws.

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PATENTS AND PROPRIETARY TECHNOLOGY

Our success will depend, in part, on our ability to obtain commercially valuable patent claims and protect our intellectual property. We currently own or license approximately 56 issued U.S. patents, approximately 40 pending U.S. patent applications, approximately 60 issued foreign patents and approximately 109 pending foreign patent applications. These patents and patent applications primarily relate to (1) the chemical composition, use, and method of manufacturing FACTIVE, (2) pharmaceutical compositions, methods of their use and treatment, and methods of manufacturing ANTARA, (3) anti-infective compounds and their uses, and (4) the field of human and pathogen genetics. Our material patents are as follows:

U.S. Patent No. 5,633,262 granted May 27, 1997, relating to quinoline carboxylic acid derivatives having 7-(4-amino-methyl-3-oxime) pyrrolidine substituent; licensed from LG Life Sciences; expiring June 15, 2015;

U.S. Patent No. 5,776,944 granted July 7, 1998, relating to 7-(4-aminomethyl-3-methyloxyiminopyrroplidin-1-yl)-1-cyclopropyl-6-fluoro-4-oxo-1,4-dihydro-1, 8-naphthyridine-3- carboxylic acid; licensed from LG Life Sciences; expiring April 4, 2017;

U.S. Patent No. 5,869,670 granted February 9, 1999, relating to 7-(4-aminomethyl-3-methyloxyiminopyrrolidin-1-yl)-1-cyclopropyl-6-fluoro-4-oxo-1,4-dihydro-1, 8-naphthyridine-3- carboxylic acid; licensed from LG Life Sciences; expiring June 15, 2015;

U.S. Patent No. 5,962,468 granted October 5, 1999, relating to 7-(4-aminomethyl-3-methyloxyiminopyrrolidin-1-yl)-1-cyclopropyl-6-fluoro-4-oxo-1,4-dihydro-1, 8-naphthyridine-3 carboxylic acid; licensed from LG Life Sciences; expiring June 15, 2015;

U.S. Patent No. 6,340,689 granted January 22, 2002, relating to methods of using quinolone compounds against atypical upper respiratory pathogenic bacteria; licensed from LG Life Sciences; expiring September 14, 2019;

U.S. Patent No. 6,262,071 granted July 17, 2001, relating to methods of using antimicrobial compounds against pathogenic Mycoplasma bacteria; licensed from LG Life Sciences; expiring September 21, 2019;

U.S. Patent No. 6,331,550 granted December 18, 2001, relating to methods of using quinolone compounds against anaerobic pathogenic bacteria; licensed from LG Life Sciences; expiring September 21, 2019;

U.S. Patent No. 6,455,540 granted September 24, 2002, relating to methods of use of quinolone compounds against anaerobic pathogenic bacteria; licensed from LG Life Sciences; expiring September 21, 2019;

U.S. Patent No. 6,723,734 granted April 20, 2004, relating to the salt of naphythyridine carboxylic acid derivative; licensed from LG Life Sciences; expiring March 20, 2018;

U.S. Patent No. 6,803,376 granted October 12, 2004, relating to methods of use of quinolone compounds against pneumococcal pathogenic bacteria; licensed from LG Life Sciences; expiring September 21, 2019;

U.S. Patent No. 7,101,574 granted September 5, 2006, relating to pharmaceutical compositions containing fenofibrate and methods of preparing the same; licensed from Ethypharm, S.A.; expiring August 20, 2020; and

U.S. Patent No. 7,317,001 granted January 8, 2008, relating to methods of use of Ramoplanin for the treatment of *Clostridium difficile*-Associated Disease (CDAD); expiring December 20, 2024.

We are not currently involved in any litigation, settlement negotiations, or other legal action regarding patent issues and we are not aware of any patent litigation threatened against us except for the Orchid Healthcare Paragraph IV matter described further below. Our patent position involves complex legal and factual questions,

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and legal standards relating to the issuance, scope, validity and enforceability of claims in the applicable technology fields are still evolving. Therefore, the degree of future protection for our proprietary rights is uncertain.

Under our development, license and supply agreement with Ethypharm, S.A., we assumed all of the rights and obligations related to the development, manufacturing, marketing and sale of ANTARA in the United States. This license includes one issued U.S. patent and several pending patent applications. In conjunction with the financing of our acquisition of ANTARA, we entered into a Security Agreement with Paul Royalty Fund Holdings II, LP, an affiliate of Paul Capital Partners, or Paul Capital, under which our wholly-owned subsidiary, Guardian II Acquisition Corporation granted Paul Capital a security interest in substantially all of its assets, including all rights to ANTARA intellectual property, in order to secure its performance under the financing agreements with Paul Capital. These patents and applications include claims that relate to pharmaceutical compositions containing fenofibrate using the drug delivery technologies incorporated in ANTARA, methods of their use and treatment, and methods of preparing the same. The patent issued to Ethypharm which is listed in the FDA Orange Book is set to expire in 2020.

Under our license agreement with LG Life Sciences, we obtained an exclusive license to develop and market gemifloxacin in certain territories. This license covers 18 issued U.S. patents and a broad portfolio of corresponding foreign patents and pending patent applications. These patents include claims that relate to the chemical composition of FACTIVE, methods of manufacturing and its use for the prophylaxis and treatment of bacterial infections. We have received a Notice of Final Determination from the U.S. Patent and Trademark Office on our patent term extension application for U.S. Patent No. 5,776,944 extending its patent term 659 days to April 4, 2017. The principal U.S. patents are currently set to expire at various dates, ranging from 2015 to 2019.

On May 30, 2008 we received notice of a Paragraph IV certification from Orchid Healthcare, a Division of Orchid Chemicals & Pharmaceuticals Ltd. (Orchid), notifying us of the filing of an ANDA with the FDA for a generic version of FACTIVE. Orchid s notice sets forth allegations that eight of the nine FDA Orange Book listed patents are invalid and/or will not be infringed by Orchid s manufacture, importation, use, or sale of the product for which the ANDA was submitted. The notice does not, however, include a Paragraph IV certification with respect to U.S. Patent No. 5,633,262, which is also listed in the FDA Orange Book. Accordingly, the FDA cannot finally approve Orchid s ANDA until the expiry of U.S. Patent No. 5,633,262 in June 2015.

We have not commenced a lawsuit against Orchid relating to these eight patents and are continuing to evaluate whether to commence litigation in response to Orchid s Paragraph IV certification. In the event Orchid elects to amend its ANDA to include a Paragraph IV certification with respect to the ninth patent, U.S. Patent No. 5,633,262, we believe that we will be entitled to an automatic thirty-month stay of FDA approval of the ANDA if either we and/or LG Life Sciences initiate a timely patent infringement lawsuit against Orchid, which could be a substantial cost and there are no assurances that we would be successful.

The patents relating to Ramoplanin include claims relating to methods of manufacturing Ramoplanin as well as methods of increasing the yield of the active compound. On January 8, 2008, the United States Patent and Trademark Office (USPTO) issued us a U.S. patent relating to methods of use of Ramoplanin for the treatment of *Clostridium difficile*-associated disease, or CDAD. We also have applications pending relating to various novel uses of Ramoplanin as well as a formulation containing Ramoplanin. The patent covering the chemical composition of Ramoplanin has expired. To provide additional protection for Ramoplanin, we rely on proprietary know-how relating to maximizing yields in the manufacture of Ramoplanin, and intend to rely on the five years of data exclusivity we believe we would receive under the Hatch-Waxman Act in the U.S. and the ten years of market exclusivity in Europe available through the European Medicines Agency (EMEA), because Ramoplanin would be a new chemical entity not previously marketed commercially.

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We also have the exclusive right to use FACTIVE trademarks, trade names, domain names and logos in conjunction with the use or sale of the product in the territories covered by the license. We acquired exclusive rights to ANTARA trademarks, trade names, domain names and logos. After becoming aware that Antara Biosciences, Inc. filed trademark applications with the USPTO for the ANTARA and ANTARA BIOSCIENCES marks in connection with biotechnology related goods and services we filed a complaint in Federal District Court alleging, among other things, trademark infringement seeking to enjoin ANTARA BIOSCIENCES from using the ANTARA mark. We have reached a settlement with ANTARA BIOSCIENCES whereby they have agreed to abandon their ANTARA trademark applications and cease using the ANTARA marks. Accordingly we have dismissed our complaint before the Federal District Court.

We also rely upon unpatented trade secrets and improvements, unpatented know-how and continuing technological innovation to develop and maintain our competitive position. We generally protect this information with confidentiality agreements that provide that all confidential information developed or made known to others during the course of the employment, consulting or business relationship shall be kept confidential except in specified circumstances. Agreements with employees provide that all inventions conceived by the individual while employed by us are our exclusive property. We cannot guarantee, however, that these agreements will be honored, that we will have adequate remedies for breach if they are not honored or that our trade secrets will not otherwise become known or be independently discovered by competitors.

Manufacturing

Currently, our source of supply of bulk capsules of ANTARA is Ethypharm, S.A, which produces the capsules at its facilities in France. Ethypharm is able to receive ANTARA API from two vendors in Spain and Italy. We also have an agreement with Catalent Pharma Solutions (formerly Cardinal Health) to package finished ANTARA capsules.

Under the terms of our agreement with LG Life Sciences, LG Life Sciences has agreed to supply and we are obligated to purchase from LG Life Sciences all of our anticipated commercial requirements for FACTIVE API. LG Life Sciences supplies the FACTIVE API from its manufacturing facility in South Korea. Patheon Pharmaceuticals Inc. currently manufactures the finished tablets. With respect to our sublicense of commercialization rights to FACTIVE in ex-US territories:

- Pfizer Mexico must purchase all of its commercial requirements in Mexico for FACTIVE API from us, but has the option to receive FACTIVE product from us or to fill and finish the final tabletted FACTIVE product at its manufacturing facilities in Mexico. We have transferred the required technology to Pfizer Mexico so that it can start its fill and finish activities;

- Abbott Canada must purchase its commercial requirements for Canada of FACTIVE finished product from us;

- With respect to the anticipated commercialization of FACTIVE in Europe, Menarini must purchase all of its requirements for FACTIVE active pharmaceutical ingredient from us, but may request that we supply finished FACTIVE product to it for an interim period of time while the technology transfer process is completed.

Pursuant to our acquisition of worldwide rights to Ramoplanin from Pfizer (formerly Vicuron), we are responsible for the manufacture of both the active pharmaceutical ingredient and finished dosage form of Ramoplanin. Although we plan to seek a partner for Ramoplanin, a contract manufacturer or the partner would be required to produce both the active pharmaceutical ingredient and the final dosage form to support related manufacturing activities.

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Human Resources

As of December 31, 2007, we had 322 full-time equivalent employees. None of our employees are covered by a collective bargaining agreement, and we consider our relations with our employees to be good.

Properties

Our executive offices are located at 1000 Winter Street, Suite 2200, Waltham, Massachusetts. We lease approximately 36,000 square feet of space at our Winter Street facility and our lease expires on March 31, 2012. During 2007, we incurred aggregate rental costs, excluding maintenance and utilities, for our Corporate headquarter Waltham facility of approximately $833,000. Additionally, in 2006 we incurred approximately $1.8 million in rental costs which included obligations under a lease for approximately 81,000 square feet of space at our former executive offices located at 100 Beaver Street, Waltham, Massachusetts, which expired on November 15, 2006. We subleased approximately 47,000 square feet at our former Beaver Street facility, and we received approximately $1.6 million in sublease income in 2006.

In 2007, we expanded our commercial sales and marketing capabilities by adding offices in New Jersey. Our commercial sales and marketing offices are located at 23 Orchard Road, Suite B103, Skillman, New Jersey. We lease approximately 10,000 square feet of space at the Orchard Road facility and our lease term, which extends five years, will begin in early 2008 and expire in 2013.

We also maintain a west coast lease at 7300 Shoreline Court, South San Francisco, California, for approximately 68,000 square feet of laboratory and administrative space. The remaining average yearly base rent for the west coast facility is approximately $4.7 million. The lease for this facility expires on February 28, 2011 and we have subleased to third parties approximately 61,300 square feet of the facility through various dates ranging from December 31, 2008 to February 28, 2011. In 2007, we received approximately $2.6 million in sublease income from the west coast subleases.

Legal Proceedings

From time to time we are involved in legal actions in the normal course of business, some of which seek monetary damages, including claims for punitive damages. These actions, when finally concluded and determined, will not, in our opinion, have a material adverse effect on our financial position, results of operations or cash flows.

We believe that we have obtained adequate insurance or, where appropriate, have established adequate reserves in connection with these legal proceedings.

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MANAGEMENT

Executive Officers and Directors

The table below lists our Executive Officers and Directors and their ages and positions as of August 15, 2008:

Name	Age	Position(s)
Steven M. Rauscher	55	President, Chief Executive Officer, and Director
Philippe M. Maitre	52	Executive Vice President, Chief Financial Officer
Dominick C. Colangelo	44	Executive Vice President, Corporate Development & Operations
Mark Glickman	43	Senior Vice President of Sales and Marketing
David K. Stone[1][2][4]	51	Chairman of the Board and Director
John R. Leone[4]	61	Director
Gregory B. Brown, M.D[2][3]	55	Director
Robert J. Hennessey[1][2]	66	Director
William R. Mattson[3][4]	61	Director
Gary Patou, M.D.[4]	49	Director
Williams S. Reardon[1]	62	Director
Norbert G. Riedel Ph.D.[2][3]	50	Director

(1) Member of Audit Committee
(2) Member of Nominating and Corporate Governance Committee
(3) Member of Compensation Committee
(4) Member of Compliance Committee

Mr. Rauscher became the Chief Executive Officer and President of Oscient in October 2000 and served as Chairman from May 2003 to February 2004. For more than 18 years, Mr. Rauscher was employed by Abbott Laboratories, holding various positions including Vice President of Sales for the U.S. Pharmaceutical Products Division, Vice President of Business Development for the International Products Division, and Vice President of Corporate Licensing. Following Abbott, he was Chief Executive Officer and a director of Americas Doctor, Inc., a company that provides clinical research and marketing services to the pharmaceutical industry, since 1995. Mr. Rauscher is a member of the Board of Directors of Acorda Pharmaceuticals and Target Discovery, Inc.

Mr. Maitre was appointed Senior Vice President and Chief Financial Officer of the Company in May 2006 and promoted to Executive Vice President in February 2008. Mr. Maitre worked for 18 years at Sanofi-Aventis and predecessor companies, serving most recently as Deputy CFO and Corporate Controller. Mr. Maitre then served as Chief Financial Officer of PPD, Inc. from 2000 to 2002, as President and Chief Executive Officer of ANOSYS Inc. from 2003 to 2005 and subsequently as a consultant to various biopharmaceutical companies until his employment by the Company

Mr. Colangelo was appointed Senior Vice President for Corporate Development and Operations in January 2005 and promoted to Executive Vice President in February 2006. Prior to joining the Company, Mr. Colangelo was Director of Lilly Ventures, for Eli Lilly. Previously Mr. Colangelo held several executive positions with Eli Lilly, including Director, Strategy and Business Development for the Growth Disorders Products group. Mr. Colangelo joined Eli Lilly in 1995.

Mr. Glickman was appointed Vice President of Sales in August 2007 and promoted to Senior Vice President of Sales and Marketing in July 2008. Mr. Glickman held various positions at Kos Pharmaceuticals from 2001 to 2007 including Vice President of Sales. Following Kos Pharmaceuticals, Mr. Glickman was the Vice President of Sales of Bayer Healthcare s Diabetes Care Division for the first half of 2007. Mr. Glickman was also previously employed by Bristol-Myers Squibb as a District sales manager and senior marketing manager.

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Mr. Stone is the Founder and Managing Director of Liberty Tree Advisors, LLC, a consulting and private placement firm focusing on emerging life sciences companies. He was a Managing Director, Partner and Venture Advisor at Flagship Ventures, an early-stage venture capital firm, from 2000 to 2007. From 1989 to 1999, Mr. Stone was at Cowen & Company, where he followed the biopharmaceutical industry, holding the position of Managing Director from 1994 to 1999. Mr. Stone began his career in biotechnology in 1983 as a Project Manager and later Communications Director at Genetics Institute (now part of Wyeth Pharmaceuticals). He earned a B.S. in Microbiology from Colorado State University and an MBA from Harvard Business School.

Mr. Leone, a Partner at Paul Capital Healthcare, has over 30 years of pharmaceutical industry experience. Most recently, he was President and Chief Executive Officer of Cambrex Corporation, a life sciences company committed to accelerating the discovery and commercialization of human therapeutics. Previously, Mr. Leone was at Aventis, where he served as Senior Vice President and Chief Operating Officer of U.S. Commercial Operations. Among other initiatives, Mr. Leone spearheaded the successful integration of Aventis predecessor companies, Rhone-Poulenc Rorer and Hoechst Marion Roussel. His industry experience also includes both domestic and international management roles with Pfizer and Wyeth. Mr. Leone currently serves on the board of directors of Viropharma and Forticell Bioscience. Mr. Leone received his B.S. degree in Engineering from the U.S. Military Academy at West Point and his M.B.A. from the University of Colorado.

Dr. Brown joined the Oscient Board in August 2006. He is a founder and Managing Director of Cowen Healthcare Royalty Partners, an alternative asset management practice affiliated with Cowen Group, Inc. From 2006 to 2007, Dr. Brown served as an independent consultant at Compo Capital Advisors, LLC. Dr. Brown was previously a Partner at Paul Capital Partners from 2003 to 2006. Dr. Brown also worked at Adams, Harkness & Hill from 1997 to 2002, where he served as the co-head of investment banking, and at Vector Securities International from 1992 to 1997. Before receiving his business degree, Dr. Brown was a practicing thoracic and vascular surgeon. He earned his MBA from Harvard Business School, his M.D. from SUNY Upstate Medical Center, and his AB from Yale College.

Mr. Hennessey served as Chief Executive Officer and President of Oscient Pharmaceuticals from March 1993 until October 2000 and Chairman of the Board from May 1994 through May 2003. Mr. Hennessey served as interim Chief Executive Officer of Penwest Pharmaceuticals from February 15, 2005 to December 15, 2005. Mr. Hennessey currently serves on the board of directors of Penwest Pharmaceuticals and, until January 31, 2008, Repligen Corporation. Prior to joining Oscient in 1993, Mr. Hennessey had significant pharmaceutical industry experience, holding positions in Strategic Planning and Business Development for Sterling Drug, Abbott Laboratories, SmithKline and Merck Sharp & Dohme.

Mr. Mattson has served on Oscient s Board since June 2006. Mr. Mattson is Chairman Emeritus of The Mattson Jack Group, a healthcare consulting firm he established in 1986. Previously, Mr. Mattson worked for Monsanto and its subsidiary Searle Pharmaceuticals from 1983-1986 as Director of Marketing Development and Area Vice President. From 1970 to 1983, Mr. Mattson worked in various general management and business development roles at Abbott Laboratories. Mr. Mattson is a member of the St. Louis College of Pharmacy Board of Trustees.

Dr. Patou joined Oscient Pharmaceuticals following the merger with GeneSoft Pharmaceuticals and served as Executive Vice President and Chief Medical Officer through April 2005. He is currently an executive partner at MPM Capital. Prior to the merger, Dr. Patou served as President of Genesoft beginning in December 2000. Prior to joining Genesoft, Dr. Patou worked at GlaxoSmithKline (1995-2000), initially as Vice President of Anti-Infective Development. He subsequently became Senior Vice President & Director, Project and Portfolio Management with responsibility for all therapy areas. Dr. Patou began his career with British Biotech Pharmaceuticals (now Vernalis). He qualified as a physician in the UK in 1982 and is a fellow of the Royal College of Pathologists. Dr. Patou also currently serves on the board of Xenon Pharmaceuticals.

Mr. Reardon is retired from PricewaterhouseCoopers LLP where he was employed from June 1973 to July 2002. Until his retirement, Mr. Reardon was a business assurance (audit) partner at PWC s Boston office and leader of

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its Life Sciences Industry Practice for New England and the Eastern United States. From 1998 to 2000, Mr. Reardon served on the Board of the Emerging Companies Section of the Biotechnology Industry Organization. He also served on the Board of Directors of the Massachusetts Biotechnology Council from 2000 until his retirement from PWC. Mr. Reardon is currently a Board Member at Idera Pharmaceuticals, Inc., and Synta Pharmaceuticals, Inc., serving as Audit Committee Chairman of each.

Dr. Riedel is currently Chief Scientific Officer and Corporate Vice President for Baxter International Inc., a manufacturer of health care products, specialty therapeutics and medical instruments. From 1998 until March 2001, Dr. Riedel served as President of the Recombinant Strategic Business Unit for Baxter Bioscience, a division of Baxter International. Prior to joining Baxter in 1998, Dr. Riedel served as Head of Global Biotechnology for Hoechst Marion Roussel, Inc.

Our Board of Directors

Our directors are elected at the annual meeting of shareholders and hold office (subject to the By-laws) until the next annual meeting of shareholders and until their successors are elected and qualified. The Board of Directors has determined that each of Messrs. Reardon, Riedel, Stone, Mattson and Hennessey is independent within the meaning of Rule 4200 of the NASDAQ Stock Market, Inc. (NASDAQ) listing standards as currently in effect and on the date of our annual meeting of shareholders.

Committees of the Board of Directors

The Board of Directors has four standing committees. Each committee operates pursuant to a written charter. The Board may also establish other committees to assist in the discharge of its responsibilities.

Audit Committee

We have an Audit Committee established in accordance with applicable rules. The Audit Committee of the Board of Directors currently consists of Messrs. Reardon, Hennessey and Stone. In the opinion of the Board of Directors, each of the members of the Audit Committee is independent within the meaning of Rules 4200 and 4350 of the NASDAQ listing standards (as currently in effect and on the date of our annual meeting of stockholders). The Board of Directors has determined that Mr. Reardon, the Chairman of the Audit Committee, possesses the attributes of an audit committee financial expert under the rules of the SEC and the NASDAQ, and has, therefore, designated him as the Audit Committee financial expert. The Audit Committee held six meetings during the last fiscal year, one of which was a joint meeting with the Compliance Committee. The Board of Directors has adopted an Audit Committee Charter. A copy of the charter is available on the Company s website (www.oscient.com).

Compensation Committee

The Board of Directors has a compensation committee, which currently consists of Dr. Riedel (Chairman), Mr. Brown and Mr. Mattson. All members of the Compensation Committee are independent directors, and none of them are present or past employees or officers of ours or any of our subsidiaries. No member of the Compensation Committee has had any relationship with us requiring disclosure under Item 404 of Regulation S-K under the Exchange Act. None of our executive officers has served on the Board or Compensation Committee (or other committee serving an equivalent function) of any other entity, one of whose executive officers served on our Board or compensation committee. The Compensation Committee held six meetings during the last fiscal year. In fiscal 2007, the Compensation Committee retained W.T. Haigh and Company as a compensation consultant to assist it benchmarking our compensation against industry standards, as described in more detail in the Compensation Discussion and Analysis above.

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The Compensation Committee s primary purpose and responsibilities include the following:

- Review and approve corporate goals and objectives relating to CEO and other executive officer compensation, evaluate the CEO s and other executive officers performance in light of those goals and objectives and, either as a committee or together with the other independent directors, determine and approve the CEO s and other executive officers compensation level (encompassing base pay, management incentive plans, stock, benefits and perquisites);
- Make recommendations to the Board regarding director compensation;
- Make recommendations to the Board regarding the adoption of employee incentive compensation plans and equity-based plans;
- Oversee administration of our equity-based plans;
- Review and approve management proposals for annual employee salary planning; and
- Perform periodic review of major employee benefit plans.

The Board of Directors has adopted a Compensation Committee Charter. A copy of the charter is available on the Company s website (www.oscient.com).

Nominating and Corporate Governance Committee

We have a Nominating and Corporate Governance Committee composed of independent members within the meaning of rule 4200 of the NASDAQ listing standards, which currently consists of Mr. Stone (Chairman), Dr. Riedel and Mr. Brown. The Nominating and Corporate Governance Committee did not hold any meetings during the last fiscal year.

The Board of Directors has adopted a Nominating and Corporate Governance Committee Charter. A copy of the charter is available on the Company s website (www.oscient.com). Under the charter, the responsibilities of the Nominating and Corporate Governance Committee include:

- identifying and evaluating individuals qualified to become members of the Board; and
- recommending nominees for the annual meeting of stockholders.

The Nominating and Corporate Governance Committee will consider director candidates recommended by our stockholders. Recommendations with regard to nominees for election to the Board of Directors may be submitted by any stockholder entitled to vote for the election of directors in writing, received by the Clerk of the Company at least 120 days prior to the date on which we first mailed our proxy materials for the prior year s annual meeting of stockholders, or, if we did not have an annual meeting of stockholders in the prior year, 90 days prior to the date of the annual meeting. Each notice of nomination must set forth (i) the name, age, business address and, if known, residence address of each nominee, (ii) the principal occupation or employment of each such nominee, and (iii) the number of shares of our common stock which are beneficially owned by each such nominee. All such notices should be sent to: Oscient Pharmaceuticals, 1000 Winter Street, Suite 2200, Waltham, MA 02451, Attn: Clerk.

The Nominating and Corporate Governance Committee has established certain minimum qualifications for Board members, including:

the ability of the prospective nominee to represent the interests of our stockholders;

the prospective nominee s standards of integrity, commitment and independence of thought and judgment;

the prospective nominee s ability to dedicate sufficient time, energy and attention to the diligent performance of his or her duties, including consideration of his or her service on other corporate boards;

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- the prospective nominee s ability to contribute to the range of talent, skill and expertise present on the Board; and

- the extent to which the prospective nominee helps the Board reflect the diversity of our stockholders, employees, customers and communities.

The Nominating and Corporate Governance Committee also considers the ability of the nominee to meet the applicable requirements of SEC regulations, state law and our Articles of Organization and By-laws.

The Nominating and Corporate Governance Committee has established a process for identifying and evaluating nominees for director. The Committee will annually assess the qualifications, expertise, performance and willingness to serve of existing directors. If at this time or at any other time during the year the Board of Directors determines a need to add a new director with specific qualifications or to fill a vacancy on the Board, the Nominating and Corporate Governance Committee will then initiate the search, working with staff support and seeking input from other directors and senior management, considering nominees previously submitted by stockholders, and, if deemed necessary or appropriate, hiring a search firm. An initial slate of candidates satisfying the specific qualifications, if any, and otherwise qualifying for membership on the Board will then be identified and presented to the independent directors. The independent directors will then prioritize the candidates and determine if other directors or senior management have relationships with the preferred candidates and can initiate contact. If not, contact would be initiated by a search firm. To the extent feasible, all of the members of the Nominating and Corporate Governance Committee and the CEO will interview the prospective candidate(s). Evaluations and recommendations of the interviewers will be submitted to the whole Board for final evaluation. The Board will meet to consider such information and to select candidates for appointment to the Board at the annual meeting. Nominees recommended by a stockholder will be evaluated on the same basis as other nominees.

Compliance Committee

We established a Compliance Committee of the Board of Directors in July 2005. The Compliance Committee currently consists of four Board members: Dr. Patou (Chairman) and Messrs. Leone, Mattson and Stone. The Compliance Committee had three meetings during the last fiscal year, one of which was a joint meeting with the Audit Committee.

The Board of Directors has adopted the Compliance Committee Charter. A copy of the charter is available on the Company s website (www.oscient.com). Under the charter, the responsibilities of the Compliance Committee include:

- review the adequacy of our internal controls, policies, procedures and programs regarding (i) product safety and quality, (ii) the development, manufacturing, marketing, distribution and sale of our products, and (iii) our compliance with related legal and regulatory requirements; and

- oversee the work of our senior compliance executives and other relevant members of senior management and receive reports from such officers about material issues and/or matters related to our compliance with such laws and regulations.

The Compliance Committee does not have oversight responsibility for financial matters, including financial statements and systems of internal control over financial reporting, which are monitored by the Audit Committee.

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EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Objectives of Compensation Program

Our goal is to attract, retain, motivate, and reward our employees through the use of competitive compensation plans that serve to closely align employee interests with that of the Company and the long-term interests of our stockholders. Competitive and labor market dynamics as well as financial position influence our compensation philosophy. We strive to retain and reward the highest caliber management team by offering competitive compensation plans, which are comparable to those offered by our competitors, and promote performance-based compensation. To more closely align the interests of employees with those of the stockholders, we employ equity-based employee awards.

Overview of Compensation and Process

We strive to attract and retain the necessary executive talent, reward annual performance and provide incentives to reward performance that is intended to create long-term stockholder value. The amount of each element of compensation is determined by or under the direction of our Compensation Committee, which considers the following factors in determining the amount of salary and other benefits to pay each executive:

- performance against corporate and individual goals for the previous year;
- difficulty of achieving desired results in the coming year;
- value of his or her unique skills and capabilities to support long-term performance of the Company;
- performance of their general management responsibilities; and
- contribution as a member of the executive management team.

Our compensation policy strives to provide a balance between short and long-term compensation in order to attract and retain talent and provide incentives to maximize long-term value for our company and our stockholders. The compensation of the executive officer team consists of a combination of salary, annual cash incentives, equity grants, contributions to or accruals under benefit plans and participation in various other plans generally available to all employees, such as our 401(k) plan. We provide cash compensation in the form of base salary to meet competitive salary norms and annual cash incentive payments to reward performance against specific annual corporate goals. We provide equity awards to reward performance against specific objectives and long-term strategic goals and help align the interest of our executive officers with those of our stockholders. Equity awards are determined by performance and competitive market practice with respect to equity awards granted to executives as a percentage of common shares outstanding.

Each year we review the compensation paid to all employees, including executive officers, to ensure that the key elements and overall compensation remain competitive with prevailing industry benchmark data of similarly situated companies and remain aligned with stockholder interests. In fiscal 2007, the Compensation Committee engaged W.T. Haigh and Company to assist in benchmarking and assessing our compensation program against market standards. W.T. Haigh prepared a benchmarking report for the Compensation Committee based on a peer group of eighteen companies and the Radford Biotechnology Survey, which provides data for a broader range of biotechnology and pharmaceutical companies. The peer group was selected based upon similarities in pharmaceutical industry specialty, number of employees, market capitalization and net sales. The peer group consisted of: Abaxis, Inc., Akorn, Inc., ArQule, Inc., Auxilium Pharmaceuticals, Inc., Barrier Therapeutics, Inc., Bentley Pharmaceuticals, Inc., CollaGenex Pharmaceuticals, Inc., Columbia Laboratories, Inc., Cytogen Corporation, Enzon Pharmaceuticals, Inc., Indevus Pharmaceuticals, Inc., ISTA Pharmaceuticals, Inc., Nabi Biopharmaceuticals, Quidel Corporation, Santarus, Inc., SciClone Pharmaceuticals, Inc., Sciele Pharma, Inc. and Stratagene Corporation. The Compensation Committee utilizes benchmarking data as a guide to ensure that executive compensation and mix of compensation elements remain competitive with market standards.

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Compensation Components

The components of our compensation program are described in more detail below:

Base Salary

Base salaries for our named executive officers are established based on their responsibilities, experience, performance and expected contribution to the Company. Salary levels also take into account the salary and compensation paid by similar companies with which we compete for executive talent. Base salaries are reviewed annually taking into account the executive officer s effectiveness in achieving the corporate goals set out for the previous year, his or her expected contribution for the coming year and the competitive data. Base salaries are also evaluated relative to other components of our compensation program to ensure the executives total compensation and mix of components is consistent with our compensation philosophy and objectives.

Each year, the Company establishes a budget for merit based salary increases for its employees. The Committee retains discretion as to whether or not salary increases will be granted and makes a determination based upon achievement of the corporate goals (discussed under Annual Incentives below), individual performance and market data. In fiscal 2007, the Committee determined that the 2007 bases salaries for Messrs. Rauscher, Colangelo and Maitre would remain unchanged.

Annual Incentives

Our named executive officers are eligible to receive annual cash incentive payments in an amount equal to a percentage of their annual base salary based on attainment of corporate performance goals as determined by the Compensation Committee. The Committee sets a percentage of base salary as a target for each named executive officers annual incentive cash bonus and then determines the annual incentive cash bonus to be paid based on achievement of stated goals.

Each year, the Chief Executive Officer recommends corporate goals for the prospective year. The Compensation Committee reviews, modifies if necessary, and approves the proposed goals and then sets and prioritizes officer performance goals for the year and assigns relative weight of importance for each performance goal. In prior years, in assessing executive officer performance, the Committee considered individual performance goals for each executive officer in addition to the corporate goals. In fiscal 2007, the Committee decided to measure executive officer performance against the corporate goals only and not utilize individual performance goals. The Committee s decision reflects its belief that the corporate goals provide unified objectives for the management team and a more objective basis for assessing executive performance and determining annual incentive payments.

The fiscal 2007 corporate performance goals were linked to revenue, cash management and certain strategic and operational objectives. The Committee assigned each goal a weight based upon its relative importance to the Company. Credit is awarded and apportioned based on the achievement of a performance goal which ranges from 85% to 150% of the proposed goal. If a goal is not achieved at the 85% level, then no credit is awarded. Based on the actual results and the weight of each goal an aggregate performance score is computed, which is then used to determine the annual incentive amount paid to each named executive officer.

The Committee evaluated overall 2007 performance against the goals summarized below:

ANTARA and FACTIVE net sales: The Company established sales targets for each product. Given the importance of product revenues to the Company, the Committee further provided that no incentive payments would be made unless aggregate sales of ANTARA and FACTIVE equaled or exceeded 85% of the aggregate sales target for the products. The Company achieved ANTARA net sales of $58.6 million as of December 31, 2007 exceeding the established target for that product. FACTIVE US net sales were $16.4 million as of December 31, 2007 which did not meet the target for that product. Aggregate sales exceeded 85% of the aggregate sales target.

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Secure additional capital: In April 2007, the Company secured an additional $40.4 million in net proceeds exceeding the established target.

Additional financial objectives: The Company had a year end cash balance of $12.1 million as of December 31, 2007 (excluding new financing) which exceeded the goal. However, the net loss of $63.7 million (excluding the impact of certain non-cash gains) did not meet the established objective.

Strategic goals: Corporate development and operational goals including, among other items, acquiring or licensing a third product were not achieved in 2007.

Based on these actual results and the weighting of each goal the actual aggregate performance score achieved in fiscal 2007 was 75.6%. The target bonus levels for Messrs. Rauscher, Colangelo and Maitre in fiscal 2007 were 60%, 50% and 40% of their base salaries, respectively, which translate to target bonuses of $259,650, $170,000 and $108,000, respectively, as listed in the Grant of Plan Based Awards for 2007 presented later in the proxy. Multiplying these target bonuses by the aggregate performance score of 75.6% provides the annual incentive payouts to Messrs. Rauscher, Colangelo and Maitre for fiscal 2007 in the amounts of $196,253, $128,537 and $81,659, respectively, as reported in the Summary Compensation Table, which follows this Compensation Discussion and Analysis.

Long-Term Equity Incentives

We grant equity awards to our named executive officers, in the form of restricted stock grants and stock options, to provide employees, including executive officers, with longer term incentives and as a key tool to encourage employee retention. Because of the direct relationship between the value of an equity award and the market price of our common stock, we believe that granting stock options and other equity awards is an effective method of motivating executive officers to manage our company in a manner that is consistent with the interests of our stockholders. Equity awards are typically granted to employees when they are hired, upon promotions and each year in connection with annual performance review. For annual performance grants, the executive team makes a recommendation to the Compensation Committee as part of the Company s annual salary planning cycle which occurs in March and the Committee determines the grant for each executive officer. Equity awards typically include a mix of options to purchase our common stock and restricted shares of our common stock that vest over a prescribed period. Exercise prices for option grants are wholly determined by the Compensation Committee and are fixed at the fair market value on the date of Compensation Committee approval or at a specified date of grant.

We grant stock awards to our executive officers and eligible employees based upon prior performance, the importance of retaining their services and the potential for their performance to help us attain our long-term goals. In determining annual equity awards the Compensation Committee also takes into account the extent to which previous equity awards continue to provide appropriate incentives to employees. Company and individual performance and competitive market practices are key considerations in determining size and mix of grants for employees, including executive officers. Equity grants awarded to officers and other eligible employees are typically confined to a certain percentage of common shares outstanding. The Committee considered data from benchmarking analysis conducted by W.T. Haigh and Company, which among other compensation elements, compared equity stakes held by the named executive officers to other executives in comparable positions in the peer group and the Radford Survey. Based on the factors described above, the Committee determined that 2007 equity grants should be granted at a level equal to 75% of last year s grants. On February 25, 2008, as part of the annual process for determining annual compensation and annual equity awards Messrs. Rauscher, Colangelo and Maitre received restricted stock awards of 18,147 shares, 14,672 shares and 14,000 shares, respectively, all of which vest over two years and stock options to purchase 45,303 shares, 36,629 shares and 35,000 shares of common stock, respectively, which vest over two years; however for Messrs. Rauscher and Colangelo, as with other employees with at least two years tenure with the Company, twenty-five percent of the stock options vested on the day of the grant and the remaining seventy-five percent vest over two years. All options were granted at an exercise price of $2.16, the closing sale price of a share of the Company s common stock on February 25, 2008.

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These equity awards granted to our executive officers in the aggregate represent 1.2% of common shares outstanding as of December 31, 2007 and follow the Company s practice of considering officer grants within the confines of performance, market practices, annual approved usage rate and past practice with respect to percentage of outstanding shares awarded to our executive officers.

Other Benefits

Our executives are entitled to few benefits that are not otherwise available to all of our employees. Other benefits for executive officers are limited to executive life insurance. Our Chief Executive Officer also receives a predetermined annual allowance of $14,652 as prescribed in Mr. Rauscher s employment agreement with the Company which is paid primarily for car allowances and Philippe Maitre, our Executive Vice President and Chief Financial Officer, received $64,711 as a reimbursement for relocation expenses in fiscal 2007.

All of our named executive officers participated in our 401(k) plan and received matching employer contributions at the same rate as other employee-participants. Our health and insurance plans are the same for all employees and our healthcare premiums follow a shared cost schedule, under which employees contribute approximately 23% of the healthcare premiums.

Termination-based compensation

Under the terms of their employment agreements, our executive officers are, under specified circumstances, entitled to receive severance payments and, in some cases, accelerated vesting of equity awards upon termination of employment. The severance payments, and in particular the change of control severance, are intended to aid in employee retention and maintain productivity in the event of a change of control of the Company. In addition, these payments are designed to align executive and stockholder interests by enabling executives to consider corporate transactions that are in the best interests of the stockholders and other constituents of the Company without undue concern over whether the transactions may jeopardize the executives own employment. The specific triggering provisions and severance due each of the executive officers is described below under Employment Agreements and Potential Payments upon Change of Control. We believe that our severance arrangements are in line with severance packages offered to executive officers of companies of similar size to us represented in the compensation data we reviewed.

162(m) Policy

Under Section 162(m) of the Internal Revenue Code, publicly held corporations may be prohibited from deducting as an expense for federal income tax purposes total compensation in excess of $1 million paid to certain executive officers in a single year. However, Section 162(m) provides an exception for qualifying performance-based compensation, including compensation attributable to certain stock options. We periodically review the potential consequences of Section 162(m) and may structure the performance-based portion of our executive compensation to comply with certain exemptions in Section 162(m). However, we reserve the right to use our judgment to authorize compensation payments that do not comply with the exemptions in Section 162(m) when we believe that such payments are appropriate and in the best interests of the stockholders, after taking into consideration changing business conditions or the officer s performance.

Post-Employment Compensation

Pension Benefits

We do not provide pension arrangements or post-retirement health coverage for our executives or employees. Our executive officers are eligible to participate in our 401(k) defined contribution plan. In any plan year, we will contribute to each participant a matching contribution equal to 50% of the first 6% of the participant s compensation that has been contributed to the plan, as prescribed in the plan document and within federal tax limits. All of our executive officers participated in our 401(k) plan during fiscal 2007 and received matching contributions.

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Nonqualified Deferred Compensation

We do not provide any nonqualified defined contribution or other deferred compensation plans.

Summary Compensation Table for 2007

The following table sets forth a summary of annual and long-term compensation awarded, earned or paid for the fiscal year ended December 31, 2007 and December 31, 2006 to our Chief Executive Officer and two Executive Vice Presidents.

Name and Principal Position	Year	Salary ($)	Non-Equity Incentive Plan Compensation ($)	Stock Awards ($)[1]	Option Awards ($)[2]	All Other Compensation ($)	Total ($)
Steven Rauscher	2007	432,600	196,253	156,883	390,698	25,709[3]	1,202,143
Chief Executive Officer and President	2006	432,115	325,282	92,196	919,779	174,240[6]	1,943,612
Dominick Colangelo	2007	340,000	128,537	125,818	267,581	7,200[4]	869,136
Executive Vice President, Corporate Development and Operations	2006	338,654	206,136	73,757	193,495	7,050[7]	819,092
Philippe Maitre	2007	270,000	81,659	41,546	52,883	64,711[5]	510,799
Executive Vice President and Chief Financial Officer	2006	155,769[9]	96,904	14,264	18,001	22,022[8]	306,960

(1) Reflects the amounts recognized for financial statement reporting purposes for fiscal 2007 and 2006 in accordance with SFAS No. 123R Refer to Note 2, Stock-Based Compensation, in the Notes to Consolidated Financial Statements found in our Annual Report on Form 10-K filed with the SEC on February 6, 2008 for the assumptions used to determine the valuation of our stock awards.

(2) The values shown reflect the dollar amounts relating to option awards recognized for financial statement purposes for the fiscal year ended December 31, 2007 and 2006 in accordance with SFAS No. 123R. Refer to Note 2, Stock-Based Compensation, in the Notes to Consolidated Financial Statements found in our Annual Report on Form 10-K filed with the SEC on February 6, 2008 for the assumptions used to determine the valuation of our option awards.

(3) The 2007 amount represents $3,758 in contributions to Mr. Rauscher s life insurance premiums, $6,750 to the Company s 401(k) Retirement Savings Plan and $15,201 in compensation allowances related to car allowances.

(4) The 2007 amount represents $450 in contributions to Mr. Colangelo s life insurance premiums, and $6,750 to the Company s 401(k) Retirement Savings Plan.

(5) This amount represents $4,673 in contributions to the Company s 401(k) Retirement Savings Plan and $60,038 in relocation costs.

(6) The 2006 amount represents $3,758 in contributions to Mr. Rauscher s life insurance premiums, $6,600 to the Company s 401(k) Retirement Savings Plan, $14,652 in compensation allowances which are paid in accordance with Mr. Rauscher s employment agreement primarily for car allowances and $149,230 related to income realized for payment in full of all principal outstanding under a note whereby, the Company loaned Mr. Rauscher $163,000 to allow him to pay income tax liabilities associated with the grant of 3,000 restricted shares. In accordance with the terms of the loan, Mr. Rauscher transferred 3,000 shares to the Company as payment in full under such loan and paid the Company an amount equal to $41,334 for interest due to the Company pursuant to such loan.

(7) The 2006 amount represents $450 in contributions to Mr. Colangelo s life insurance premiums, and $6,600 to the Company s 401(k) Retirement Savings Plan.

(8) This amount represents $22,022 in relocation costs.

(9) Mr. Maitre commenced employment with the Company May 2006, and this amount represents the pro-rata amount paid to Mr. Maitre of his $270,000 base salary in fiscal 2006.

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Grants of Plan-Based Awards for 2007

The following table sets forth certain information with respect to the options granted during or for the fiscal year ended December 31, 2007 to each of our named executive officers.

Name and Principal Position	Estimated Future Payouts Under Non-Equity Incentive Plan Awards		Grant Date	All Other Stock Awards: Number of Shares of Stock or Units[1]	All Other Option Awards: Number of Securities Underlying Options[2]	Exercise or Base Price of Option Awards[3]	Grant Date Fair Value of Stock and Option Awards[4]
	Target ($)	Maximum ($)		(#)	(#)	($)	($)
Steven Rauscher Chief Executive Officer and President	259,560	389,340	03/7/07	24,196	60,404	4.94	176,677
Dominick Colangelo Executive Vice President, Corporate Development and Operations	170,000	255,000	03/7/07	19,562	48,838	4.94	141,015
Philippe Maitre Executive Vice President and Chief Financial Officer	108,000	162,000	03/7/07	7,722	19,278	4.94	58,836

(1) Awards consist of restricted stock awards that vest 50% per year for two years from date of grant.

(2) All options vest in eight equal quarterly installments beginning 90 days form the grant date.

(3) The exercise price of the stock option awards is equal to the average of the high and low sales price of the common stock on the day of grant as reported by The NASDAQ Global Market.

(4) This column represents the grant date fair value of each equity award computed in accordance with SFAS No. 123R. Refer to Note 2, Stock-Based Compensation, in the Notes to Consolidated Financial Statements found in our Annual Report on Form 10-K filed with the SEC on February 6, 2008 for the assumptions used to determine the valuation of our equity awards.

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Outstanding Equity Awards Value at Fiscal Year-End Table

The following table includes certain information with respect to the value of all unexercised options previously awarded to the named executive officers at the fiscal year end December 31, 2007.

	Option Awards					Stock Awards			
Name and Principal Position	Number of Securities Underlying Unexercised Options Exercisable	Number of Securities Underlying Unexercised Options Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options	Option Exercise Price	Option Expiration Date[1]	Number of Shares or Units of Stock That Have Not Vested	Market Value of Shares or Units of Stock That Have Not Vested	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested
Steven Rauscher	34,037			$ 115.50	10/25/2010				
Chief Executive Officer and	30,000			$ 115.50	10/25/2010				
President	3,463			$ 115.50	10/25/2010				
	1,953			$ 13.36	3/6/2012				
	3,751			$ 45.16	3/6/2012				
	3,750			$ 45.16	3/6/2012				
	2,500			$ 8.80	10/9/2012				
	1,667			$ 8.80	10/9/2012				
	834			$ 8.80	10/9/2012				
	8,251			$ 3.072	3/11/2013				
	2,344			$ 10.24	3/11/2013				
	2,344			$ 10.24	3/11/2013				
	1,069			$ 15.42	2/3/2014				
	2,278			$ 41.76	4/12/2014				
	51,812			$ 41.76	4/12/2014				
	8,311			$ 41.76	4/12/2014				
	1			$ 21.80	3/6/2015				
	9,285			$ 21.80	3/6/2015				
	1	4,166[3]		$ 21.80	3/6/2015				
	45,834			$ 21.80	3/6/2015				
	1,068			$ 18.20	12/20/2015				
	1	595[4]		$ 15.40	2/26/2016				
	27,344	3,311[4]		$ 15.40	2/26/2016				
						12,098[5]	$ 16,332		
	22,652	37,752[4]		$ 4.94	3/6/2017				
Dominick Colangelo	6,954	6,954[2]		$ 28.76	1/2/2015				
Executive Vice President	8,672	8,670[2]		$ 28.76	1/2/2015				
	21,875	3,125[4]		$ 15.40	2/26/2016				
						9,781[5]	$ 13,204		
	18,314	30,524[4]		$ 4.94	3/6/2017				
Philippe Maitre	5,469	16,406[2]		$ 13.64	5/21/2016				
Executive Vice President and						3,861[5]	$ 5,212		
Chief Financial Officer						6,562[5]	$ 8,859		
	7,229	10,829[4]		$ 4.94	3/6/2017				
		1,220[4]		$ 4.94	3/6/2017				

(1) The expiration date of each option occurs ten years after the date of grant of each option.
(2) Options become exercisable in four equal annual installments from the date of grant.
(3) Options become exercisable in twelve equal quarterly installments beginning 90 days from the date of grant.
(4) Options become exercisable in eight equal quarterly installments beginning 90 days from the date of grant.
(5) Restricted stock vests in two equal installments on November 30, 2008 and November 30, 2009, respectively.

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Options Exercised and Stock Vested in the year ended December 31, 2007

	Stock Awards	
Name	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)
Steven Rauscher	18,348	23,852
Dominick Colangelo	14,781	19,215
Philippe Maitre	6,049	17,327

Employment Agreements

Steven Rauscher, President and Chief Executive Officer

Steven Rauscher, President and Chief Executive Officer, has an employment agreement with us, which commenced on October 26, 2000. Mr. Rauscher s current base salary is $432,600 per year. The agreement entitles Mr. Rauscher to receive an annual incentive bonus target of 60% of his base salary based on our achievement of certain performance measures as determined by the Board of Directors. Upon hiring in October 2000, Mr. Rauscher was awarded stock options to purchase 67,500 shares of common stock at an exercise price of $115.50 per share, the fair market value of the common stock on the date of grant. These options are fully vested. In connection with his commencement of employment with us in 2001, Mr. Rauscher was also awarded 3,000 shares of restricted common stock share.

In the event that Mr. Rauscher s employment is terminated by us for reasons other than for cause, or he terminates it with good reason (as defined), the agreement provides for the continuation of all compensation and benefits for a period of up to 12 months, or until such time as he finds comparable employment, whichever occurs first. Also, if, within two years following a change of control (as defined) of the Company, Mr. Rauscher s employment is terminated other than for cause, or he experiences a material reduction in responsibilities or compensation, or is required to relocate out of the greater Boston area, he will receive a lump sum severance payment in an amount equal to two times the sum of his base salary and annual target incentive bonus, as well as the pro-rated portion of his target bonus for the year in which his employment is terminated, and any remaining unvested options and restricted shares will immediately and fully vest and all his options will remain exercisable for the shorter of two years from his date of termination or the expiration date of the option. Mr. Rauscher is also entitled to continue to participate in the Company s group health and dental plans for a period of 24 months following termination and the Company is obligated to continue to contribute to the premium cost of that coverage for such period. Mr. Rauscher s employment agreement also provides that he will be entitled to receive a payment to cover any excise tax payable with respect to such severance payments as a result of Section 280G of the U.S. tax code.

Dominick Colangelo, Executive Vice President, Corporate Development and Operations

Dominick (Nick) Colangelo, Esq., Executive Vice President, Corporate Development and Operations, has an employment agreement with us, which commenced on January 1, 2005. Mr. Colangelo s current base salary is $340,000 per year. The agreement, as amended, entitles Mr. Colangelo to receive an annual incentive bonus target of 50% of his salary based on his performance and that of the Company against goals to be determined by the Board of Directors annually. Upon hiring in January 2005, Mr. Colangelo received a cash signing bonus of $100,000 and was awarded stock options to purchase 31,250 shares of common stock at $28.76 per share, the fair market value of the common stock on the date of grant, which options vest in four equal annual installments on the anniversary of his commencement of employment.

In the event that Mr. Colangelo s employment is terminated by us for reasons other than for cause, or he terminates it with good reason (as defined), the agreement provides for the continuation of all compensation and benefits for a period of up to nine months, or until such time as he finds comparable employment, whichever

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occurs first. Also, if, within two years following a change of control (as defined) of the Company, Mr. Colangelo s employment is terminated other than for cause, or he experiences a material reduction in responsibilities or compensation at the surviving company, or he is required to relocate out of the greater Boston area, he will receive a lump sum severance payment equal to one and a half times the sum of his base salary and annual target incentive bonus, as well as the pro-rated portion of his target bonus for the year in which his employment is terminated and any remaining unvested restricted shares and options will immediately and fully vest and all his options will remain exercisable for the shorter of two years from his date of termination or the expiration date of the option. Mr. Colangelo is also entitled to continue to participate in the Company s group health and dental plans for a period of 18 months following termination and the Company is obligated to continue to contribute to the premium cost of that coverage for such period. Mr. Colangelo s employment agreement also provides that he will be entitled to receive a payment to cover any excise tax payable on such severance payments as a result of Section 280G of the U.S. tax code.

Philippe Maitre, Executive Vice President and Chief Financial Officer

Philippe Maitre, Executive Vice President and Chief Financial Officer, has an employment agreement with us, which commenced on May 22, 2006. Mr. Maitre s current base salary is $300,000 per year. The agreement entitles Mr. Maitre to receive an annual incentive bonus target of 50% of his base salary based on his performance and that of the Company against goals to be determined by the Board of Directors annually after consultation with Mr. Maitre. Upon hiring, Mr. Maitre received a cash signing bonus of $25,000 and was awarded (i) stock options to purchase 21,875 shares of common stock at an exercise price of $13.64 per share, the fair market value of the common stock on the date of grant, which options vests in four equal annual installments on the anniversary of his commencement of employment, and (ii) 8,750 shares of restricted common stock which stock vest in four equal annual installments on the anniversary of his commencement of employment. We also agreed to reimburse Mr. Maitre for reasonable relocation expenses up to $125,000.

In the event that Mr. Maitre s employment is terminated by us for reasons other than for cause, or he terminates it with good reason (as defined), the agreement provides for the continuation of all compensation and benefits for a period of up to nine months, or until such time as he finds comparable employment, whichever occurs first. Also, if, within two years following a change of control (as defined) of the Company, Mr. Maitre s employment is terminated other than for cause, or he experiences a material reduction in responsibilities at the surviving company, he will receive a lump sum severance payment equal to one and a half times the sum of his base salary and annual target incentive bonus, as well as the pro-rated portion of his target bonus for the year in which his employment is terminated and any remaining unvested restricted shares and options will immediately and fully vest and all his options will remain exercisable for the shorter of two years from his date of termination or the expiration date of the option. Mr. Maitre is also entitled to continue to participate in our group health and dental plans for a period of 18 months following termination and the Company is obligated to continue to contribute to the premium cost of that coverage for such period. Mr. Maitre s employment agreement also provides that he will be entitled to receive a payment to cover any excise tax payable on such severance payments as a result of Section 280G of the U.S. tax code.

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Potential Payments Upon Termination of Employment or Change of Control Under Employment Agreements

The following table summarizes the potential payments to each named executive officer assuming that one of the following events occurs. The table assumes that the event occurred on December 31, 2007, the last business day of our fiscal year. We have assumed a price per share of our common stock of $1.35, which was the closing price of our common stock on December 31, 2007.

Name	Termination Other Than For Cause or Resignation With Good Reason	Termination Other Than For Cause Following a Change in Control
Steven Rauscher President and Chief Executive Officer	$ 705,402[1]	$ 2,444,928[2]
Dominick Colangelo Executive Vice President, Corporate Development and Operations	392,432[3]	1,213,489[4]
Philippe Maitre Executive Vice President and Chief Financial Officer	293,432[5]	878,009[6]

(1) Includes payment of the following: $432,600 for the continuation of salary, $259,560 for his target bonus and $13,242 for continuation of benefits for a period of 12 months following such termination, or until Mr. Rauscher finds comparable employment. We have assumed payment for the full 12 months.

(2) Includes payment of the following: $1,384,320 in a lump sum payment for salary and bonus, equivalent to two times his base salary for fiscal year 2007 plus two times his annualized target incentive bonus; $259,560 for the pro-rated portion of his target bonus for the year in which he was terminated; $26,485 for benefits, the value of which is based upon the premiums in effect on December 31, 2007; $183,833 for accelerated vesting of equity awards, based on the fair value of unvested stock options as of December 31, 2007 in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, Share-based Payments ; and, $590,730 for any excise tax payable with respect to such severance payments in accordance with Section 280G of the U.S. tax code. The gross-up figures assume a December 31, 2007 change in control and termination date. For purposes of these figures, the following are included as parachute payments: cash severance payable upon the termination in connection with the change of control, additional pro-rated bonus amounts payable upon the termination, and the value of the acceleration of outstanding equity awards, all determined in accordance with applicable tax regulations. Any earned but unpaid salary or bonus amounts due following the termination are not treated as parachute payments. We have assumed that all outstanding options are cashed out in the assumed transaction for an amount equal to the excess, if any, of $1.35 (the closing price of our common stock on December 31, 2007, the last business day of the year) over the exercise per share under the option, multiplied by the number of shares subject to the option. Finally, these figures assume that none of the parachute payments will be discounted as attributable to reasonable compensation and no value is attributed to the executive executing a non-competition agreement in connection with the assumed termination of employment.

(3) Includes payment of $255,000 for the continuation of salary, $127,500 for his target bonus and $9,932 for continuation of benefits for a period of nine months following such termination, or until Mr. Colangelo finds comparable employment. We have assumed payment for the full nine months.

(4) Includes payment of the following: $765,000 in a lump sum payment for salary and bonus, equivalent to one and a half times the sum of his base salary for fiscal year 2007 plus his annualized target incentive bonus; $170,000 for the pro-rated portion of his target bonus for the year in which he was terminated; $19,864 for benefits, the value of which is based upon the premiums in effect on December 31, 2007; and $258,625 for accelerated vesting of equity awards, based on the fair value of unvested stock options as of December 31, 2007 in accordance with the provisions of SFAS No. 123R, Share-based Payments .

(5) Includes payment of $202,500 for the continuation of salary, $81,000 for his target bonus and $9,932 for continuation of benefits for a period of nine months following such termination, or until Mr. Maitre finds comparable employment. We have assumed payment for the full nine months.

(6) Includes payment of the following: $567,000 in a lump sum payment for salary and bonus, equivalent to one and a half times the sum of his base salary for fiscal year 2007 plus his annualized target incentive bonus; $108,000 for the pro-rated portion of his target bonus for the year in which he was terminated; $19,864 for benefits, the value of which is based upon the premiums in effect on December 31, 2007;

and, $183,145 for accelerated vesting of equity awards, based on the fair value of unvested stock options as of December 31, 2007 in accordance with the provisions of SFAS No. 123R, Share-based Payments .

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RELATED PARTY TRANSACTIONS

In accordance with our Audit Committee charter, our Audit Committee is responsible for reviewing and approving the terms and conditions of all related party transactions. Although we have not entered into any financial transactions with any immediate family member of a director or executive officer of our Company, if we were to do so, any such material financial transaction would need to be approved by our Audit Committee. A report is made to our Audit Committee annually disclosing all related parties that are employed by us and related parties that are employed by other companies with whom we had a material relationship during that year, if any. In determining whether to approve or ratify an interested transaction, the Audit Committees takes into account such factors as they deem appropriate, which may include whether the interested transaction is on terms no less favorable than terms generally available to an unaffiliated third party under the same or similar circumstances and the extent of the related person s interest in the transaction.

We did not have any reportable related party transaction in fiscal 2007 and we have not had any reportable related party transactions thus far in fiscal 2008.

We have determined that, in 2006, we had the following reportable related transaction described below.

To finance the acquisition of ANTARA capsules in August 2006, we entered into several financing arrangements with Paul Royalty Fund Holdings II, LP, an affiliate of Paul Capital Partners (PRF), in consideration for an aggregate amount of $70.0 million. In connection with such financing arrangements, we agreed to elect one person designated by PRF to our Board following the closing in August of 2006 and to continue to nominate one person designated by PRF for election to our Board by our shareholders. Initially, Greg Brown and Walter Flamenbaum were PRF s previous representatives and John Leone currently acts as the PRF designee to our Board. In connection with such financing transaction, we entered into the Revenue Interests Assignment Agreement pursuant to which we sold to PRF the right to receive specified royalties on Oscient s net sales in the United States (and the net sales of its affiliates and licensees) of FACTIVE tablets and Guardian II sold to Paul Capital the right to receive specified royalties on Guardian II s net sales in the United States (and the net sales of its affiliates and licensees) of ANTARA capsules, in each case until December 31, 2016 in exchange for an aggregate of $40 million from Paul Capital. The royalty payable to Paul Capital on net sales of ANTARA and FACTIVE are tiered as follows: 9% for the first $75 million in annual net revenues, 6% for annual net revenues in excess of $75M, but less than $150 million, and 2% for annual net revenues which exceed $150 million. Once the cumulative royalty payments to Paul Capital exceed $100 million, the royalties become nominal. Further, our wholly owned subsidiary, Guardian II, entered into a Note Purchase Agreement with PRF pursuant to which Guardian II issued and sold a $20,000,000 aggregate principal amount of 12% senior secured note due on the fourth anniversary of the closing date, subject to Guardian II s option to extend the maturity to the sixth anniversary of the closing date, provided (i) there are no defaults under the note at the time, and (ii) we issue to PRF, at the time of the exercise of such option, a warrant for a number of shares of common stock equal to 10% of the principal balance plus accrued interest divided by $6.94, with an exercise price of $6.94 per share. In connection with such financial agreements, Guardian II and PRF entered into a Security Agreement under which Guardian II granted to PRF a security interest in and to substantially all assets owned by Guardian II (including rights to the ANTARA products) in order to secure its performance under each of the agreements with PRF. As part of the financing, we and PRF also entered into a Common Stock and Warrant Purchase Agreement, pursuant to which, in exchange for $10 million, Oscient sold to PRF 1,388,889 shares of the common stock (as adjusted pursuant to the one-for-eight reverse stock split) at a price of $7.20 per share (as adjusted pursuant to the one-for-eight-reverse stock split) and issued PRF a warrant to purchase 288,019 shares of common stock (as adjusted pursuant to the one-for-eight reverse stock split) at an exercise price of $6.94 per share (as adjusted pursuant to the one-for-eight reverse stock split). The Warrant is exercisable for seven years from the date of closing.

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SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information regarding the beneficial ownership of Company common stock as of June 30, 2008 by:

- each person known by us to beneficially own more than 5% of our Company common stock;
- each director and nominee for director of the Company;
- each executive officer of the Company; and
- all of our directors and executive officers of the Company as a group.

The percentages shown are based on shares of Company common stock outstanding as of June 30, 2008, and where indicated also include beneficially owned shares of common stock underlying the Company s outstanding convertible notes. Unless otherwise indicated, the address for each stockholder is c/o Oscient Pharmaceuticals Corporation, 1000 Winter Street, Suite 2200, Waltham, Massachusetts 02451. Unless otherwise indicated, each person or entity named in the table has sole voting power and investment power (or shares such power with his or her spouse) with respect to all shares of capital stock listed as owned by such person or entity.

Beneficial ownership and percentage ownership are determined in accordance with the rules and regulations of the SEC and include voting or investment power with respect to shares of stock. This information does not necessarily indicate beneficial ownership for any other purpose. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of common stock subject to options held by that person that are currently exercisable or exercisable within 60 days of the date hereof are deemed outstanding. Such shares, however, are not deemed outstanding for the purposes of computing the percentage ownership of any other person. Except as indicated in the footnotes to the following table or pursuant to applicable community property laws, each stockholder named in the table has sole voting and investment power with respect to the shares set forth opposite such stockholder s name. The percentage of beneficial ownership is based on 14,140,292 shares of common stock outstanding on June 30, 2008.

	Amount and Nature of Beneficial Ownership	Percent of Class Including Convertible Notes	Amount and Nature of Beneficial Ownership Excluding Convertible Notes	Percent of Class Excluding Convertible Notes
5% Stockholders:				
Akanthos Capital Management, LLC	1,740,741(1)	11.0%		
Alexandra Investment Management, LLC	844,445(2)	5.6%		
Bruce & Co., Inc.	1,089,038(3)	7.2%		
Citigroup Incorporated	1,390,445(4)	9.0%		
Credit Agricole SA	2,638,519(5)	15.7%		
Highbridge Capital Management, LLC	1,743,310(7)	11.0%	32,421(7)	0.2%
Paul Royalty Fund Holdings II	1,676,908(8)	11.6%	1,676,908(8)	11.6%
Renaissance Technologies, LLC	991,976(9)	7.0%	991,976(9)	7.0%
Visium Asset Management, LP	1,777,778(10)	11.2%		
Zazove Associates, LLC	1,398,593(11)	9.0%		
Directors and Named Executive Officers:				
Gregory B. Brown	2,575(12)		2,575(12)	
Dominick Colangelo	141,457(13)	1.0%	141,457(13)	1.0%
Mark A. Glickman	49,380(14)	0.3%	49,380(14)	0.3%

Robert J. Hennessey	17,166[15]	0.1%	17,166[15]	0.1%
John R. Leone	1,677,808[16]	11.6%	1,677,808[16]	11.6%
Philippe M. Maitre	75,562[17]	0.5%	75,562[17]	0.5%
William R. Mattson	2,575[18]		2,575[18]	
Gary Patou	19,641[19]	0.1%	19,641[19]	0.1%
Steven M. Rauscher	374,854[20]	2.6%	374,854[20]	2.6%
William S. Reardon	11,367[21]	0.1%	11,367[21]	0.1%
Norbert G. Riedel	20,965[22]	0.1%	20,965[22]	0.1%
David K. Stone	23,195[23]	0.2%	23,195[23]	0.2%
All directors and officers as a group (12 persons)	2,416,545[24]	16.2%	2,416,545[24]	16.2%

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(1) Includes 1,740,741 shares of Common Stock issuable upon the conversion of the Company s 3.50% Convertible Senior Notes due 2011. The address of this shareholder is 21700 Oxnard Street, Suite 1520, Woodland Hills, CA 91367. This information is based on the Schedule 13F filed on August 14, 2008 by Akanthos Capital Management, LLC.

(2) Includes 844,444 shares of Common Stock issuable upon the conversion of the Company s 3.50% Convertible Senior Notes due 2011. The address of this shareholder is 767 Third Avenue, 39th Floor, New York, New York, 10017. This information is based on the Schedule 13F filed on August 14, 2008 by Alexandra Investment Management, LLC.

(3) Includes 1,089,038 shares of Common Stock issuable upon the conversion of the Company s 3.50% Convertible Senior Notes due 2011. The address of this shareholder is 20 N. Wacker Drive, Suite 2414, Chicago, IL 60606. This information is based on the Schedule 13F filed on August 20, 2008 by Bruce & Co., Inc.

(4) Includes (i) 1,390,445 shares of Common Stock issuable upon the conversion of the Company s 3.50% Convertible Senior Notes due 2011. The address of this shareholder is 399 Park Avenue, New York, NY 10043. This information is based on the Schedule 13F filed on August 14, 2008 by Citigroup Incorporated.

(5) Includes (i) 2,638,519 shares of Common Stock issuable upon the conversion of the Company s 3.50% Convertible Senior Notes due 2011. The address of this shareholder is 91-93 BD Pasteur, 75015 Paris, France. This information is based on the Schedule 13F filed on August 13, 2008 by Credit Agricole, SA.

(6) Includes (i) 1,710,889 shares of Common Stock issuable upon the conversion of the Company s 3.50% Convertible Senior Notes due 2011, and (ii) 25,000 shares of Common Stock issuable to Smithfield Fiduciary, LLC, a wholly owned subsidiary of Highbridge International, LLC, upon the exercise of warrants to purchase shares of Common Stock. In addition to such warrants and common shares, the reporting persons may be deemed to beneficially own 161,917 shares of Common Stock issuable to Highbridge International, LLC and 58,891 shares of Common Stock issuable to Smithfield Fiduciary, LLC, a wholly-owned subsidiary of Highbridge International, LLC, upon the exercise of warrants to purchase shares of Common Stock; however, pursuant to the terms of these warrants, the warrants cannot be exercised until such time as its holders would not beneficially own after such exercise more than 4.99% of the outstanding shares of Common Stock. The address of this shareholder is 9 West 57th Street, 27th Floor, New York, New York 10019. This information is based on the Schedule 13G filed on February 7, 2008 and the Schedule 13F filed on August 13, 2008 by Highbridge Capital Management, LLC.

(7) Includes 25,000 shares of Common Stock issuable to Smithfield Fiduciary, LLC, a wholly owned subsidiary of Highbridge International, LLC, upon the exercise of warrants to purchase shares of Common Stock. In addition to such warrants and common shares, the reporting persons may be deemed to beneficially own 161,917 shares of Common Stock issuable to Highbridge International, LLC and 58,891 shares of Common Stock issuable to Smithfield Fiduciary, LLC, a wholly-owned subsidiary of Highbridge International, LLC, upon the exercise of warrants to purchase shares of Common Stock; however, pursuant to the terms of these warrants, the warrants cannot be exercised until such time as its holders would not beneficially own after such exercise more than 4.99% of the outstanding shares of Common Stock. The address of this shareholder is 9 West 57th Street, 27th Floor, New York, New York 10019. This information is based on the Schedule 13G filed on February 7, 2008 by Highbridge Capital Management, LLC.

(8) Includes 1,388,889 restricted shares directly held by Paul Royalty Fund Holdings II (PRFH) and indirectly held by Paul Royalty Fund II, LP (PRF), Paul Royalty Associates II, LP (PRA), Paul Royalty Management, LLC (PRM) and Paul Capital Advisors, LLC (PCA). PRFH directly owns 1,388,889 shares of Common Stock. PRF and PRA may be deemed to indirectly own 1,388,889 shares of common stock held by PRFH because PRF and PRA are the general partners of PRFH. PRM may be deemed to indirectly own the shares because PRM is the general partner of PRF and PRA. As manager of PRA, PCA exercises voting and dispositive power over investments held by PRA. Includes warrants exercisable for 288,019 shares of Common Stock held by PRFH. PRF and PRA may be deemed to own the warrants held by PRFH because PRF and PRA are the general partners of PRFH. PRM may be deemed to own the warrants because PRM is the general partner of PRF and PRA. As manager of PRA, PCA exercises voting and dispositive power over investments held by PRA. The address of this shareholder is 50 California Street, Suite 3000, San Francisco, CA 94111. This information is based on information contained in a joint Schedule 13G filed on August 28, 2006 by PRFH.

(9) The address of the shareholder is 800 Third Avenue, New York, NY 10022. This information is based on information contained in a Schedule 13F filed on August 14, 2008 by Renaissance Technologies, LLC.

(10) Includes 1,777,778 shares of Common Stock issuable upon the conversion of the Company s 3.50% Convertible Senior Notes due 2011. Visium Asset Management, LP has indirect beneficial ownership as the investment manager of pooled investment vehicles. The address of this shareholder is 950 Third Avenue, New York, NY 10022. This information is based on the Schedule 13F filed on August 19, 2008 by Visium Asset Management, LP.

(11) Includes 1,398,593 shares of Common Stock issuable upon the conversion of the Company s 3.50% Convertible Senior Notes due 2011. The address of this shareholder is 1001 Tahoe Blvd., Incline Village, NV 89451. This information is based on the Schedule 13F filed on July 31, 2008 by Zazove Associates, LLC.

(12) Includes (i) 1,375 shares of common stock, which shares are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008 and (ii) 450 restricted shares.

(13) Includes (i) 94,988 shares of common stock, which shares are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008 and (ii) 23,781 restricted shares.

(14)

Includes (i) 13,223 shares of common stock, which shares are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008 and (ii) 29,907 restricted shares.

(15) Includes (i) 10,208 shares of common stock, which shares are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008 and (ii) 450 restricted shares.

(16) Includes 1,388,889 restricted shares directly held by PRFH and indirectly held by PRF, PRA, PRM and PCA. PRFH directly owns 1,388,889 shares of Common Stock. PRF and PRA may be deemed to indirectly own 1,388,889 shares of

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common stock held by PRFH because PRF and PRA are the general partners of PRFH. PRM may be deemed to indirectly own the shares because PRM is the general partner of PRF and PRA. As manager of PRA, PCA exercises voting and dispositive power over investments held by PRA. Includes warrants exercisable for 288,019 shares of Common Stock held by PRFH. PRF and PRA may be deemed to own the warrants held by PRFH because PRF and PRA are the general partners of PRFH. PRM may be deemed to own the warrants because PRM is the general partner of PRF and PRA. As manager of PRA, PCA exercises voting and dispositive power over investments held by PRA. Mr. Leone, a partner of Paul Capital Healthcare, is the designee of PRF to the Company s Board of Directors. Includes 900 restricted shares.

(17) Includes (i) 31,737 shares of common stock, which shares are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008 and (ii) 22,907 restricted shares.

(18) Includes (i) 1,375 shares of common stock, which shares are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008 and (ii) 450 restricted shares.

(19) Includes (i) 5,500 shares of common stock, which shares are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008 and (ii) 450 restricted shares.

(20) Includes (i) 307,644 shares of common stock, which shares are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008 and (ii) 30,245 restricted shares.

(21) Includes (i) 8,814 shares of common stock, which shares are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008 and (ii) 450 restricted shares.

(22) Includes (i) 19,625 shares of common stock, which shares are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008 and (ii) 450 restricted shares.

(23) Includes (i) 18,345 shares of common stock, which shares are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008 and (ii) 450 restricted shares.

(24) Includes (i) 512,834 shares of common stock that are issuable upon the exercise of vested options or options that are to become vested within 60 days following June 30, 2008, (ii) 110,890 restricted shares held by officers and directors, (iii) warrants exercisable for 288,019 shares of common stock held by PRFH and (iv) 1,388,889 restricted shares held by PRFH.

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LEGAL MATTERS

Ropes & Gray LLP, Boston, Massachusetts, will pass upon certain legal matters relating to the exchange offer. Certain legal matters will be passed upon for the dealer managers by Shearman & Sterling LLP, New York, New York.

EXPERTS

Ernst & Young LLP, independent registered public accounting firm, has audited our consolidated financial statements and schedule at December 31, 2007 and 2006, and for each of the three years in the period ended December 31, 2007, as set forth in their report. We have included our financial statements and schedule in the prospectus and elsewhere in the registration statement in reliance on Ernst & Young LLP s report, given on their authority as experts in accounting and auditing.

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OSCIENT PHARMACEUTICALS CORPORATION

INDEX TO FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of

Oscient Pharmaceuticals Corporation

We have audited the accompanying consolidated balance sheets of Oscient Pharmaceuticals Corporation (and subsidiaries) as of December 31, 2007 and 2006, and the related consolidated statements of operations shareholders (deficit) equity, and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Oscient Pharmaceuticals Corporation (and subsidiaries) at 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, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material aspects the information set forth therein.

As discussed in Note 12 to the consolidated financial statements, on January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share Based Payments* which requires the Company to recognize expense for all share-based payments based on their fair values.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Oscient Pharmaceutical Corporation s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 4, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Boston, Massachusetts

February 4, 2008

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OSCIENT PHARMACEUTICALS CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	December 31, 2007	December 31, 2006
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 48,268	$ 38,196
Restricted cash		2,483
Notes receivable	486	590
Accounts receivable (net of allowance for bad debts of $35 and $349 in 2007 and 2006, respectively)	15,032	11,937
Inventories	9,059	14,237
Prepaid expenses and other current assets	2,886	2,791
Total current assets	75,731	70,234
Property and Equipment, at cost:		
Manufacturing and computer equipment	4,695	4,722
Equipment and furniture	564	1,159
Leasehold improvements	138	138
	5,397	6,019
Less Accumulated depreciation	4,590	4,522
	807	1,497
Restricted cash	4,198	4,129
Long-term notes receivable		1,269
Other assets	5,585	4,074
Intangible assets, net	110,903	120,011
Goodwill	76,960	78,193
	$ 274,184	$ 279,407
LIABILITIES AND SHAREHOLDERS DEFICIT		
Current Liabilities:		
Current maturities of long-term obligations	$ 38	$ 38
Accounts payable	10,262	10,402
Accrued expenses and other current liabilities	20,928	16,418
Current portion of accrued facilities impairment charge	2,128	2,182
Deferred revenue	364	750
Total current liabilities	33,720	29,790
Long-term Liabilities:		
Long-term obligations, net of current maturities	252,859	234,186
Noncurrent portion of accrued facilities impairment charge	8,831	11,718
Other long-term liabilities	7,216	5,073
Deferred revenue	273	636
Commitments and Contingencies (Note 11)		
Shareholders Deficit:		
Common stock, $0.10 par value Authorized 174,375 shares, Issued and Outstanding 13,892 and 13,559 in 2007 and 2006, respectively	1,389	1,356
Series B restricted common stock, $0.10 par value Authorized 625 shares, Issued and Outstanding none		

Additional paid-in-capital	415,654	412,553
Accumulated deficit	(445,758)	(415,905)
Total shareholders deficit	(28,715)	(1,996)
	$ 274,184	$ 279,407

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

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OSCIENT PHARMACEUTICALS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

	Year Ended December 31,		
	2007	**2006**	**2005**
Revenues (net):			
Product sales	$ 78,458	$ 38,244	$ 20,458
Co-promotion		6,890	2,954
Other	1,511	1,018	197
Total net revenues	79,969	46,152	23,609
Costs and expenses (1):			
Cost of product sales	31,269	19,613	9,830
Research and development	5,845	12,406	14,432
Selling and marketing	66,278	69,211	74,931
General and administrative	14,573	16,841	13,088
Total costs and expenses	117,965	118,071	112,281
Loss from operations	(37,996)	(71,919)	(88,672)
Other income (expense):			
Interest income	2,541	2,995	3,400
Interest expense	(28,206)	(11,056)	(8,126)
Gain on disposition of investment	231	1,617	2,162
Gain on exchange of convertible notes	30,824		
Gain on derivative	3,023		
Other income	114	65	2,643
Net other income (expense)	8,527	(6,379)	79
Loss from operations before income tax	(29,469)	(78,298)	(88,593)
Provision for income tax	(384)	(179)	
Net loss	$ (29,853)	$ (78,477)	$ (88,593)
Net loss per common share:			
Basic and diluted	$ (2.19)	$ (6.58)	$ (9.26)
Weighted average common shares outstanding:			
Basic and diluted	13,600,787	11,925,485	9,568,598

(1) Includes non-cash stock-based compensation as follows:

Cost of product sales	$ 40	$ 67	$
Research and development	50	136	836
Selling and marketing	972	1,236	
General and administrative	1,651	2,437	170

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

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OSCIENT PHARMACEUTICALS CORPORATION

CONSOLIDATED STATEMENTS OF SHAREHOLDERS (DEFICIT) EQUITY AND COMPREHENSIVE LOSS

(in thousands, except share data)

	Common Stock Shares	$0.10 Par Value	Additional Paid-In Capital	Accumulated Deficit	Deferred Compensation	Note Receivable From Officer	Total Shareholders (Deficit) Equity	Comprehensive Loss
Balance at December 31, 2004	**9,475**	**$ 948**	**$ 363,467**	**$ (248,835)**	**$ (1,017)**	**$ (163)**	**$ 114,400**	**$ (93,271)**
Exercise of stock options	174	17	854				871	
Issuance of stock under employee stock purchase plan	20	2	415				417	
Amortization of deferred compensation					1,006		1,006	
Net loss				(88,593)			(88,593)	(88,593)
Balance at December 31, 2005	**9,669**	**967**	**364,736**	**(337,428)**	**(11)**	**(163)**	**28,101**	**(88,593)**
Exercise of stock options	90	9	157				166	
Issuance of stock under employee stock purchase plan	79	8	732				740	
Issuance of common stock in private placement	2,254	225	33,252				33,477	
Issuance of common stock to Paul Capital	1,389	139	9,819				9,958	
Issuance of restricted stock	78	8	(8)					
Reversal of deferred compensation			(11)		11			
Stock based compensation expense			3,876				3,876	
Settlement of note receivable						163	163	
Net loss				(78,477)			(78,477)	(78,477)
Balance at December 31, 2006	**13,559**	**1,356**	**412,553**	**(415,905)**			**(1,996)**	**(78,477)**
Exercise of stock options	5	1	16				17	
Issuance of stock under employee stock purchase plan	95	9	395				404	
Net issuance of restricted stock	233	23	(23)					
Stock based compensation expense			2,713				2,713	
Net loss				(29,853)			(29,853)	(29,853)
Balance at December 31, 2007	**13,892**	**$ 1,389**	**$ 415,654**	**$ (445,758)**	**$**	**$**	**$ (28,715)**	**$ (29,853)**

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

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OSCIENT PHARMACEUTICALS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31,		
	2007	**2006**	**2005**
Cash Flows from Operating Activities:			
Net Loss	$ (29,853)	$ (78,477)	$ (88,593)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	9,847	7,158	5,411
Provision for excess and obsolete inventories	793	1,631	1,067
(Recovery of) provision for bad debts	(172)	349	
Non-cash interest expense	9,623	1,468	1,557
Gain on exchange of notes	(30,824)		
Gain on derivatives	(3,023)		
Gain on disposition of investment	(231)	(1,617)	(2,162)
Stock-based compensation	2,713	3,876	1,006
Changes in assets and liabilities, net of acquisition			
Accounts receivable	(2,922)	(6,080)	(1,983)
Inventories	4,386	(1,796)	(7,129)
Prepaid expenses and other current assets	(96)	2,134	6,597
Accounts payable	(141)	3,955	(2,633)
Accrued expenses and other liabilities	4,915	3,335	(6,762)
Deferred revenue	(750)	1,386	(1,302)
Accrued facilities impairment charge	(2,618)	(2,826)	(2,947)
Accrued other long-term liabilities	3,692	1,869	993
Net cash used in operating activities	(34,661)	(63,635)	(96,880)
Cash Flows from Investing Activities:			
Proceeds from disposition of investment	231	1,617	2,387
Purchases of property and equipment	(56)	(263)	(1,328)
Proceeds from sale of property and equipment	7	1	294
Decrease in restricted cash	2,414	5,118	5,246
(Increase) decrease in other assets	(63)	(329)	471
Proceeds from notes receivable	1,373	790	440
Purchases of marketable securities			(2,706)
Proceeds from maturities of marketable securities		2,696	94,694
Issuance of notes receivable		(186)	(2,740)
Cash flows related to acquisition of ANTARA		(77,563)	
Net cash provided by (used in) investing activities	3,906	(68,119)	96,758
Cash Flows from Financing Activities:			
Proceeds from issuance of notes, net of issuance costs	40,444		
Proceeds from private placement of common stock, net of issuance costs		33,477	
Proceeds from issuance of stock in connection with acquisition of ANTARA, net of issuance costs		9,958	
Proceeds from exercise of stock options	17	166	871
Proceeds from issuance of stock under the employee stock purchase plan	404	740	417
Proceeds from issuance of notes		20,000	
Proceeds from assignment of revenue interest		40,000	
Payments on long-term obligations	(38)	(9)	(291)

Net cash provided by financing activities	40,827	104,332	997
Net Increase (Decrease) in Cash and Cash Equivalents	10,072	(27,422)	875
Cash and Cash Equivalents, beginning of year	38,196	65,618	64,743
Cash and Cash Equivalents, end of year	$ 48,268	$ 38,196	$ 65,618
Supplemental Disclosure of Cash Flow Information:			
Interest paid during period	$ 14,925	$ 6,053	$ 5,346
Income tax paid during period	$ 18	$ 25	$

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

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements

(1) Operations

Oscient Pharmaceuticals Corporation (the Company) is a commercial-stage pharmaceutical company marketing FDA-approved products in the United States. The Company s strategy is to gain access to new products via transactions, including acquisition, in-licensing and co-promotion. Oscient has developed a commercial infrastructure, including a national sales force calling on targeted primary care physicians, cardiologists, endocrinologists and pulmonologists in the United States.

Oscient currently markets two products; ANTARA® (fenofibrate) capsules, a cardiovascular product and FACTIVE® (gemifloxacin mesylate) tablets, a fluoroquinolone antibiotic. ANTARA is approved by the FDA to treat hypercholesterolemia (high blood cholesterol) and hypertriglyceridemia (high triglycerides) in combination with a healthy diet. The Company licenses the rights to ANTARA from Ethypharm S.A of France (Ethypharm). The Company began promoting ANTARA in late August 2006. FACTIVE is indicated for the treatment of community-acquired pneumonia of mild to moderate severity (CAP) and acute bacterial exacerbations of chronic bronchitis (AECB). The Company licenses the rights to gemifloxacin, the active ingredient in FACTIVE tablets, from LG Life Sciences of the Republic of Korea (LG Life Sciences). The Company launched FACTIVE in the U.S. market in September 2004.

Additionally, the Company has a novel, late-stage antibiotic candidate, Ramoplanin, for the treatment of *Clostridium difficile*-associated disease. The Company has made the strategic decision to concentrate its financial resources on building its revenues for products promoted to community-based physicians in the United States and is currently seeking to out-license, co-develop or sell its rights to Ramoplanin to a partner.

As shown in the consolidated financial statements, at December 31, 2007, the Company has total cash and cash equivalents balance of approximately $52,466,000, which includes $4,198,000 in restricted cash, and an accumulated deficit of approximately $445,758,000. Based on the Company s available capital, current operating plan and management s ability to manage expenses, the Company believes that the cash on hand as of December 31, 2007, is sufficient to fund continuing operations through at least the end of 2008. The Company may seek to raise additional capital within the next 12 months through the sale of debt or equity securities. The Company s ability to raise additional capital, however, will be heavily impacted by, among other factors, the investment market for biopharmaceutical companies and the progress of the ANTARA and FACTIVE commercial programs as well as the Company s progress in meeting its operational and financial objectives, acquiring, licensing or co-promoting an additional product and developing a partnership to advance the Ramoplanin clinical development program. Additional financing may not be available to the Company when needed, or, if available, may not be available on favorable terms. If the Company cannot obtain adequate financing on acceptable terms when such financing is required, the Company s business will be adversely affected.

(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 the consolidated financial statements.

(a) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Guardian II Acquisition Corporation, Collaborative Genetics, Inc., Collaborative Securities Corp. (a Massachusetts Securities Corporation), Oscient Pharmaceuticals U.K. Ltd., and GeneSoft Pharmaceuticals LLC. All intercompany accounts and transactions have been eliminated in consolidation.

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(b) Revenue Recognition

The Company s principal source of revenue is the sale of ANTARA capsules and FACTIVE tablets. In the second quarter of 2005, the Company began recognizing co-promotion revenue in connection with its co-promotion agreement with Auxilium Pharmaceuticals, Inc. (Auxilium), which terminated on August 31, 2006. Other historical sources of revenue include biopharmaceutical alliances and royalties from the divested genomic services business. In future periods, product revenues will continue to increase based on anticipated increased volume of prescriptions of ANTARA capsules and FACTIVE tablets. Conversely, the Company expects revenues derived from biopharmaceutical alliances will continue to decrease.

Although ANTARA revenue results are anticipated to be steady throughout the fiscal year, the Company expects demand for FACTIVE to be highest from December to March as the incidence of respiratory tract infections, including CAP and AECB, tends to increase during the winter months. In addition, fluctuations in the severity of the annual respiratory tract infection season may cause product sales to vary from year to year. Due to these seasonal fluctuations in demand for FACTIVE, the Company s results in any particular quarter may not be indicative of the results for any other quarter or for the entire year.

Product Sales

The Company follows the provisions of Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition (a replacement of SAB 101) (SAB No. 104) and recognizes revenue from product sales upon delivery of product to wholesalers, when persuasive evidence of an arrangement exists, the fee is fixed or determinable, title to product and associated risk of loss has passed to the wholesaler and collectability of the related receivable is reasonably assured. All revenues from product sales are recorded net of applicable allowances for sales returns, rebates, special promotional programs, and discounts. For arrangements where the risk of loss has not passed to wholesalers or pharmacies, the Company defers the recognition of revenue by recording deferred revenue until such time that risk of loss has passed. The cost of ANTARA and FACTIVE associated with amounts recorded as deferred revenue is recorded in inventory until such time as risk of loss has passed.

Co-Promotion Revenue

On August 31, 2006, the Company and Auxilium mutually agreed to conclude the co-promotion arrangement and agreed to share profits from primary care sales, as provided for under the co-promotion agreement, through August 31, 2006. Amounts earned under the Company s co-promotion agreement with Auxilium from the sale of TESTIM gel, a product developed by Auxilium, are classified as co-promotion revenue in the Company s consolidated statements of operations. Auxilium was obligated to pay the Company a co-promotion fee based on a specified percentage of the gross profit from TESTIM sales attributable to primary care physicians in the U.S. that exceeded a specified cumulative sales threshold, determined on an annual basis. The specific percentage was based upon TESTIM sales levels attributable to primary care physicians and the marketing expenses incurred by the Company in connection with the promotion of TESTIM under the co-promotion agreement. Such co-promotion revenue was earned when TESTIM units were dispensed through patient prescriptions. There was no cost of goods sold associated with co-promotion revenue, and the selling and marketing expenses incurred with respect to the co-promotion arrangement are classified as selling and marketing expenses in the Company s consolidated statements of operations. As part of the termination of the co-promotion agreement, the Company received $1,800,000 from Auxilium as additional compensation for commercialization efforts by the Company s sales force through August 31, 2006, which was recognized as revenue during the year ended December 31, 2006. The Company does not expect any future co-promotion revenue in association with its agreement with Auxilium.

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

Other Revenues

Other revenues primarily consist of sublicensing revenues related to FACTIVE. The Company recognizes revenue in accordance with SAB No. 104 and Emerging Issues Task Force (EITF) Issue No. 00-21, Revenue Arrangements with Multiple Deliverables (EITF No. 00-21). In accordance with EITF No. 00-21, the up-front license payments related to the various sublicense agreements will be recognized as revenue over the term of the Company s continuing obligations under the arrangements which range from eighteen months to thirty-three months. Substantive milestones achieved are recognized as revenue when earned and when payment is reasonably assured, if the Company has completed its remaining obligations under the arrangement. If the Company has further obligations, milestone payments are recognized as revenue if the Company has sufficient evidence of fair value for its remaining obligations otherwise the milestone payment is recognized as revenue over the remaining performance period.

On August 1, 2006, the Company announced that it received notice from Pfizer Mexico that FACTIVE was approved by the Ministry of Health in Mexico to be marketed as FACTIVE-5 for the treatment of community-acquired pneumonia, acute bacterial exacerbations of chronic bronchitis and acute bacterial sinusitis which generated a milestone payment recognized as revenue in 2006. On January 4, 2007, the Company announced that it had granted commercialization rights to FACTIVE in Europe to Menarini International Operation Luxembourg SA (Menarini), a wholly-owned subsidiary of Menarini Industrie Farmaceutiche Riunite S.r.l. Part of this arrangement included an up-front license payment which the Company is recognizing over the term of the Company s obligations under the arrangement. On March 2, 2007, the Company announced that Abbott Laboratories, Ltd. (Abbott Canada), the Canadian affiliate of Abbott Laboratories, had received approval to begin the promotion of FACTIVE in Canada. In connection with the terms of the agreement with Abbott, a milestone payment related to regulatory approval of the Company s manufacture of FACTIVE for Canada was recorded as other revenue during 2007. The Company expenses incremental direct costs associated with sublicense agreements in the period in which the expense is incurred. The Company subsequently amended the agreement on January 31, 2008 whereby Abbott Canada s development and commercialization obligations were substantially reduced. See Note 20.

(c) Sales Rebates, Discounts and Incentives

The Company s sales of ANTARA and FACTIVE are made to pharmaceutical wholesalers for further distribution through pharmacies to the ultimate consumers of the product. When the Company delivers its product, the Company reduces the amount of gross revenue recognized from such product sales based primarily on estimates of four categories of discounts and allowances that suggest that all or part of the revenue should not be recognized at the time of the delivery product returns, cash discounts, rebates, and special promotional programs.

Product Returns

Factors that are considered in the Company s estimate of future ANTARA and FACTIVE product returns include an analysis of the amount of product in the wholesaler and pharmacy channel, review of consumer consumption data as reported by external information management companies, actual and historical return rates for expired lots, the remaining time to expiration of the product, and the forecast of future sales of the Company s product. Consistent with industry practice, the Company offers contractual return rights that allow its customers to return product within six months prior to and twelve months subsequent to the expiration date of its product. ANTARA capsules and FACTIVE tablets each have a 36-month expiration period from the date of manufacturing. During 2007, the Company increased its estimate for product returns as a result of returns of product lots related to the seven-day course of treatment of FACTIVE tablets. The Company believes the product returns were a result of a

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

combination of the shift in product demand from seven-day course of treatment to five-day course of treatment and returns associated with initial stocking of FACTIVE. As of December 31, 2007 and 2006, the Company s product return reserve was approximately $3,169,000 and $774,000, respectively. This reserve is evaluated on a quarterly basis, assessing each of the factors described above, and adjusted accordingly. Based on the factors noted above, the Company believes its estimate of product returns is reasonable, and changes, if any, from this estimate would not have a material impact to the Company s financial statements.

Cash Discounts

The Company s standard invoice includes a contractual cash 2% discount, net 30 days terms. Based on historical experience, the Company estimates that most of its customers deduct a 2% discount from their balance. The cash discount reserve is presented as an allowance against trade receivables in the consolidated balance sheets. As of December 31, 2007 and 2006, the balance of the cash discounts reserve was approximately $343,000 and $202,000, respectively.

Rebates

The liability for commercial managed care rebates is calculated based on historical and current rebate redemption and utilization rates with respect to each commercial contract. The liability for Medicaid rebates is calculated based on historical and current rebate redemption and utilization rates contractually submitted by each state. As of December 31, 2007 and 2006, the balance of the accrual for managed care and Medicaid rebates for ANTARA and FACTIVE was approximately $4,263,000 and $2,994,000, respectively. Considering the estimates made by the Company, as well as estimates reflected in third party utilization reports that are used in evaluating the required liability balance, the Company believes its estimates are reasonable. As of December 31, 2007, the significant change to the Company s estimates in the periods presented is primarily attributable to the acquisition of the ANTARA product line.

Special Promotional Programs:

The Company, from time to time, offers certain promotional incentives to its customers for both ANTARA and FACTIVE and will continue this practice in the future. Such programs include: sample cards to retail consumers, certain product incentives to pharmacy customers, and other sales stocking allowances. The Company accounts for these programs in accordance with EITF No. 01-09, Accounting for Consideration Given by a Vendor to a Customer (EITF No. 01-09). Examples of programs utilized to date are as follows:

Voucher Rebate Programs for ANTARA

Since acquiring ANTARA in August 2006, the Company has initiated three voucher rebate programs for ANTARA whereby the Company offered a point-of-sale rebate to retail consumers. The liabilities the Company recorded for these voucher rebate programs were estimated based upon the historical rebate redemption rates for similar completed programs by other pharmaceutical companies as reported to the Company by a third party claims processing organization and actual redemption rates on completed programs by the Company. The first program expired on December 31, 2006, the second program expired on September 30, 2007, and the third program expires on February 28, 2009. As of December 31, 2007 and 2006, the balance of the liabilities for these voucher programs totaled approximately $491,000 and $619,000, respectively.

Voucher Rebate Programs for FACTIVE

The Company periodically initiates voucher rebate programs for FACTIVE whereby the Company offers mail-in rebates and point-of-sale rebates to retail consumers. The liabilities the Company records for these voucher

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Notes to Consolidated Financial Statements (Continued)

rebate programs are estimated based upon the historical rebate redemption rates for similar completed programs. In April 2007, the Company initiated a voucher rebate program whereby the Company offered a point-of-sale rebate to retail consumers. This program expired on December 31, 2007. In October 2007, the Company initiated another voucher rebated program whereby the Company offered a point-of-sale rebate to retail consumers. This program expires on April 30, 2008. As of December 31, 2007 and 2006, the balance of the liabilities for these voucher programs totaled approximately $1,396,000 and $452,000, respectively.

(d) Cash, Cash Equivalents and Marketable Securities

The Company applies the provisions of the Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS No. 115). At December 31, 2007 and 2006, the Company held cash and cash equivalents. Cash equivalents are short-term, highly liquid investments with original maturities of 90 days or less. Cash equivalents are carried at cost, which approximates fair value. At December 31, 2007 and 2006, cash and cash equivalents consisted of money market funds. At December 31, 2007 and 2006, the Company did not hold investments, and as a result, had no net unrealized loss. The fair value of the Company s cash equivalents is determined based on market value.

(e) Accounts Receivable

Trade accounts receivable consists of amounts due from wholesalers for the purchase of ANTARA and FACTIVE. Accounts receivable related to sales of FACTIVE are the accounts receivable of the Company and accounts receivable related to sales of ANTARA are the accounts receivable of Guardian II Acquisition Corporation (Guardian II) (the entity which holds all of the ANTARA assets), a wholly-owned subsidiary of the Company. Guardian II granted Paul Royalty Fund Holdings II, LP, an affiliate of Paul Capital Partners (Paul Capital), a security interest in substantially all of its assets, including its accounts receivable, to secure its obligations to Paul Capital. See Note 11(b).

The Company performs ongoing credit evaluations on its customers and collateral is generally not required. As of December 31, 2007 and 2006, the Company reserved approximately $35,000 and $39,000, respectively, for bad debts related to the sale of ANTARA or FACTIVE. The Company continuously reviews all customer accounts to determine if an allowance for uncollectible accounts is necessary. The Company currently provides substantially all of its distributors with payment terms of up to 30 days on purchases of ANTARA and FACTIVE. Amounts past due from customers are determined based on contractual payment terms. Through December 31, 2007, payments have generally been made in a timely manner and the Company has not written off any customer accounts receivable balances. The Company also reserved $0 and $310,000 as of December 31, 2007 and 2006, respectively, related to other non-trade receivables.

The following table represents accounts receivable (in thousands):

	December 31,	
	2007	2006
Trade, net	$ 14,950	$ 10,658
Other	82	1,279
Total	$ 15,032	$ 11,937

(f) Restricted Cash

In connection with the 3 1/2% convertible debt offering completed in May 2004, the Company was required to set aside cash in an amount equal to the first six semi-annual interest payments related to such debt. As of with

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Notes to Consolidated Financial Statements (Continued)

December 31, 2006, the Company s restricted cash consisted, in part, of the remaining semi-annual interest payment totaling approximately $2,673,000 which was paid on April 15, 2007. There was no such restricted cash requirement in connection with the 3.50% convertible debt offering completed in May 2007. At December 31, 2007, approximately $3,697,000 of cash is restricted in connection with a letter of credit issued for the building lease at the Company s South San Francisco, California facility, approximately $433,000 of cash is restricted in connection with a letter of credit issued for the building lease at the Company s Waltham, Massachusetts facility and approximately $68,000 of cash is restricted in connection with a letter of credit issued for the building lease at the Company s Skillman, New Jersey facility. The restrictions related to the South San Francisco facility, the Waltham facility and the Skillman facility expire on February 28, 2011, March 31, 2012 and February 2013, respectively.

(g) Property and Equipment

The Company records property and equipment at cost. Major replacements and improvements are capitalized, while general repairs and maintenance are expensed as incurred. The Company depreciates its property and equipment over the estimated useful life of the assets using the straight-line method starting when the asset is placed in service. The estimated useful life for leasehold improvements is the term of the lease (which is lower than the useful life of the assets).

	Estimated Useful Life
Manufacturing and computer equipment	3-5 Years
Equipment and furniture	3-5 Years
Leasehold improvements	7 Years

As of December 31, 2007, the Company recorded approximately $188,000 as a capital lease obligation with accumulated depreciation of $47,000. The capitalized lease obligation is being depreciated using the straight-line method over the term of the lease and is being classified as computer equipment in the accompanying consolidated balance sheets.

Depreciation expense was approximately $738,000, $781,000 and $644,000 for the fiscal years ended December 31, 2007, 2006 and 2005, respectively.

(h) Inventories

Inventories are stated at the lower of cost or market value, with cost determined under the average cost method which approximates actual cost. Products are removed from inventory on a first-in-first-out basis and recognized as cost of goods sold on an average cost basis.

On a quarterly basis, the Company analyzes inventory levels, and provides a reserve for inventory and marketing samples that have become obsolete, have a cost basis in excess of their expected net realizable value or are in excess of forecast requirements to cost of product revenues and marketing expense, respectively. During 2007, approximately $1,204,000 of ANTARA inventory obtained in the product acquisition became obsolete and was expensed. Expired inventory is disposed of and the related costs are written off against the previously established reserves.

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Notes to Consolidated Financial Statements (Continued)

At December 31, 2007 and 2006, there was approximately $1,088,000 and $454,000 in ANTARA sample product to be used for ANTARA marketing programs and approximately $655,000 and $1,091,000 in FACTIVE sample product to be used for FACTIVE marketing programs. These are classified as other current assets in the accompanying consolidated balance sheets.

The following table represents net trade inventories (in thousands):

	As of December 31	
	2007	2006
Raw material	$ 2,846	$ 4,488
Work-in-process	3,022	5,628
Finished goods	3,191	4,121
Total	$ 9,059	$ 14,237

(i) 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 anti-dilutive. Anti-dilutive common stock equivalents which consist of stock options, securities sold under the Company s employee stock purchase plan, convertible notes, warrants and unvested restricted stock that are not included in diluted net loss per share totaled 20,447,015, 6,316,089 and 4,826,615 shares of the Company s common stock (prior to the application of the treasury stock method) during the years ended December 31, 2007, 2006 and 2005, respectively.

(j) Single Source Suppliers

ANTARA

Pursuant to the Company s license arrangement with Ethypharm, Ethypharm is responsible for the manufacture and supply of ANTARA finished product or ANTARA bulk product at the Company s option. The disruption or termination of the supply of ANTARA by Ethypharm or its third party contractors could have a material adverse effect on the Company s business, financial position and results of operations.

FACTIVE

The Company currently obtains the active pharmaceutical ingredient for its commercial requirements for FACTIVE from LG Life Sciences. The Company purchases the active pharmaceutical ingredient pursuant to a long-term supply agreement. The disruption or termination of the supply of the commercial requirement for FACTIVE or a significant increase in the cost of the active pharmaceutical ingredient from this source could have a material adverse effect on the Company s business, financial position and results of operations.

(k) 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, (SFAS No. 105) requires disclosure of any significant off-balance-sheet and credit risk concentrations. The Company has no off-balance-sheet or credit risk concentrations 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 unaffiliated institutions.

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Notes to Consolidated Financial Statements (Continued)

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 product revenues:

Year-Ended December 31,	Number of Significant Customers	Percentage of Total Product Revenues by Customer		
		A	B	C
2007	3	36%	38%	15%
2006	3	41%	32%	12%
2005	2	52%	29%	*

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

As of December 31,	Number of Significant Customers	Percentage of Total Trade Accounts Receivable by Customer		
		A	B	C
2007	3	45%	34%	12%
2006	3	39%	34%	11%

* balance is less than 10%

To date, the Company has not written off any significant customer receivable balances.

(l) Use of Estimates

The preparation of consolidated 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These estimates include the following: reserves for inventory obsolescence, sales and managed care rebate reserves, special promotional programs, product returns reserves and the useful lives and expected future cash flows for intangible assets.

(m) Financial Instruments

The estimated fair value of the Company s financial instruments, including cash, cash equivalents and accounts receivable, approximates the carrying values of these instruments.

In connection with financing the acquisition of ANTARA, the Company recognized an embedded derivative instrument related to a put/call liability. In connection with the convertible debt exchange, the Company recognized an embedded derivative instrument related to an interest make-whole provision. Both are recognized in the accompanying consolidated financial statements at fair value and are recorded as other long-term liabilities in the accompanying consolidated balance sheets. Changes in fair value are recorded in the accompanying consolidated statements of operations. See Note 11.

(n) Reclassifications

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

(o) Advertising Costs

The Company expenses advertising costs as incurred. Advertising costs were approximately $2,735,000, $3,260,000 and $7,666,000 for the fiscal years ended December 31, 2007, 2006 and 2005, respectively.

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Notes to Consolidated Financial Statements (Continued)

(p) Comprehensive Loss

The Company follows the provisions of SFAS No. 130, Reporting Comprehensive Income (SFAS No. 130). SFAS No. 130 requires disclosure of all components of comprehensive income (loss) on an annual and interim basis. Comprehensive 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 sources. In 2007, 2006 and 2005, the net loss of approximately $29,853,000, $78,477,000 and $88,593,000, respectively, is equal to the comprehensive net loss.

(q) Segment Reporting

The Company follows the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS No. 131). 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 the chief financial officer. All of the Company s assets are located in the United States. Approximately 96% of the Company s product revenues are generated from customers based in the United States.

The Company believes it operates in one segment called pharmaceutical. Product sales and the financial information disclosed herein represent all of the material financial information related to the Company s one operating segment.

Sales by product within the Company s operating segment are as follows:

	Year- Ended December 31,		
	2007	2006	2005
ANTARA	$ 58,571	$ 16,778	$
FACTIVE	19,887	21,466	20,458
Total Product Sales	$ 78,458	$ 38,244	$ 20,458

(r) 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). Under SFAS No. 144, long-lived assets and identifiable intangible assets with finite lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If indicators of impairment exist, recoverability of assets to be held and used is assessed by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. Recoverability measurement and estimating the undiscounted cash flows is done at the lowest possible level for which there are identifiable assets. If the aggregate undiscounted cash flows are less than the carrying value of the asset, then the resulting impairment charge to be recorded is calculated based on the amount by which the carrying amount of the asset exceeds its fair value. Any write-downs are recorded as permanent reductions in the carrying amount of the asset.

During 2007, events and circumstances, primarily a reduction in projected long term cash flows, indicated that the FACTIVE intangible asset could become impaired. However, at December 31, 2007, the Company s

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Notes to Consolidated Financial Statements (Continued)

estimate of undiscounted cash flows indicated that such carrying amounts are expected to be recovered and therefore the assets are not impaired. Nonetheless, it is reasonably possible that the estimate of undiscounted cash flows may change in the near term resulting in the need to write down the intangible asset associated with FACTIVE to fair value. The Company s estimate of undiscounted cash flows is based upon several significant assumptions including, but not limited to, estimated domestic sales growth, the ability to significantly penetrate international markets and the ability to satisfy its minimum requirements under the agreement with the licensor, LG Life Science.

The Company also follows the provisions of SFAS No. 142, Goodwill and Other Intangible Assets, (SFAS No. 142). Under SFAS No. 142, goodwill and purchased intangible assets with indefinite lives are not amortized but are reviewed periodically for impairment. The Company performs an annual evaluation of goodwill at the end of each fiscal year to test for impairment or more frequently if events or circumstances indicate that goodwill may be impaired. Because the Company has a single operating segment, which is its sole reporting unit, the Company performs this test by comparing the fair value of the entity with its book value, including goodwill. If the fair value exceeds the book value, goodwill is not impaired. If the book value exceeds the fair value, then the Company would calculate the potential impairment loss by comparing the implied fair value of goodwill with the book value. If the implied fair value of goodwill is less than the book value, then an impairment charge would be recorded.

As December 31, 2007, the Company does not believe that any of its long-lived assets, goodwill, or intangible assets are impaired.

(s) Stock-Based Compensation

Effective January 1, 2006, the Company adopted SFAS No. 123(Revised 2004), Share-Based Payment (SFAS No. 123R) using the modified prospective transition method. SFAS No. 123R requires all share-based payments, including grants of stock options, to be recognized in the income statement as an operating expense, based on their fair values. Under the modified prospective transition method, compensation cost recognized during the year ended December 31, 2006 includes (1) compensation cost for all share-based payments granted prior to, but not vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123), and (2) compensation cost for all share-based payments granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. Such amounts have been reduced by an estimate of forfeitures on all unvested awards. Stock-based compensation expense primarily relates to stock options, restricted stock, and stock issued under the Company s employee stock purchase plan. Results for prior periods are not restated.

Prior to January 1, 2006, the Company followed the provisions of SFAS No. 148, Accounting for Stock-Based Compensation, Transition and Disclosure (SFAS No. 148) and adopted the disclosure-only provisions of SFAS No. 123. In addition, the Company applied the intrinsic value method under Accounting Principles Board Opinion (APB) No. 25 Accounting for Stock Issued to Employees (APB No. 25) and related interpretations, in accounting for its stock-based compensation plans for awards to employees, rather than the alternative fair value accounting method provided for under SFAS No. 123. Under APB No. 25, when the exercise price of options granted under the plans equals the market price of the underlying stock on the date of grant, no compensation expense is required. In accordance with EITF No. 96-18, Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services (EITF No. 96-18), the Company records compensation expense equal to the fair value of options granted to non-employees over the period of service, which is generally the vesting period. The Company generally used the straight-line method of amortization for stock-based compensation. Had compensation cost for these plans been determined consistent

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Notes to Consolidated Financial Statements (Continued)

SFAS No. 123R, the Company s consolidated net loss and net loss per share would have been increased to the following pro forma amounts (in thousands, except per share amounts):

	Year Ended December 31, 2005
Net loss as reported	$ (88,593)
Add: Share-based employee compensation cost, included in the determination of net loss as reported	1,006
Less: Total share-based compensation expense determined under the fair value method for all employee awards	(7,231)
Pro forma net loss	$ (94,818)
Basic and diluted net loss per share	
As reported	$ (9.26)
Pro forma	$ (9.91)

The adoption of SFAS No. 123R increased the Company s year ended December 31, 2007 and 2006 net loss and cash flows used in operating activities by $2,713,000 and $3,829,000, respectively, and basic and diluted net loss per share by $0.20 and $0.33, respectively. The compensation expense under SFAS No. 123R is recorded in cost of product sales, research and development expense, selling and marketing expense, and general and administrative expense based on the specific allocation of employees receiving the equity awards. Additionally, the Company eliminated the January 1, 2006 deferred compensation balance against additional paid-in capital upon adoption of SFAS No. 123R.

The fair value of each option award is estimated on the grant date using the Black-Scholes-Merton option-pricing model based on the assumptions noted in the following table:

	Year Ended December 31,					
	2007		2006		2005	
Expected volatility	60.03	61.77%	52.14	62.18%	48.35	53.13%
Risk-free interest rate	3.77	5.04%	4.35	5.07%	3.71	4.45%
Expected life (years)	5.55	6.17	5.55	6.25	5.00	
Expected dividend						

The expected life of the stock options granted was estimated based on the historical exercise patterns over the option lives while considering employee exercise strategy and cancellation behavior.

Expected volatility is determined based on historical volatility data of the Company s common stock from the period of time beginning with the Company s merger with GeneSoft in February 2004 and other factors through the month of grant. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant commensurate with the expected life assumption. The Company has not paid and does not anticipate paying cash dividends; therefore, the expected dividend yield is assumed to be 0%.

The total compensation cost that has been charged to income for the years ended December 31, 2007 and 2006 was approximately $2,713,000 and $3,876,000 respectively. The Company s policy is to recognize compensation cost for awards with service conditions and graded vesting using the straight-line method. Additionally, the Company s policy is to issue authorized but previously unissued shares to satisfy share option exercises, the issuance of restricted stock and stock issued under the Employee Stock Purchase Plan (ESPP). The amount

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Notes to Consolidated Financial Statements (Continued)

of stock-based compensation recognized during a period is based on the fair value of the portion of the awards that are ultimately expected to vest. In addition, the requisite service period is generally equal to the vesting term. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term forfeitures is distinct from cancellations or expirations and represents only the unvested portion of the surrendered option. The Company estimates forfeitures based on historical data, adjusted for known trends. The Company has applied an annual forfeiture rate of 21.39% to options in calculating total recognized compensation cost as of December 31, 2007. This analysis is re-evaluated annually and the forfeiture rate is adjusted as necessary. Ultimately, the actual expense recognized over the vesting period will only be for those shares that vest.

Using the Black-Scholes-Merton option-pricing model, the weighted average grant date fair values of options granted during the years ended December 31, 2007, 2006 and 2005 were $2.46, $7.36 and $9.60, respectively. For the year ended December 31, 2007, the Company granted 605,661 stock options with a weighted average exercise price of $4.17. For the year ended December 31, 2006, the Company granted 243,644 stock options with a weighted average exercise price of $13.49. For the year ended December 31, 2005, the Company granted 536,250 stock options with a weighted average exercise price of $19.92.

During the years ended December 31, 2007, 2006 and 2005, the total intrinsic value of options exercised was $120,000, $754,000 and $2,842,000, respectively. The total amount of cash received from exercise of these options during the years ended December 31, 2007, and 2006 and 2005 was $17,000, $166,000 and $870,000, respectively.

The 2001 Incentive Plan also provides for awards of nontransferable shares of restricted common stock which are subject to forfeiture. All shares of restricted stock vest based on service conditions in two equal installments over a two-year period. Generally, the fair value of each restricted stock award is equal to the market price of the Company s stock at the date of grant. Certain restricted share awards provide for accelerated vesting if there is a change in control.

A summary of activity related to restricted stock under the Option Plans as of December 31, 2007, is indicated in the following table (in thousands, except weighted average data):

	Number of Shares	Weighted-Average Grant Date Fair Value
Nonvested at December 31, 2006	50	$ 16.82
Granted	276	3.98
Vested	(70)	1.62
Forfeited	(42)	4.51
Nonvested at December 31, 2007	214	$ 7.64

As of December 31, 2007, there was approximately $3,580,000 of total unrecognized compensation cost related to unvested share based awards. This cost is expected to be recognized over a weighted average remaining requisite service period of 1.33 years. The Company expects approximately 442,000 unvested options to vest at some point in the future. Options expected to vest are calculated by applying an estimated forfeiture rate to the unvested options.

(t) Recent Accounting Pronouncements

Fair Value Measurements

In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 157 Fair Value Measurements (SFAS No. 157). SFAS No. 157 establishes a common definition for fair value,

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Notes to Consolidated Financial Statements (Continued)

creates a framework for measuring fair value, and expands disclosure requirements about such fair value measurements. SFAS No. 157 is effective for the Company s first quarter of 2008. The Company is in the process of studying the impact of this interpretation on its financial accounting and reporting, however, the Company does not expect the adoption of SFAS No. 157 to have a material impact on its financial position or results of operations.

Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS No. 159). SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. Furthermore, SFAS No. 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 will be effective for the Company beginning on January 1, 2008. The Company is in the process of studying the impact of this interpretation on its financial accounting and reporting, however, the Company does not expect the adoption of SFAS No. 159 to have a material impact on its financial position or results of operations.

Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development

In June 2007, the Emerging Issues Task Force issued EITF Issue 07-03, Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development (EITF No. 07-03). EITF No. 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under EITF No. 07-03, an entity would defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF No. 07-03 is effective for fiscal years beginning after December 15, 2007 and interim periods within those years. The Company does not expect the adoption of EITF No. 07-03 to have a material impact on its financial position or results of operations.

Accounting for Collaborative Arrangements

In November 2007, the Emerging Issues Task Force issued EITF Issue 07-01 Accounting for Collaborative Arrangements (EITF No. 07-01). EITF No. 07-01 requires collaborators to present the results of activities for which they act as the principal on a gross basis and report any payments received from (made to) other collaborators based on other applicable GAAP or, in the absence of other applicable GAAP, based on analogy to authoritative accounting literature or a reasonable, rational, and consistently applied accounting policy election. Further, EITF No. 07-01 clarified that the determination of whether transactions within a collaborative arrangement are part of a vendor-customer (or analogous) relationship subject to Issue 01-9, Accounting for Consideration Given by a Vendor to a Customer EITF No. 07-01 is effective for fiscal years beginning December 15, 2008. The Company has not yet completed its evaluation of EIFT 07-01, but does not currently believe that it will have a material impact on the results of operations, financial position or cash flows.

(3) Acquisition of ANTARA

On August 18, 2006, the Company acquired the rights to ANTARA in the United States from Reliant Pharmaceuticals in a transaction accounted for as an acquisition of a business in accordance with SFAS No. 141, Business Combinations (SFAS No. 141) and accordingly, allocated the purchase price of ANTARA based upon the estimated fair value of net assets acquired and liabilities assumed. The Company performed a valuation

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Notes to Consolidated Financial Statements (Continued)

study to determine the allocation of the estimated purchase price of the ANTARA acquisition among the tangible and intangible assets acquired as well as their estimated amortization period. The estimated useful life of the intangible assets is assumed to be fourteen years which was based upon the remaining life of the patents covering ANTARA, the regulatory barriers to competition, and management s knowledge of existing competitors research activities. The Company has completed an analysis of the fair values of the liabilities assumed in connection with the acquisition, including certain liabilities that qualify for recognition under EITF No. 95-3 Recognition of Liabilities in Connection with a Purchase Business Combination (EITF No. 95-3). ANTARA s operations, assumed as of the date of acquisition, are included in the Company s results of operations beginning on August 18, 2006.

The following is a summary of the Company s estimate of the fair values of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

Allocation of purchase price:	
Inventories	$ 4,344
Prepaid expenses	2,656
Intangible assets	60,780
Goodwill	16,783
Total assets acquired	84,563
Liabilities assumed	(1,427)
Net assets acquired	$ 83,136
Consideration and direct transaction costs:	
Cash	$ 82,376
Direct transaction costs	760
Total purchase price	$ 83,136

The following table presents the estimate of the fair value of the intangible assets acquired, their estimated useful lives and amortization expense (in thousands, except estimated useful lives data):

Intangible assets	Fair value of intangibles	Estimated life (in years)	Amortization for the year ended December 31, 2007
License Agreement	$ 58,900	14	$ 4,207
Manufacturing Relationship	1,880	14	134
Total	$ 60,780		$ 4,341

The following table presents the estimated remaining amortization of the intangible assets acquired (in thousands):

2007	$ 4,341

2008	4,341
2009	4,341
2010	4,341
2010	4,341
2012-2020	33,124
Total	$ 54,829

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The valuation of the purchased intangible assets of $60,780,000 was based on the result of a valuation using the income approach and applying a weighted average cost of capital of 17%. On an ongoing basis, the Company will evaluate the useful life of these intangible assets and determine if any competitive, governmental or regulatory event has impaired the value of the assets or modified their estimated useful lives.

(4) Reverse Stock Split

Pursuant to an Amendment to the amended and restated articles of organization, the Company effectuated on November 15, 2006, a one-for-eight reverse stock split of its issued and outstanding common stock, par value $0.10 per share and maintained the number of authorized shares of its common stock at 175,000,000. As a result of the reverse stock split, each eight shares of common stock issued and outstanding as of November 15, 2006 at the close of business, were automatically combined into and became one share of common stock. In cases in which the reverse stock split results in any shareholder holding a fraction of a share, such fractional share was rounded up to the nearest whole number.

Immediately after giving effect to the reverse stock split, the Company had approximately 13,552,125 shares of common stock outstanding (without giving effect to rounding due to fractional shares). The reverse stock split did not change the number of authorized shares of common stock, alter the par value of the common stock or modify any voting rights or other terms of the common stock. As a result of the reverse stock split, the per share exercise price of, and the number of shares of common stock underlying, Company stock options and warrants outstanding immediately prior were automatically proportionally adjusted, based on the one-for-eight reverse stock split ratio, in accordance with the terms of such options or warrants, as the case may be. All share and per share information in these consolidated financial statements have been retroactively restated to reflect the reverse stock split.

(5) Facility Lease Liability

At the time of merger with GeneSoft Pharmaceuticals (GeneSoft) in 2004, management approved a plan to integrate certain GeneSoft facilities into existing operations. In connection with the integration activities, the Company included in the purchase price allocation a restructuring liability of approximately $18,306,000, which included $1,419,000 in severance-related costs and $16,887,000 in facility lease impairment costs pertaining to 68,000 square feet of leased space which expires on February 28, 2011. In 2007 and 2006, in accordance with EITF No. 95-3, the Company made adjustments to the facilities lease liability based on revisions made to estimates of future rental income related to additional subleased space of approximately $838,000 and $119,000, respectively. These adjustments were recorded as a reduction to goodwill.

The following tables summarize the restructuring liability activity recorded related to the GeneSoft merger (in thousands):

	Year Ended December 31, 2007				
	Balance at December 31, 2006	Liability Adjustment	Net Cash Payments	Interest Accretion	Balance at December 31, 2007
Assumed facility lease liability	$ 13,900	$ (838)	$ (2,618)	$ 515	$ 10,959

	Year Ended December 31, 2006				
	Balance at December 31, 2005	Liability Adjustment	Net Cash Payments	Interest Accretion	Balance at December 31, 2006
Assumed facility lease liability	$ 16,204	$ (119)	$ (2,825)	$ 640	$ 13,900

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(6) Sale of Intellectual Property

During the year ended December 31, 2005, the Company sold intellectual property related to the genomic sequence of an undisclosed pathogen to Wyeth Pharmaceuticals, which was recorded as other income in the accompanying consolidated statements of operations for the year ended December 31, 2005.

(7) Goodwill and Intangible Assets

Goodwill and intangible assets consist of the following (in thousands):

	December 31,	
	2007	2006
Goodwill	$ 76,960	$ 78,193
License Agreements, net	105,285	113,925
Manufacturing Relationships, net	5,618	6,086
Total	$ 187,863	$ 198,204

(a) Goodwill

The Company s goodwill relates to the merger with GeneSoft, which occurred in February 2004 and totaled approximately $62,495,000, and the product acquisition of ANTARA, which occurred in August 2006 and totaled approximately $16,783,000. During 2007 and 2006, the Company recorded a reduction to goodwill associated with GeneSoft of approximately $838,000 and $119,000, respectively, primarily related to additional sublease income related to a facility lease liability. During 2007, the Company recorded a reduction to goodwill associated with the product acquisition of ANTARA of approximately $395,000 primarily related to reductions in accruals originally recorded during the acquisition and subsequently reversed. As of December 31, 2007, the Company does not believe that its goodwill is impaired. No amount of the goodwill balance at December 31, 2007 will be deductible for income tax purposes.

(b) Intangible Assets

As of December 31, 2007, intangible assets consist of the following (in thousands):

Asset Classification	Cost	Accumulated Amortization	Net
License Agreements	$ 128,352	$ (23,067)	$ 105,285
Manufacturing Relationships	7,103	(1,485)	5,618
Total	$ 135,455	$ (24,552)	$ 110,903

The ANTARA and FACTIVE intangible assets are amortized on a straight-line basis over the remaining legal life of the underlying patents of approximately 14.0 and 15.7 years respectively, which also corresponds to the estimated useful life of such assets. The weighted average amortization period for the license agreements is approximately 14.9 years and the weighted average amortization period for the manufacturing relationships is approximately 15.2 years, respectively. During 2007, 2006 and 2005, the Company recorded approximately $9,108,000, $6,376,000 and $4,767,000 of amortization expense, respectively.

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Notes to Consolidated Financial Statements (Continued)

The remaining amortization in future periods is as follows (in thousands):

Year-Ending December 31,	
2008	$ 9,108
2009	9,108
2010	9,108
2011	9,108
2012	9,108
Thereafter	65,363
Total	$ 110,903

(8) Notes Receivable

In connection with a lease agreement associated with vehicles for the Company s sales representatives, the Company was issued notes by the lessor totaling approximately $2,926,000 related to the repayment of security deposits made by the Company. The notes bear interest at rates ranging from 5.5% to 7.75% and have expiration dates ranging from February 2008 to November 2008. Principal and interest are repaid by the lessor to the Company over the 36 month lease term as lease payments are made on the vehicles. The balance of notes receivable as of December 31, 2007 was approximately $486,000.

(9) Income Taxes

The Company applies SFAS No. 109, Accounting for Income Taxes (SFAS No. 109), which requires the Company to recognize deferred tax assets and liabilities for expected future tax consequences of events that have been recognized in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using the enacted tax rates in effect for the year in which the differences are expected to reverse. SFAS No. 109 requires deferred tax assets and liabilities to be adjusted when the tax rates or other provisions of the income tax laws change.

The Company s income tax expense of approximately $384,000 and $179,000 for the years ended December 31, 2007 and 2006, respectively, is comprised of deferred federal and state taxes which relates to the tax effects of the Company s indefinite lived intangible that cannot be offset against the Company s deferred tax assets.

The Company s effective income tax rate as of the years ended December 31, 2007, 2006 and 2005 differed from the expected US federal statutory income tax rate as set forth below:

	December 31, 2007	December 31, 2006	December 31, 2005
Expected federal tax expense	$ (10,019)	$ (26,621)	$ (30,134)
Permanent differences	898	1,766	158
State Taxes, net of federal benefit	(1,428)	(3,627)	(3,940)
Tax Credits	(500)	2,252	(736)
Expiring net operating losses	2,165	843	27
Change in Valuation Allowance	9,268	25,566	34,623
Income tax expense	$ 384	$ 179	$

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At December 31, 2007, the Company had net operating loss carryforwards of approximately $457,708,000 and $319,468,000 available to reduce federal and state taxable income, respectively, if any. The Company does not have any net operating losses that are attributable to excess stock option deductions which would be recorded as an increase in additional paid in-capital. The Company also had tax research credit carryforwards of approximately $17,343,000 to reduce federal and state income tax, if any. Net operating loss and tax credit carryforwards are subject to review and possible adjustment by the Internal Revenue Service and may be limited in the event of certain cumulative changes in the ownership interest of significant shareholders over a three-year period in excess of 50%. To date, the Company has not performed an analysis to assess whether any such changes in ownership have occurred. Additionally, certain losses have begun to expire due to the limitations of the carryforward. The net operating loss and tax credit carryforwards expire approximately as follows (in thousands):

Expiration Date	Federal Net Operating Loss Carryforwards	State Net Operating Loss Carryforwards	Research Tax Credit Carryforwards
2008	$ 2,616	28,551	24
2009	1,038	73,384	8
2010		92,402	21
2011		66,279	691
2012	10,735	22,835	1,777
2013-2027	443,319	36,017	14,822
	$ 457,708	$ 319,468	$ 17,343

The components of the Company s net deferred tax asset at the respective dates are as follows (in thousands):

	December 31, 2007	2006
Net operating loss carryforwards	$ 153,368	$ 163,368
Research and development and other credits	12,648	14,966
Capitalized research and development costs	6,401	7,180
Depreciation	1,071	996
Facility impairment liability related to merger	4,213	5,343
Sale reserves and allowances	4,269	2,582
Intangible assets acquired at merger	(22,237)	(23,390)
Other Intangibles	(352)	(209)
Advanced payments	15,378	
Deferred compensation	2,620	2,067
Accrued expenses	4,100	2,053
Other temporary differences	1,563	2,330
Net deferred tax asset	183,042	177,286
Valuation allowance	(183,605)	(177,465)
Net deferred tax liability	$ (563)	$ (179)

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Notes to Consolidated Financial Statements (Continued)

The valuation allowance has been provided due to the uncertainty surrounding the realization of the deferred tax assets. The valuation allowance increased by approximately $6,140,000 from December 31, 2006 to December 31, 2007, primarily due to an increase in net operating loss carryforwards. The valuation allowance increased by $26,819,000 from December 31, 2005 to December 31, 2006, primarily due to the increase in net operating loss carryforwards.

The acquisition of the ANTARA assets from Reliant was deemed to be a taxable acquisition. As such, the goodwill is tax deductible. The Company accounts for goodwill pursuant to SFAS No. 142 and as of December 31, 2007, the Company has not taken an impairment charge. Therefore, the tax amortization expense generated a deferred tax liability without the ability to recognize an equal amount of deferred tax asset due to the determination that a valuation allowance is required on its gross deferred tax assets.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109 (the Interpretation) (FIN No. 48). The Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109. The Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Interpretation is effective for fiscal years beginning after December 15, 2006. The Company applied the provisions of the Interpretation effective January 1, 2007; however, the adoption of the Interpretation did not have a material effect on the Company s financial condition, results of operations or cash flows.

In accordance with FIN No. 48, the Company will recognize any interest and penalties related to unrecognized tax benefits in income tax expense.

During the twelve month period ended December 31, 2007, the Company recorded an increase to its liability for unrecognized tax benefits of approximately $20,804,000, which relates to positions taken during the current period upon adoption of FIN No. 48. Interest or penalties have not been accrued. If the tax benefit is ultimately recognized, there will be no impact to the Company s effective tax rate as a result of the Company s valuation allowance. The Company does not anticipate any significant increases or decreases to its liability for unrecognized tax benefits within the next 12 month period.

A reconciliation of the beginning and ending amount of unrecognized tax benefits (which are not recorded as a liability because they are offset by net operating loss carryforwards) are as follows:

Balance, January 1, 2007	$ 20,804
Increases (decreases) for tax positions taken during a prior period	
Increases (decreases) for tax positions taken during the current period	
Decreases relating to settlements	
Decreases resulting from the expiration of the statute of limitations	
Balance, December 31, 2007	$ 20,804

The Company files income tax returns in the U.S. federal and various state jurisdictions. The Company is generally no longer subject to income tax examinations by U.S. federal, state and local tax authorities for years before 1992.

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Notes to Consolidated Financial Statements (Continued)

(10) Commitments and Contingencies

(a) Lease Commitments

The Company s headquarters in Waltham, MA, consisting of approximately 36,000 square feet, is under an operating lease which expires on March 31, 2012 and includes an option to renew for an additional five years. The rent payments include lease escalation clauses. In addition, for the months of November and December in 2007 and 2006, total rental payments are abated by approximately $131,000 and $121,000, respectively. The rent differential related to the rent holidays and escalation provisions is accounted for as deferred rent.

The Company assumed a lease obligation in South San Francisco, California when it merged with GeneSoft. The leased space is approximately 68,000 square feet and the lease expires on February 28, 2011. A portion of the facility in South San Francisco, California has been subleased to third parties in 2007 and 2006.

In 2007, the Company moved its commercial sales and marketing office to Skillman, New Jersey. The Company s new commercial sales and marketing facility of approximately 10,000 square feet is under an operating lease, the term of which begins in early 2008 and expires on January 31, 2013. The rent payments under the Company s commercial sales and marketing facility lease include lease escalation clauses. In addition, for the first four months of the lease term, total rental payments are abated by approximately $68,300. The rent differential related to the rent holidays and escalation provisions will be accounted for as deferred rent.

The future minimum lease payments under the operating leases at December 31, 2007 are as follows (in thousands):

Year-Ending December 31,	Restructuring/Impaired Facility	Headquarter Facility	Sales & Marketing Facility
2008	$ 4,519	$ 906	$ 120
2009	4,677	936	209
2010	4,821	978	214
2011	807	978	219
2012		245	224
Thereafter			19
Total	$ 14,824	$ 4,043	$ 1,005

Rent expense relating to the Company s headquarters in each of the years ended 2007, 2006, and 2005 amounted to approximately $833,000 for each year. Rent payments for facilities accounted for in the restructuring and facility impairment accruals amounted to $4,366,000, $5,255,000, and $5,204,000 in 2007, 2006, and 2005, respectively. Rental payments received from subleasing arrangements were approximately $2,565,000, $3,922,000, and $3,571,000 in 2007, 2006, and 2005, respectively, and were accounted for as part of the Company s restructuring and impairment accruals. The aggregate minimum amount of rental payments to be received from 2008 to 2011 from existing contracted subleasing arrangements is approximately $4,379,000 as of December 31, 2007.

(b) Employment Agreements

The Company has employment agreements with its executive officers and several key employees, which provide for bonuses, as defined, and severance benefits upon termination of employment, as defined.

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Notes to Consolidated Financial Statements (Continued)

(c) Litigation

The Company is involved in various legal matters, which arise in the ordinary course of business. The Company does not believe that the ultimate resolution of any matter will have a material adverse effect on its financial condition, results of operations or cash flows.

(11) Long-term Obligations

Long-term obligations consist of the following (in thousands):

	As of December 31,	
	2007	2006
3.50% Senior convertible promissory notes, net of discount	$ 179,508	$
3 1/2% Senior convertible promissory notes	829	152,750
5% Convertible promissory notes	13,300	22,310
Revenue interest assignment	39,129	38,995
12% Senior secured note	20,000	20,000
Capital lease	131	169
	252,897	234,224
Less current portion of capital lease	38	38
	$ 252,859	$ 234,186

(a) Debt Obligations

On February 6, 2004, in connection with its merger with GeneSoft, the Company issued approximately $22,310,000 in principal amount of 5% convertible five year promissory notes due February 2009 (the 2009 Notes). Following the exchange offer completed in May 2007 described below, there are approximately $13,300,000 principal amount of the 2009 Notes outstanding at December 31, 2007. The 2009 Notes are convertible into the Company s common stock at the option of the holders, at a conversion price of $53.13 per share, as adjusted pursuant to the reverse stock split which the Company effectuated in November 2006.

In the quarter ended June 26, 2004, the Company issued $152,750,000 in principal amount of its 3 1/2% senior convertible promissory notes due in April 2011 (the Original 2011 Notes). Following the exchange offer completed in May 2007 described below, there are approximately $829,000 principal amount of the Original 2011 Notes outstanding at December 31, 2007. These notes are convertible into the Company s common stock at the option of the holders at a conversion price of $53.14 per share, as adjusted pursuant to the reverse stock split which the Company effectuated in November 2006. The Company may not redeem the outstanding Original 2011 Notes at its election before May 10, 2010. After this date, the Company can redeem all or a part of the Original 2011 for cash at a price equal to 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest. The holders right of repurchase under the Original 2011 Notes is identical to the right of repurchase under the New Notes (defined below) and is described below.

In May 2007, the Company completed (i) an exchange offer with certain holders of the Original 2011 Notes in which the Company exchanged $151,921,000 aggregate principal amount of its new 3.50% Convertible Senior Notes due 2011 (the New Notes) for $151,921,000 aggregate principal amount of its then outstanding Original 2011 Notes; and (ii) an exchange offer with holders of the 2009 Notes in which the Company exchanged approximately $10,574,000 aggregate principal and accrued interest amount of its then outstanding 2009 Notes for approximately $13,746,000 aggregate principal amounts of the New Notes. The Company also issued an

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Notes to Consolidated Financial Statements (Continued)

additional $60,000,000 of New Notes to the public for cash at a public offering price of 77.5% of principal, resulting in $46,500,000 in gross proceeds to the Company.

The New Notes are initially convertible into approximately 16,718,000 common shares at a conversion rate of 74.074 of the Company s common shares per $1,000 principal amount of New Notes, which is equivalent to a conversion price of approximately $13.50 per common share. The New Notes are convertible at any time by the holder. In the event of a fundamental change, holders of the Original 2011 Notes and the New Notes have the right to require the Company to repurchase all or any portion of their notes at a price equal to 100% of the principal amount plus accrued and unpaid interest. Under the indenture for the Original 2011 Notes and the New Notes, a fundamental change will be deemed to occur if (i) a change of control transaction occurs in which substantially all of the Company s common stock is exchanged either for consideration other than common stock that is listed on a U.S. national securities exchange or is exchanged for consideration other than common stock that is approved for quotation on a U.S. system of automated dissemination of quotations of securities or (ii) the Company s common stock is neither listed for trading on a U.S. national securities exchange nor approved for listing on any U.S. system of automated dissemination of quotations of securities prices.

Before May 10, 2010, the Company may not redeem the New Notes. On or after May 10, 2010, the Company may redeem any or all of the New Notes at 100% of the principal amount, plus accrued and unpaid interest. In addition, the Company may automatically convert some or all of the New Notes on or prior to the maturity date if the closing price of its common shares has exceeded 130% of the conversion price then in effect for at least 20 trading days during any consecutive 30 trading day period ending within five trading days prior to the notice of auto-conversion (the auto-conversion feature). If a holder elects to voluntary convert their New Notes or the Company elects to automatically convert some or all of the New Notes on or prior to May 10, 2010, the Company will pay additional interest to holders of New Notes being converted. This additional interest will be equal to the amount of interest that would have been payable on the New Notes from the last day interest was paid on the New Notes, through and including May 10, 2010. Additional interest, if any, will be paid in cash or in common shares of the Company, at the Company s option. If the Company pays additional interest upon a voluntary conversion with its common shares, such shares will be valued at the conversion price that is in effect at that time. If the Company pays additional interest upon an automatic conversion with its common shares, such shares will be valued at 90% of the automatic conversion price that is in effect at that time.

The Company has accounted for the New Notes in accordance with the guidance as set forth in EITF No. 96-19, Debtor s Accounting for a Modification or Exchange of Debt Instruments (EITF No. 96-19), SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended (SFAS No. 133), EITF No. 05-7, Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues (EITF No. 05-7), EITF No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock (EITF No. 00-19), EITF No. 05-02, Meaning of Conventional Convertible Debt Instrument (EITF No. 05-02) and EITF No. 01-6, The Meaning of Indexed to a Company s Own Stock (EITF No. 01-6), and determined that the exchange represents an extinguishment of existing debt rather than a modification. Accordingly, the Company recorded a gain of approximately $30,824,000 upon the extinguishment of debt, which was a result of exchanging a majority of the Original 2011 Notes and a portion of the 2009 Notes that were issued at par value, for the New Notes that were issued at 77.5% of par (i.e. a 22.5% discount). The gain arose due to the fact that the fair value of the Original 2011 Notes exceeded that of the New Notes. The debt issuance costs related to the Original 2011 Notes in the amount of approximately $3,285,000 are netted against the gain.

The additional interest payment described above, which may be issued upon conversion, is considered an embedded derivative under SFAS No. 133 and requires bifurcation from the host debt. The Company also considered the provisions of EITF No. 05-2, and concluded that this is not conventional convertible debt.

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Notes to Consolidated Financial Statements (Continued)

In accordance with SFAS No. 133, the Company has separately accounted for the additional interest payment feature of the New Notes as an embedded derivative instrument, which is measured at fair value and classified on the accompanying consolidated balance sheets as other long term liabilities. Changes in the fair value of the embedded derivative are recognized in earnings. The derivative liability is revalued quarterly and changes in the fair value through either the date the additional interest payment provisions expire, at which the liability will be zero, or the date at which the additional interest payment provision is triggered, are recorded as other expense or income. For the purpose of accounting for the New Notes issued in the exchange offer, the fair value of the embedded derivative upon issuance was subtracted from the carrying value of the debt and reflected as a debt discount. The debt discount is amortized as interest expense using the effective interest method through the date the notes are scheduled to mature.

Convertible debt upon the exchange and new offering on May 1, 2007 consisted of the following (in thousands):

3.50% Convertible senior notes	$ 225,692
Discount on convertible notes	(50,781)
Embedded derivative	(3,077)
Total	$ 171,834

The additional New Notes generated gross proceeds of $46,500,000. Debt issuance costs, related to the New Notes, of approximately $6,057,000 are being amortized to interest expense, on a straight-line basis over the 48 month period to maturity of the notes. As of December 31, 2007, the fair value of the derivative is approximately $73,000 which reflects a change in the fair value of approximately $3,004,000 which is included as gain on derivative in the accompanying consolidated statements of operations.

For the year ended December 31, 2007, the Company incurred approximately $8,071,000 in interest expense on its convertible debt, which is payable on a semi-annual basis. Additionally, the Company amortized approximately $7,649,000 as non-cash interest expense related to the accretion of the bond discount and approximately $1,325,000 in new debt issuance costs.

(b) Other Financial Arrangements

To finance the acquisition of ANTARA in August 2006, the Company, together with its wholly-owned subsidiary Guardian II Acquisition Corporation (Guardian II) (the entity which holds all of the ANTARA assets), entered into several financing agreements with Paul Royalty Fund Holdings II, LP, an affiliate of Paul Capital Partners, or Paul Capital, including the Revenue Interests Assignment Agreement, the Note Purchase Agreement and the Common Stock and Warrant Purchase Agreement, in consideration for an aggregate amount of $70 million.

Revenue Interests Assignment Agreement

The Company and Guardian II entered into the Revenue Interests Assignment Agreement (the Revenue Agreement), pursuant to which the Company sold to Paul Capital the right to receive specified royalties on Oscient s net sales in the United States (and the net sales of its affiliates and licensees) of FACTIVE tablets and Guardian II sold to Paul Capital the right to receive specified royalties on Guardian II s net sales in the United States (and the net sales of its affiliates and licensees) of ANTARA capsules, in each case until December 31, 2016. The royalty payable to Paul Capital on net sales of ANTARA and FACTIVE starts each fiscal year as a high single digit royalty rate and declines to a low single digit royalty rate based on achievement of annual specified sales thresholds in each fiscal year. Once the cumulative royalty payments to Paul Capital exceed $100 million, the royalties become nominal.

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In connection with the Revenue Agreement, the Company recorded a liability, referred to as the revenue interest liability, of approximately $40 million in accordance with EITF No. 88-18, Sales of Future Revenues (EITF No. 88-18). The Company imputes interest expense associated with this liability using the effective interest rate method and has recorded a corresponding accrued interest liability. The effective interest rate is calculated based on the rate that would enable the debt to be repaid in full over the life of the arrangement. The interest rate on this liability may vary during the term of the agreement depending on a number of factors, including the level of ANTARA and FACTIVE sales. Payments made to Paul Capital as a result of ANTARA and FACTIVE sales levels will reduce the accrued interest liability and the principal amount of the revenue interest liability. The Company recorded approximately $8,020,000 and $2,089,000 in interest expense related to this agreement in 2007 and 2006, respectively.

In the event of (i) a change of control of Oscient or Guardian II, (ii) a bankruptcy of Oscient or Guardian II, (iii) a transfer by Oscient or any of its subsidiaries of substantially all of either ANTARA or FACTIVE, (iv) subject to a cure period, breach of certain material covenants and representations in the Revenue Agreement and (v) in the event the sale of ANTARA is suspended due to a court issued injunction or the Company elects to suspend sales of ANTARA, in each case as a result of a lawsuit by certain third parties (each a Put Event), Paul Capital has the right to require the Company and Guardian II to repurchase from Paul Capital its royalty interest at a price in cash which equals the greater of (a) a specified multiple of cumulative payments made by Paul Capital under the Revenue Agreement less the cumulative royalties previously made to Paul Capital; or (b) the amount which will provide Paul Capital, when taken together with the royalties previously paid, a specified rate of return (the Put/Call Price). Upon a bankruptcy event, the Company and Guardian II are automatically required to repurchase the Paul Capital royalty interest at the Put/Call Price. In the event of a change of control of Oscient, the Company has the right to repurchase the Paul Capital royalty interest for an amount equal to the Put/ Call Price. The Company has determined that Paul Capital s put option and the Company s call option meet the criteria to be considered an embedded derivative and should be accounted for as such. The Company initially recorded a net liability of $1,005,000 related to the put/call option to reflect its estimated fair value as of the date of the agreement, in accordance with SFAS No. 133. This liability is revalued on a quarterly basis to reflect any changes in the fair value and any gain or loss resulting from the revaluation is recorded in earnings. As of December 31, 2007, the fair value of the derivative is approximately $986,000 which reflects a change in the fair value of approximately $19,000 which has been recorded as a gain on derivative in the accompanying consolidated statements of operations.

During the first two fiscal years immediately following the fiscal year in which combined annual net sales of ANTARA and FACTIVE are equal to or greater than $125 million, the Company and Guardian II have the right, but not the obligation, to reduce the royalty percentages due under the Revenue Agreement to Paul Capital by fifty percent (50%) by paying Paul Capital a price in cash which will provide Paul Capital, when taken together with the royalties previously paid, a specified rate of return. During the first two fiscal years immediately following the fiscal year in which combined annual net sales of ANTARA and FACTIVE are equal to or greater than $250 million, the Company and Guardian II have the right, but not the obligation, to repurchase the Paul Capital royalty interest at a price in cash which will provide Paul Capital, when taken together with the royalties previously paid, a specified rate of return.

Note Purchase Agreement

Guardian II entered into a Note Purchase Agreement (the Note Purchase Agreement) with Paul Capital pursuant to which Guardian II issued and sold a $20,000,000 aggregate principal amount of 12% senior secured note (the Note), due on the fourth anniversary of the closing date, subject to Guardian II s option to extend the maturity to the sixth anniversary of the closing date, provided (i) there are no defaults under the Note at the time,

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Notes to Consolidated Financial Statements (Continued)

and (ii) the Company issues to Paul Capital, at the time of the exercise of such option, a warrant for such number of shares of common stock equal to 10% of the principal balance plus accrued interest divided by $6.94, with an exercise price of $6.94 per share. If the Company exercises such option, the number of shares subject to the warrant issuable to Paul Capital would be between 288,018 shares and 367,529 shares, depending upon the amount, if any, of the interest payable on the Note the Company elects to have added to the principal of the Note rather than paid in cash as described below.

Interest is payable semi-annually in arrears on the last day of each of March and September. Guardian II has the option to pay interest in cash or to have 50% of the interest paid in cash and 50% of the interest added to principal. In the event of a change of control of Oscient or on or after the second anniversary of the closing, the Company may at its option prepay all or any part of the Note at a premium which declines over time. In the event of default, with event of default defined as a continuing Put Event under the Revenue Agreement as described in more detail above, the outstanding principal and interest in the Note shall become immediately due and payable. As of December 31, 2007, the Company exercised its option to add approximately $1,694,000 of interest expense payable to the principal of the Note. This amount is recorded as other long-term liabilities on the accompanying consolidated balance sheets.

Subject to the Revenue Agreement and the Note Purchase Agreement, without the prior written consent of Paul Capital, the Company has agreed not to (i) amend, waive any rights under, or terminate any material license agreements, including the agreements relating to the ANTARA products and FACTIVE products, (ii) enter into any new agreement or amend or fail to exercise any of its material rights under existing agreements that would adversely affect Paul Capital s royalty interest, and (iii) sell any material assets related to ANTARA or FACTIVE.

Pursuant to the terms of the Revenue Agreement and the Note Purchase Agreement, Guardian II and Paul Capital entered into a Security Agreement (the Security Agreement) under which Guardian II granted to Paul Capital a security interest in and to substantially all assets owned by Guardian II (including rights to the ANTARA products) in order to secure its performance under each of the Revenue Agreement, the Note Purchase Agreement and the Note. To the extent the indebtedness under certain of its pre-existing debt obligations is refinanced or replaced and such replacement or refinancing indebtedness is secured, the Company has agreed to equally and ratably secure its obligations under the Revenue Agreement.

Common Stock and Warrant Purchase Agreement

As part of the financing, the Company and Paul Capital also entered into a Common Stock and Warrant Purchase Agreement (the Stock and Warrant Purchase Agreement), pursuant to which, in exchange for $10 million, the Company sold to Paul Capital 1,388,889 shares (the Shares) of the Common Stock, at a price of $7.20 per share (the Private Placement) and issued Paul Capital a warrant (the Warrant) to purchase 288,018 shares of Common Stock (the Warrant Shares) at an exercise price of $6.94 per share. The Warrant is exercisable for seven years from the date of closing. The Warrant contains a net share settlement feature and penalties if the Company does not deliver the applicable amount of Warrant Shares within three trading days of exercise of a Warrant by Paul Capital. The Warrant also contains provisions providing that, at Paul Capital s election, the Company must repurchase the Warrant from Paul Capital upon a sale of the Company in which the consideration for such sale is solely cash. The warrant has not been exercised as of December 31, 2007.

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Notes to Consolidated Financial Statements (Continued)

The following table presents future maturities of debt (in thousands):

Year-Ending December 31,	
2008	$ 38
2009	13,338
2010	20,038
2011	180,354
2012	
Thereafter	39,129
Total	$ 252,897

(12) Stockholders Equity

(a) Equity Plans

The Company granted stock options to key employees and consultants under its 1991, 1993, 1995 and 1997 Stock Option Plans, and continues to grant stock-based awards under its 2001 Incentive Plan (collectively, the Option Plans). On August 13, 2007, the Board of Directors approved the Company s 2007 Employment Inducement Award Plan (the 2007 Inducement Plan) and authorized 500,000 shares of common stock for issuance under the 2007 Inducement Plan. The Compensation Committee of the Board of Directors determines the purchase price and vesting schedule applicable to each option grant. As of December 31, 2007, there were no shares reserved for future grants under the 1991, 1993, 1995 and 1997 Plans. The 2001 Incentive Plan, as amended and restated, provides for the grant of non-qualified stock options, incentive stock options, restricted stock, stock appreciation rights, unrestricted stock, deferred stock, convertible securities, and cash and equity-based performance awards. The 2007 Inducement Plan provides for the grant of non-qualified stock options and restricted stock. As of December 31, 2007, 1,697,316 shares were authorized and 480,503 shares were available for future issuance under the 2001 Incentive Plan and 500,000 shares were authorized and 239,537 shares were available for future issuance under the 2007 Inducement Plan. In addition, under separate agreements not covered by any plan, the Company has granted certain key employees and directors of the Company an aggregate of 65,506 options to purchase common stock.

The Company also has an Employee Stock Purchase Plan (ESPP), which was adopted in February 2000. Under the ESPP, eligible employees may contribute up to 15% of their earnings toward the semi-annual purchase of the Company s common stock. The employees purchase price is 85% of the fair market value of the common stock at the time of grant of option or the time at which the option is deemed exercised, whichever is less. The most recently completed offering period began July 1, 2007 and ended on December 31, 2007; therefore, July 1, 2007 is considered the grant date for the purposes of recognizing the stock-based compensation expense for this offering period. The Company projects the estimated contributions at the beginning of the period and uses the Black-Scholes-Merton option-pricing model in order to determine the estimated fair value of the stock to be issued. At the end of the offering period, the Company adjusts the estimated contributions to actual. Under Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees (APB No. 25), the Company was not required to recognize stock-based compensation expense for the cost of shares issued under the Company s ESPP in 2005, as the ESPP was determined to be noncompensatory. Upon adoption of SFAS No. 123R, the Company began recording stock-based compensation expense related to the ESPP.

However, effective the beginning of the most recently completed offering in 2007, the Company reduced the discount from 15% to 5% for employees to purchase shares, resulting in a purchase price of 95% of the fair market value of the common stock at the time of grant of option or the time at which the option is deemed

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Notes to Consolidated Financial Statements (Continued)

exercised, whichever is less. Under SFAS 123R, no compensation expense is required to be recorded when the employee discount is 5% or less. As of December 31, 2007, 431,250 shares were authorized and 77,103 shares were available for future issuance under this plan.

In December 2005, in accordance with transition guidance issued by the Internal Revenue Code in connection with Section 409A, the Company approved a plan to cancel the outstanding discounted stock options and issue replacement options with an exercise price equal to the current fair market value of the Company s common stock.

The replacement options were not discounted and therefore not subject to the additional taxes imposed by Section 409A. Because the replacement options have a higher exercise price than the canceled discounted options, a cash payment in an amount equal to the aggregate spread between the two exercise prices, as well as an amount to cover the tax payable in respect of such payment, has been made to each affected optionee. The cash payments under this plan totaled approximately $65,000 which were accounted for as compensation expense in the year ended December 31, 2005. The Company does not anticipate issuing discounted stock options as part of employee compensation in the future.

A summary of activity related to stock options under the Option Plans as of December 31, 2007 is presented below (in thousands, except weighted average data):

	Number of Shares (in thousands)	Exercise Price Range	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding, December 31, 2006	987	$ 3.07-221.28	$ 31.18		
Granted	606	1.76-7.38	4.17		
Exercised	(5)	3.07-4.08	3.46		
Canceled	(325)	2.62-81.75	21.78		
Outstanding, December 31, 2007	1,263	$ 1.76-221.28	$ 20.75	7.70	$
Exercisable, December 31, 2007	701	$ 3.07-221.28	$ 32.15	6.58	$

The range of exercise prices for options outstanding and options exercisable under the Option Plans at December 31, 2007 are as follows:

			Options Outstanding		Options Exercisable	
Range of Exercise Prices		Weighted Average Remaining Contractual Life of Options Outstanding (in years)	Number of Shares (in thousands)	Weighted Average Exercise Price	Number of Shares (in thousands)	Weighted Average Exercise Price
$ 1.76	3.28	9.53	207	$ 2.79	8	$ 3.07
$ 3.30	4.91	9.17	92	4.44	9	4.18
$ 4.94	4.94	9.18	223	4.94	84	4.94
$ 4.96	13.64	7.39	128	10.01	64	10.27
$ 13.72	15.40	7.82	161	14.82	130	14.88
$ 15.42	23.52	7.20	160	21.37	143	21.57
$ 23.72	41.76	6.14	169	36.52	144	37.78
$ 42.88	148.75	3.84	121	89.58	117	91.12
$164.75	164.75	2.72	1	164.75	1	164.75

$221.25	221.25	2.55	1	221.25	1		221.25
Total		7.70	1,263	$ 20.98	701	$	32.15

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Notes to Consolidated Financial Statements (Continued)

(b) Sale of Common Stock

On April 11, 2006, the Company completed a private placement of its common stock with institutional investors and other accredited investors. The Company sold an aggregate of 2,254,402 shares of its common stock at a price of $15.44 per share and warrants to purchase up to 1,149,745 shares of common stock at a price of $1.00 per warrant. The warrants have an exercise price of $17.76 per share and a term of five years.

(c) Warrants

As of December 31, 2007, the Company had warrants outstanding for the purchase of 1,861,083 shares of common stock at exercise prices ranging from $6.94 $90.64, as adjusted for the reverse stock split effectuated by the Company in November 2006. These warrants are fully vested at December 31, 2007 and are as follows (in thousands, except exercise price data):

Warrants Outstanding	Exercise Price	Expiration
319	$ 27.84	October 15, 2008
74	$ 24.53	December 31, 2008
1,150	$ 17.76	April 11, 2011
6	$ 90.64	June 13, 2011
312	$ 6.94	August 18, 2013

(d) Note Receivable from Officer

In March 2001, the Company loaned $163,000 to an officer of the Company to allow him to pay income tax liabilities associated with a restricted stock grant of 3,000 shares. The loan carried an interest rate of 4%. The principal amount of the note was non-recourse as it was secured only by the 3,000 shares of restricted stock. The interest portion of the loan was full-recourse as it was secured by the officer s personal assets. The officer paid the Company approximately $41,000 for interest due to the Company pursuant to the loan. Pursuant to the terms of the note, the note came due on December 31, 2006, at which point the officer transferred the 3,000 shares of restricted stock to the Company as payment in full of all principal outstanding under such loan.

(e) Common Stock Reserved

Common stock reserved for future issuance at December 31, 2007 consists of the following (in thousands):

Stock option and incentive plans	2,197
Employee stock purchase plan	77
Warrants	1,861
Conversion of convertible notes	17,035
Total	21,170

(13) Incentive Savings 401(k) Plan

The Company maintains an incentive savings 401(k) plan (the 401(k) Plan) for the benefit of all employees. The Company matches 50% of the first 6% of salary, which for 2007 was limited to the first $225,000 of annual salary. The Company contributed approximately $424,000, $356,000 and $183,000 to the 401(k) Plan for the years ended December 31, 2007, 2006 and 2005, respectively.

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Notes to Consolidated Financial Statements (Continued)

(14) Supply Agreement for ANTARA

In accordance with the acquisition of ANTARA in August of 2006, the Company was assigned rights to and assumed obligations under an exclusive license to the rights to ANTARA licensed from Ethypharm S.A. In order to maintain the exclusivity of these rights, the Company must achieve minimum annual sales in the United States and Canada until February 2012 or pay amounts to Ethypharm to compensate for any shortfall. During 2007, the Company recorded approximately $471,000 as additional royalties related to the expected shortfall. During the term of the agreement, the Company is obligated to pay a royalty on sales of ANTARA in the U.S. including a royalty on other fenofibrate monotherapy products in formulation and dosage forms that may be substantially similar or identical to ANTARA developed by the Company. The license term expires in February 2020 and, absent notice of termination by either party, automatically renews for consecutive periods of two (2) years each. Under the terms of the agreement, at the Company s option, Ethypharm is obligated to either manufacture and deliver to the Company finished fenofibrate product or deliver bulk product to the Company for encapsulation and packaging. Ethypharm also has a right of first refusal on any divestiture of the ANTARA rights by the Company. Additional Company obligations under the Ethypharm agreement include using commercially reasonable efforts to maintain a sales force of at least 150 representatives through February 2008 and funding a portion of the active pharmaceutical ingredient safety stock that Ethypharm is required to maintain

(15) Supply Agreement for FACTIVE

The Company licenses from LG Life Sciences the right to develop and commercialize gemifloxacin (FACTIVE), a novel fluoroquinolone antibiotic, in North America, France, Germany, the United Kingdom, Luxembourg, Ireland, Italy, Spain, Portugal, Belgium, the Netherlands, Austria, Greece, Sweden, Denmark, Finland, Norway, Iceland, Switzerland, Andorra, Monaco, San Marino, Vatican City, Poland, Czech Republic, Slovakia, Slovenia, Hungary, Estonia, Latvia, Lithuania, Liechtenstein, Malta, Cyprus, Romania, Bulgaria, Croatia, Serbia and Montenegro, Bosnia and Herzegovina, Albania and the Former Yugoslav Republic of Macedonia. The term of the agreement with respect to each country extends at least through the life of the patents covering gemifloxacin in such country. In the United States, the last of the issued patents for composition of matter expires in 2018. The patent term could extend further in countries outside of the U.S. depending upon several factors, including whether the Company obtains patent extensions and the timing of its commercial sale of the product in a particular country.

Under the terms of the agreement, LG Life Sciences has agreed to supply and the Company is obligated to purchase from LG Life Sciences all of its anticipated commercial requirements for the FACTIVE API. LG Life Sciences currently supplies the FACTIVE API from its manufacturing facility in South Korea.

The agreement with LG Life Sciences also requires that the Company achieves a minimum gross sales level of $30 million from its licensed territories over a 12-month period of time starting on the third anniversary from the launch of FACTIVE in the U.S. in 2004 which, if not met, LG Life Sciences could elect to terminate the agreement and have the technology be returned to LG Life Sciences. Under this agreement, the Company is responsible, at its expense and through consultation with LG Life Sciences, for the clinical and commercial development of gemifloxacin in the countries covered by the license, including the conduct of clinical trials, the filing of drug approval applications with the FDA and other applicable regulatory authorities and the marketing, distribution and sale of gemifloxacin in its territory.

The Company is obligated to pay a royalty on sales of FACTIVE in North America and the territories covered by the license in Europe. These royalty obligations expire with respect to each country covered by the agreement on the later of (i) the expiration of the patents covering FACTIVE in such country or (ii) the expiration of data exclusivity in Mexico, Canada or the European Union respectively, or 2014 in the U.S. The Company is also

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Notes to Consolidated Financial Statements (Continued)

obligated to make aggregate milestone payments of up to $40 million (not including payments previously made pursuant to up-front obligations or achievements of certain milestones) to LG Life Sciences including milestone payments required by the amendments described below upon achievement of additional regulatory approvals and sales thresholds.

On March 31, 2005, the Company amended its license and option agreement with LG Life Sciences. As part of the amendment of the agreement, the Company made a one-time, up-front payment of $2 million to LG Life Sciences which was recorded to general and administrative expense in the three month period ended March 31, 2005 and agreed to make certain additional milestone payments upon obtaining regulatory approvals and sales thresholds. The amended agreement also includes a reduction of future royalties payable to LG Life Sciences at certain FACTIVE revenue levels in territories covered by the agreement.

The Company further amended its agreement with LG Life Sciences on February 3, 2006, pursuant to which LG Life Sciences agreed to a reduction of future royalties payable for sales of FACTIVE tablets in Mexico and Canada and the termination of LG Life Sciences co-promotion rights in these countries. The modified agreement also calls for additional milestone payments to be made to LG Life Sciences upon consummation of sublicense agreements in Mexico and Canada (which payments were made to LG in February 2006 and August 2006, respectively) as well as upon receipt of regulatory approval of FACTIVE in each of such countries. Additionally, on December 27, 2006, the Company amended its agreement with LG Life Sciences to reduce future royalties payable to LG Life Sciences for sales of FACTIVE tablets in Europe to provide for a reduction in the supply price for the active pharmaceutical ingredient for FACTIVE for product to be sold in Europe. In lieu of milestone payments previously agreed to by the parties, this amendment also requires the Company to pay LG Life Sciences a portion of any milestone or license fee payments the Company receives from its European partner.

(16) Co-Promotion of TESTIM

On April 11, 2005, the Company entered into a co-promotion agreement with Auxilium Pharmaceuticals, Inc. (Auxilium), under which the Company and Auxilium co-promoted in the United States Auxilium s product, TESTIM gel, a topical 1% testosterone gel indicated for the treatment of male hypogonadism. On August 31, 2006, the Company and Auxilium mutually agreed to conclude this co-promotion arrangement and agreed to share profits from primary care sales, as provided for under the co-promotion agreement, through August 31, 2006. As part of the termination of the co-promotion agreement, the Company received $1,800,000 from Auxilium as additional compensation for commercialization efforts by its sales force through August 31, 2006, which has been recognized as revenue at December 31, 2006.

(17) Partnering Arrangements for FACTIVE

Sublicense Agreement with Pfizer, S.A. de C.V.

On February 6, 2006, the Company entered into a Sublicensing and Distribution Agreement with Pfizer, S.A. de C.V. (Pfizer Mexico), pursuant to which the Company sublicensed its rights to sell FACTIVE tablets in Mexico to Pfizer Mexico. In exchange for those rights, Pfizer Mexico has paid the Company an up-front payment and has agreed to pay milestone payments upon obtaining certain regulatory approvals and sales goals, as well as royalties on future sales. The up-front payment is being recognized as revenue over the term of the Company s continuing obligations under the agreement. These royalty rates are subject to reduction upon expiration of certain patents in Mexico for FACTIVE or if a generic form of gemifloxacin has a material impact on Pfizer Mexico s sales volumes in Mexico. Pfizer Mexico is obligated to exclusively purchase from the Company, and the Company must exclusively supply, all active pharmaceutical ingredients for FACTIVE. The agreement with Pfizer Mexico may be terminated by either party upon the occurrence of certain termination events, including

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Notes to Consolidated Financial Statements (Continued)

Pfizer Mexico s right to terminate at any time after the first anniversary of launch of FACTIVE tablets in Mexico upon nine months prior written notice. Upon termination, Pfizer Mexico is obligated to assign any and all rights to regulatory approvals in Mexico to the Company or its designee. Pfizer Mexico is currently marketing FACTIVE-5 in Mexico for the treatment of CAP, AECB and ABS.

Supply and Marketing Agreement with Abbott Laboratories

On August 9, 2006, the Company granted the commercialization rights to FACTIVE tablets in Canada to Abbott Laboratories, Ltd. (Abbott Canada), the Canadian affiliate of Abbott. In exchange for those rights, Abbott Canada agreed to a transfer price on product purchases and to make certain payments to the Company upon achievement of certain regulatory and sales milestones. FACTIVE tablets are currently approved in Canada for the five-day treatment of AECB. The Company subsequently amended the agreement on January 31, 2008 whereby Abbott Canada s development and commercialization obligations were substantially reduced. See Note 20.

Menarini International Operation Luxembourg SA

The Company entered into a License, Supply and Marketing Agreement with Menarini International Operation Luxembourg SA (Menarini), a wholly-owned subsidiary of Menarini Industrie Farmaceutiche Riunite S.r.l. dated December 28, 2006, whereby the Company sublicensed its rights to sell FACTIVE tablets in the European Union to Menarini. Under the terms of the Company s agreement with Menarini, Menarini is responsible for obtaining regulatory approval for FACTIVE in the European Union, and the Company has agreed to reimburse Menarini for expenses associated with such regulatory development up to an agreed limit. Menarini has paid the Company an up-front payment which is being recognized as revenue over the term of the Company s continuing obligations under the agreement of approximately thirty-three months. Menarini has also agreed to pay the Company milestone payments upon obtaining certain regulatory and reimbursement approvals and upon achieving certain annual net sales goals, which could total up to $23.0 million, if all the milestones are achieved. Menarini will pay the Company a transfer price on purchases of the active pharmaceutical ingredient, or API, for FACTIVE, which is determined based on a percentage of quarterly sales of FACTIVE by Menarini in Europe. Menarini is also obligated to exclusively purchase from the Company, and the Company must exclusively supply, all API for FACTIVE to be sold in Europe for the earlier of (1) the expiration of the life of certain patents covering the product or (ii) the expiration of data exclusivity. The Company s agreement with Menarini may be terminated by either party upon the occurrence of certain termination events, including Menarini s right to terminate if the European regulatory authorities do not recommend approval of FACTIVE at various stages of the approval process with a package insert, or label, that meets certain requirements as to the safety, dosing and indications for which FACTIVE may be prescribed. Menarini may also terminate the agreement if it does not receive approval for reimbursement from European member countries that is above a certain minimum price per tablet. Upon termination, Menarini is obligated to assign any and all rights to regulatory approvals in the European Union to the Company or its designee.

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(18) Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following (in thousands):

	December 31,	
	2007	**2006**
Sales reserves and allowances	$ 10,734	$ 6,003
Payroll and related expenses	5,244	5,640
Deferred rent	502	401
Professional fees	512	916
Interest related to convertible notes payable	2,189	1,446
Royalty interest payable	371	712
Other	1,376	1,300
	$ 20,928	$ 16,418

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(19) Quarterly Consolidated Statements of Operations (unaudited)

The following table sets forth unaudited quarterly statement of operations data for each of the eight quarters in the two year period ended December 31, 2007. In the opinion of management, this information has been prepared on the same basis as the audited financial statements appearing elsewhere in this Form 10-K, and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly the unaudited quarterly results of operations (in thousands, except per share data).

	Year	Quarter Ended December 31,	Quarter Ended September 30,	Quarter Ended June 30,	Quarter Ended March 31,
2007					
Revenues:					
Product sales	$ 78,458	$ 25,196	$ 15,457	$ 15,762	$ 22,043
Biopharmaceutical/other revenues	1,511	92	111	151	1,156
Total revenues	79,969	25,288	15,568	15,913	23,199
Costs and expenses:					
Cost of product sales	31,269	7,995	7,929	6,591	8,754
Research and development	5,845	1,573	1,476	1,292	1,505
Selling and marketing	66,278	16,842	17,632	14,348	17,455
General and administrative	14,573	4,732	3,367	2,914	3,559
Total costs and expenses	117,965	31,142	30,404	25,145	31,273
Loss from operations	(37,996)	(5,854)	(14,836)	(9,232)	(8,074)
Other income (expense):					
Interest income	2,541	559	771	720	491
Interest expense	(28,206)	(9,540)	(7,818)	(6,369)	(4,478)
Gain on disposition of investment	231		73		158
Gain on exchange of convertible debt	30,824			30,824	
Gain on derivative related to convertible notes	3,023	223	2,406	394	
Other income	114	2	15	48	49
Net other income (expense)	8,527	(8,756)	(4,553)	25,617	(3,780)
(Loss) Income before income tax	(29,469)	(14,610)	(19,389)	16,385	(11,854)
Provision for income tax	(384)	(62)	(108)	(108)	(108)
Net (loss) income	$ (29,853)	$ (14,672)	$ (19,497)	$ 16,277	$ (11,962)
Net loss per common share:					
Basic	$ (2.19)	$ (1.08)	$ (1.43)	$ 1.20	$ (0.88)
Diluted	$ (2.19)	$ (1.08)	$ (1.43)	$ 0.70	$ (0.88)
Weighted average common shares outstanding:					
Basic	13,601	13,629	13,605	13,588	13,582
Diluted	13,601	13,629	13,605	26,051	13,582

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

	Year	Quarter Ended December 31,	Quarter Ended September 30,	Quarter Ended June 30,	Quarter Ended March 31,
2006					
Revenues:					
Product sales	$ 38,244	$ 18,068	$ 8,308	$ 2,622	$ 9,246
Co-promotion	6,890		3,474	1,871	1,545
Biopharmaceutical/other revenues	1,018	196	580	60	182
Total revenues	46,152	18,264	12,362	4,553	10,973
Costs and expenses:					
Cost of product sales	19,613	7,805	6,573	2,485	2,750
Research and development	12,406	1,992	4,281	3,205	2,928
Selling and marketing	69,211	14,314	17,215	17,237	20,445
General and administrative	16,841	5,059	4,379	3,763	3,640
Total costs and expenses	118,071	29,170	32,448	26,690	29,763
Loss from operations	(71,919)	(10,906)	(20,086)	(22,137)	(18,790)
Other income (expense):					
Interest income	2,995	556	842	901	696
Interest expense	(11,056)	(4,167)	(2,807)	(2,072)	(2,010)
Gain on sale of fixed assets	2	2	(1)	1	
Gain on disposition of investment	1,617		1,380	237	
Other income	63	4	15	44	
Net other expense	(6,379)	(3,605)	(571)	(889)	(1,314)
Loss before income tax	(78,298)	(14,511)	(20,657)	(23,026)	(20,104)
Provision for income tax	(179)	(179)			
Net loss	$ (78,477)	$ (14,690)	$ (20,657)	$ (23,026)	$ (20,104)
Net loss per common share:					
Basic and diluted	$ (6.58)	$ (1.09)	$ (1.62)	$ (1.96)	$ (2.07)
Weighted average common shares outstanding:					
Basic and diluted	11,925	13,484	12,742	11,723	9,702

(20) Subsequent Events

On January 31, 2008, Abbott Canada s development and commercialization obligations were substantially reduced. In accordance with the terms of the amendment, Abbott Canada will continue to maintain FACTIVE tablets in its current product price list and it will continue to pay the Company a transfer price on FACTIVE tablets purchases. Abbott Canada is not required to pursue the CAP and ABS indications. Additionally, the amendment provides that the Company can terminate the agreement at any time with prior notice to Abbott Canada and Abbott Canada can terminate with prior notice to the Company after November 30, 2008.

(21) Event (Unaudited) Subsequent to the date of the Independent Auditors Report

On October 3, 2008, the Company received a notification from The NASDAQ Listings Qualifications of The NASDAQ Stock Market LLC that, as of October 2, 2008, the Company s market value of publicly held shares (MVPHS) had closed below the minimum $15 million threshold set forth in Marketplace Rule 4450(b)(3) for the previous thirty (30) consecutive business days, a requirement for continued listing. For NASDAQ purposes, MVPHS is the market value of the Company s publicly held shares, which is calculated by subtracting all shares held by officers, directors or beneficial owners of 10% or more of an issuer s common stock from the issuer s total shares outstanding.

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

Pursuant to Marketplace Rule 4310(c)(8)(B), the Company has ninety (90) calendar days, or until January 2, 2009, to regain compliance with the MVPHS requirement by evidencing a minimum $15 million MVPHS for ten (10) consecutive business days. If the Company does not regain compliance with the MVPHS requirement by January 2, 2009, the Company will receive written notification of delisting from NASDAQ and at that time will be entitled to request a hearing before a NASDAQ Listing Qualifications Panel (Panel) to present its plan to evidence compliance with the MVPHS requirement.

The Company has filed a registration statement with the Securities and Exchange Commission on September 10, 2008 relating to a proposed exchange offer with the holders of its 3.50% Convertible Senior Notes due 2011 (2011 Notes). The offer proposes, among other items, to exchange all of the 2011 Notes for new notes and equity. If successful, the exchange would increase the amount of outstanding shares of the Company s common stock.

If the Company s efforts to regain compliance are successful and the MVPHS exceeds $15 million for ten (10) consecutive days before January 2, 2009, the Company will regain compliance with respect to the MVPHS requirement. In the event the Company does not regain compliance, it may appeal the determination to a Panel. In the event that the Company fails to regain compliance and is unsuccessful in an appeal to the Panel, the Company s securities will be delisted from The NASDAQ Global Market. In the event that the Company s securities are delisted from The NASDAQ Global Market, the Company may not be able to meet the requirements necessary for its common stock (i) to transfer to, or list on, a U.S. national securities exchange, including The NASDAQ Capital Market or (ii) to be approved for listing on a U.S. system of automated dissemination of quotations. If such event in (i) or (ii) above occurred, holders of the Company s 2011 Notes have the right to require the Company to repurchase for cash the outstanding principal amount of the 2011 Notes plus accrued and unpaid interest through such date. There is currently approximately $225 million principal amount of 2011 Notes outstanding. The Company may not have sufficient cash or be able to raise sufficient additional capital to repay the 2011 Notes, if requested to be repurchased by the holders.

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OSCIENT PHARMACEUTICALS CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	June 30, 2008 (unaudited)	December 31, 2007
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 27,555	$ 48,268
Notes receivable		486
Accounts receivable (net of allowance for bad debts of $35 in 2008 and 2007, respectively)	9,890	15,032
Inventories, net	7,522	9,059
Prepaid expenses and other current assets	3,292	2,886
Total current assets	48,259	75,731
Property and Equipment, at cost:		
Manufacturing and computer equipment	4,453	4,695
Equipment and furniture	579	564
Leasehold improvements	183	138
	5,215	5,397
Less Accumulated depreciation	4,542	4,590
	673	807
Restricted cash	4,198	4,198
Other assets	4,842	5,585
Intangible assets, net	106,349	110,903
Goodwill	76,960	76,960
Total Assets	$ 241,281	$ 274,184
LIABILITIES AND SHAREHOLDERS DEFICIT		
Current Liabilities:		
Short-term obligations	$ 13,337	$ 38
Accounts payable	8,367	10,262
Accrued expenses and other current liabilities	23,836	20,928
Current portion of accrued facilities impairment charge	3,090	2,128
Deferred revenue	364	364
Total current liabilities	48,994	33,720
Long-term liabilities:		
Long-term obligations, net of current maturities	247,301	252,859
Noncurrent portion of accrued facilities impairment charge	6,867	8,831
Other long-term liabilities	4,057	7,216
Deferred revenue	91	273
Shareholders Deficit:		
Common stock, $0.10 par value Authorized 174,375 shares, Issued and Outstanding 14,140 and 13,892 in 2008 and 2007, respectively	1,414	1,389
Series B restricted common stock, $0.10 par value Authorized 625 shares, Issued and outstanding none		
Additional paid-in-capital	416,516	415,654
Accumulated deficit	(483,959)	(445,758)

Total shareholders deficit	(66,029)	(28,715)
Total Liabilities and Shareholders Deficit	$ 241,281	$ 274,184

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

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OSCIENT PHARMACEUTICALS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(in thousands, except per share data)

	Six-Months Ended June 30, 2008	Six-Months Ended June 30, 2007
Revenues (net):		
Product sales	$ 38,461	$ 37,805
Other revenues	190	1,307
Total net revenues	38,651	39,112
Costs and expenses:		
Cost of product sales (1)	13,363	15,345
Research and development (1)	1,864	2,797
Selling and marketing (1)	37,942	31,803
General and administrative (1)	7,826	6,473
Total costs and expenses	60,995	56,418
Loss from operations	(22,344)	(17,306)
Other (expense) income:		
Interest income	503	1,210
Interest expense	(16,687)	(10,847)
Gain on disposition of investment	412	158
Gain on exchange of convertible notes		30,824
Gain on derivative related to long-term debt	115	394
Other income	10	97
Net other (expense) income	(15,647)	21,836
(Loss) income before income tax	(37,991)	4,530
Provision for income tax	(210)	(215)
Net (loss) income	$ (38,201)	$ 4,315
Net (loss) income per common share: basic	$ (2.73)	$ 0.32
Net (loss) income per common share: diluted	$ (2.73)	$ 0.32
Weighted average common shares outstanding: basic	13,969,690	13,584,582
Weighted average common shares outstanding: diluted	13,967,690	13,589,780
(1) Includes non-cash stock-based compensation as follows:		
Cost of product sales	$ 31	$ 14
Research and development	$ 2	$ 78
Selling and marketing	$ 129	$ 466
General and administrative	$ 630	$ 821

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

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OSCIENT PHARMACEUTICALS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in thousands)

	Six-Months Ended	
	June 30, 2008	**June 30, 2007**
Cash Flows from Operating Activities:		
Net (loss) income	$ (38,201)	$ 4,315
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation and amortization	4,775	4,966
Provision for excess and obsolete inventories	338	142
Recovery of bad debts		(172)
Non-cash interest expense	7,227	2,761
Gain on exchange of convertible notes		(30,824)
Gain on change in fair value of derivatives	(115)	(394)
Gain on disposition of investment	(412)	(158)
Stock based compensation	792	1,379
Changes in operating assets and liabilities:		
Accounts receivable	5,142	3,268
Inventories	1,199	2,812
Prepaid expenses and other current assets	(406)	(388)
Accounts payable	(1,895)	(2,119)
Accrued expenses and other liabilities	90	(1,942)
Deferred revenue	(182)	(25)
Accrued facilities impairment charge	(1,213)	(1,346)
Accrued other long-term liabilities	1,296	1,387
Net cash used in operating activities	(21,565)	(16,338)
Cash Flows from Investing Activities:		
Proceeds from disposition of investment	412	158
Proceeds from repayments of notes receivable	486	409
Purchases of property and equipment	(87)	(8)
Increase in other assets	(35)	(1,171)
Decrease in restricted cash		2,482
Proceeds from sale of property and equipment		3
Net cash provided by investing activities	776	1,873
Cash Flows from Financing Activities:		
Proceeds from issuance of 3.5% Convertible Senior Notes, net of issuance costs		41,524
Proceeds from issuance of stock under the employee stock purchase plan	94	360
Payments on long-term obligations	(18)	(28)
Proceeds from exercise of stock options		17
Net cash provided by financing activities	76	41,873
Net (Decrease) Increase in Cash and Cash Equivalents	(20,713)	27,408
Cash and Cash Equivalents, beginning of period	48,268	38,196
Cash and Cash Equivalents, end of period	$ 27,555	$ 65,604

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

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements

(Unaudited)

(1) Operations and Basis of Presentation

Oscient Pharmaceuticals Corporation (the Company) is a commercial-stage pharmaceutical company marketing Food and Drug Administration (FDA)-approved products in the United States. The Company s strategy is to grow the sales of its existing products and to gain access to new products via transactions, including acquisition, in-licensing and co-promotion. Oscient has developed a commercial infrastructure, including a national sales force calling on targeted primary care physicians, cardiologists, endocrinologists and pulmonologists in the United States.

Oscient currently markets two products: ANTARA® (fenofibrate) capsules, a cardiovascular product, and FACTIVE® (gemifloxacin mesylate) tablets, a fluoroquinolone antibiotic. ANTARA is approved by the FDA to treat hypercholesterolemia (high blood cholesterol) and hypertriglyceridemia (high triglycerides) in combination with a healthy diet. The Company licenses the rights to ANTARA from Ethypharm S.A. of France (Ethypharm). The Company began promoting ANTARA in late August 2006. FACTIVE is indicated for the treatment of community-acquired pneumonia of mild to moderate severity (CAP) and acute bacterial exacerbations of chronic bronchitis (AECB). The Company licenses the rights to gemifloxacin, the active ingredient in FACTIVE tablets, from LG Life Sciences of the Republic of Korea (LG Life Sciences). The Company launched FACTIVE in the U.S. market in September 2004.

As shown in the consolidated financial statements, at June 30, 2008, the Company had total cash, cash equivalents, and restricted cash of approximately $31,753,000, which includes approximately $4,198,000 in restricted cash, and an accumulated deficit of approximately $483,959,000. The Company believes that based on its available capital, anticipated cash generated from operations and its ability to manage expenses, the cash on hand as of June 30, 2008, is sufficient to fund continuing operations for the next six to seven months. The Company will need to raise additional capital through the issuance of debt or equity securities and/or refinance its existing debt. The Company s principal liquidity needs are to meet its working capital requirements and operating expenses, re-pay its outstanding debt obligations, including payment of the $16.5 million of principal and accrued interest outstanding at June 30, 2008 on the 2009 Notes which is due February 6, 2009. The Company cannot guarantee that financing sources will be available on favorable terms or at all and/or that it will be able to refinance its existing debt. If the Company is unable to refinance its debt or raise sufficient additional capital in a timely manner, the Company may have to scale back its operations or take other measures to significantly reduce expenses which would have a material adverse effect on its business.

These consolidated 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 financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of results for the interim periods. 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 financial statements should be read in conjunction with the Company s audited consolidated financial statements and related footnotes for the year ended December 31, 2007 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 February 6, 2008.

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(Unaudited)

(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 the consolidated financial statements.

(a) Revenue Recognition

The Company s principal source of revenue is the sale of ANTARA capsules and FACTIVE tablets. ANTARA revenue results are anticipated to be non-seasonal, although the wholesaler buying patterns tend to increase toward the end of the fiscal year. The Company expects demand for FACTIVE to be highest from December to March as the incidence of respiratory tract infections, including CAP and AECB, tends to increase during the winter months. In addition, fluctuations in the severity of the annual respiratory tract infection season may cause product sales to vary from year to year. Due to these seasonal fluctuations in demand for FACTIVE, the Company s results in any particular quarter may not be indicative of the results for any other quarter or for the entire year.

Product Sales

The Company follows the provisions of Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition (a replacement of SAB No. 101) (SAB No. 104) and recognizes revenue from product sales upon delivery of product to wholesalers, when persuasive evidence of an arrangement exists, the fee is fixed or determinable, title to product and associated risk of loss has passed to the wholesaler and collectability of the related receivable is reasonably assured. All revenues from product sales are recorded net of applicable allowances for sales returns, rebates, special promotional programs, and discounts. For arrangements where the risk of loss has not passed to wholesalers or pharmacies, the Company defers the recognition of revenue by recording deferred revenue until such time that risk of loss has passed. The cost of ANTARA and FACTIVE associated with amounts recorded as deferred revenue is recorded in inventory until such time as risk of loss has passed.

Other Revenue

Other revenues primarily consist of sublicensing revenues related to FACTIVE. The Company recognizes revenue in accordance with SAB No. 104 and Emerging Issues Task Force (EITF) Issue No. 00-21, Revenue Arrangements with Multiple Deliverables (EITF No. 00-21). In accordance with EITF No. 00-21, the up-front license payments related to the various sublicense agreements will be recognized as revenue over the term of the Company s continuing obligations under the arrangements which range from eighteen months to thirty-three months. Substantive milestones achieved are recognized as revenue when earned and when payment is reasonably assured, if the Company has completed its remaining obligations under the arrangement. If the Company has further obligations, milestone payments are recognized as revenue if the Company has sufficient evidence of fair value for its remaining obligations otherwise the milestone payment is recognized as revenue over the remaining performance period. The Company expenses incremental direct costs associated with sublicense agreements in the period in which the expense is incurred.

On January 4, 2007, the Company announced that it had granted commercialization rights to FACTIVE in Europe to Menarini International Operation Luxembourg S.A. (Menarini), a wholly-owned subsidiary of Menarini Industrie Farmaceutiche Riunite S.r.l. Part of this arrangement included an up-front license payment which the Company is recognizing over the term of the Company s obligations under the arrangement. On March 2, 2007, the Company announced that Abbott Laboratories, Ltd. (Abbott Canada), the Canadian affiliate of Abbott Laboratories, began the promotion of FACTIVE in Canada. In connection with the terms of the

OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(Unaudited)

agreement with Abbott, a milestone payment related to regulatory approval of the Company s manufacture of FACTIVE for Canada was recorded as other revenue during 2007. The Company subsequently amended the agreement on January 31, 2008 whereby Abbott Canada s development and commercialization obligations were substantially reduced. The amendment also provides that the Company can terminate the agreement at any time with prior notice to Abbott Canada and Abbott Canada can terminate with prior notice to the Company after November 30, 2008.

(b) Sales Rebates, Discounts and Incentives

The Company s sales of ANTARA and FACTIVE in the U.S. are made to pharmaceutical wholesalers for further distribution through pharmacies to the ultimate consumers of the product. When the Company delivers its product, the Company reduces the amount of gross revenue recognized from such product sales based primarily on estimates of four categories of discounts and allowances that suggest that all or part of the revenue should not be recognized at the time of the delivery product returns, cash discounts, rebates, and special promotional programs.

Product Returns

Factors that are considered in the Company s estimate of future ANTARA and FACTIVE product returns include an analysis of the amount of product in the wholesaler and pharmacy channel, review of consumer consumption data as reported by external information management companies, actual and historical return rates for expired lots, the remaining time to expiration of the product, and the forecast of future sales of the Company s product. Consistent with industry practice, the Company offers contractual return rights that allow its customers to return product within six months prior to, and twelve months subsequent to, the expiration date of the product. ANTARA capsules and FACTIVE tablets each have a 36-month expiration period from the date of manufacturing. As of June 30, 2008 and December 31, 2007, the Company s product return reserve was approximately $3,543,000 and $3,169,000, respectively. This reserve is evaluated on a quarterly basis, assessing each of the factors described above, and adjusted accordingly. Based on the factors noted above, the Company believes its estimate of product returns is reasonable, and changes, if any, from this estimate would not have a material impact to the Company s financial statements.

Cash Discounts

The Company s standard invoice includes a contractual cash 2% discount, net 30 days terms. Based on historical experience, the Company estimates that most of its customers deduct a 2% discount from their balance. The cash discount reserve is presented as an allowance against trade receivables in the accompanying consolidated balance sheets. As of June 30, 2008 and December 31, 2007, the balance of the cash discounts reserve was approximately $221,000 and $343,000, respectively.

Rebates

The liability for commercial managed care rebates is calculated based on historical and current rebate redemption and utilization rates with respect to each commercial contract. The liability for Medicaid rebates is calculated based on historical and current rebate redemption and utilization rates contractually submitted by each state. As of June 30, 2008 and December 31, 2007, the balance of the accrual for managed care and Medicaid rebates for ANTARA and FACTIVE in total was approximately $4,289,000 and $4,263,000, respectively. Considering the estimates made by the Company, as well as estimates reflected in third party utilization reports that are used in evaluating the required liability balance, the Company believes its estimates are reasonable.

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(Unaudited)

Special Promotional Programs

The Company, from time to time, offers certain promotional incentives to its customers for both ANTARA and FACTIVE and will continue this practice in the future. Such programs include: sample cards to retail consumers, certain product incentives to pharmacy customers, and other sales stocking allowances. The Company accounts for these programs in accordance with EITF No. 01-09, Accounting for Consideration Given by a Vendor to a Customer (EITF No. 01-09). Examples of programs utilized to date are as follows:

Voucher Rebate Programs for ANTARA

Since acquiring ANTARA in August 2006, the Company has initiated four voucher rebate programs for ANTARA whereby the Company offered a point-of-sale rebate to retail consumers. The liabilities the Company recorded for these voucher rebate programs were estimated based upon the historical rebate redemption rates for similar completed programs and actual redemption rates on completed programs by the Company. The first program expired on December 31, 2006, the second program expired on September 30, 2007, the third program expires on February 28, 2009 and the fourth program expires on March 31, 2010. As of June 30, 2008 and December 31, 2007, the balance of the liabilities for these voucher programs totaled approximately $768,000 and $491,000, respectively.

Voucher Rebate Programs for FACTIVE

The Company periodically initiates voucher rebate programs for FACTIVE whereby the Company offers point-of-sale rebates to retail consumers. The liabilities the Company records for these voucher rebate programs are estimated based upon the historical rebate redemption rates for similar completed programs. In October 2007, the Company initiated a voucher rebate program whereby the Company offered a point-of-sale rebate to retail consumers. This program expired on April 30, 2008. In April 2008, the Company initiated another voucher rebate program whereby the Company offered a point-of-sale rebate to retail consumers. This program expires on October 15, 2008. As of June 30, 2008 and December 31, 2007, the balance of the liabilities for these voucher programs totaled approximately $390,000 and $1,396,000, respectively.

(c) Accounts Receivable

Trade accounts receivable consist of amounts due from wholesalers for the purchase of ANTARA and FACTIVE. Accounts receivable related to sales of FACTIVE are the accounts receivable of the Company and accounts receivable related to sales of ANTARA are the accounts receivable of Guardian II Acquisition Corporation (Guardian II) (the entity which holds all of the ANTARA assets), a wholly-owned subsidiary of the Company. Guardian II granted Paul Royalty Fund Holdings II, LP, an affiliate of Paul Capital Partners (Paul Capital), a security interest in substantially all of its assets, including its accounts receivable, to secure its obligations to Paul Capital. See Note 7.

The Company performs ongoing credit evaluations on its customers and collateral is generally not required. As of June 30, 2008 and December 31, 2007, the Company had reserved approximately $35,000 for bad debts related to the sale of ANTARA or FACTIVE. The Company continuously reviews all customer accounts to determine if an allowance for uncollectible accounts is necessary. The Company currently provides substantially all of its distributors with payment terms of up to 30 days on purchases of ANTARA and FACTIVE. Amounts past due from customers are determined based on contractual payment terms. Through June 30, 2008, payments have generally been made in a timely manner and the Company has not written off any customer accounts receivable balances. The Company has not provided a reserve balance related to other non-trade receivables as of June 30, 2008 and December 31, 2007.

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(Unaudited)

The following table represents accounts receivable (in thousands):

	As of June 30, 2008	As of December 31, 2007
Trade, net	$ 9,539	$ 14,950
Other, net	351	82
Total	$ 9,890	$ 15,032

(d) Restricted Cash

At June 30, 2008 and December 31, 2007, approximately $3,697,000 of cash is restricted in connection with a letter of credit issued for the building lease at the Company s South San Francisco, California facility, approximately $433,000 of cash is restricted in connection with a letter of credit issued for the building lease at the Company s Waltham, Massachusetts facility and approximately $68,000 of cash is restricted in connection with a letter of credit issued for the building lease at the Company s Skillman, New Jersey facility. The restrictions related to the South San Francisco facility, the Waltham facility and the Skillman facility expire on February 28, 2011, March 31, 2012 and June 30, 2013, respectively.

(e) Inventories

Inventories are stated at the lower of cost or market value, with cost determined under the average cost method which approximates actual cost. Products are removed from inventory on a first-in-first-out basis and recognized as cost of goods sold on an average cost basis.

On a quarterly basis, the Company analyzes inventory levels, and provides a reserve for inventory and marketing samples that have become obsolete, have a cost basis in excess of their expected net realizable value or are in excess of forecast requirements to cost of product revenues and marketing expense, respectively. Expired inventory is disposed of and the related costs are written off against the previously established reserves.

At June 30, 2008 and December 31, 2007, there was approximately $524,000 and $1,088,000 in ANTARA sample product to be used for ANTARA marketing programs and approximately $1,070,000 and $655,000 in FACTIVE sample product to be used for FACTIVE marketing programs. These are classified as other current assets in the accompanying consolidated balance sheets.

The following table represents net trade inventories (in thousands):

	As of June 30, 2008	As of December 31, 2007
Raw material	$ 1,790	$ 2,846
Work-in-process	2,526	3,022
Finished goods	3,206	3,191
Total	$ 7,522	$ 9,059

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(f) Net (Loss) Income Per Share

Basic net (loss) income per share was determined by dividing net (loss) income by the weighted average shares outstanding during the period. Diluted net income per share in 2007 was determined by dividing the net income by the weighted average shares outstanding, adjusted for the effect of potential outstanding shares, during the period. Anti-dilutive securities which consist of stock options, securities sold under the Company s employee stock purchase plan, convertible notes, warrants and unvested restricted stock that are not included in calculating the net loss per share, totaled 21,005,547 shares (prior to the application of the treasury stock method) during the six month period ended June 30, 2008.

The following outstanding securities were considered in the computation of diluted net income per share for the six month period ended June 30, 2007. Those securities that were anti-dilutive were not included in the computation of diluted net income per share:

Options for common shares	1,390,575
Warrants for common shares	1,851,983
Convertible notes, as if converted	17,029,156

The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share (in thousands, except share data) in 2007:

	Six Months Ended June 30, 2007
Numerator	
Net income	$ 4,315
Interest on convertible long-term debt	
Net income used for diluted net income per share	$ 4,315
Denominator	
Weighted average shares outstanding used for basic net income per share	13,584,582
Effect of dilutive stock options	5,198
Effect of convertible notes	
Weighted-average shares outstanding and dilutive securities used for diluted net income per share	13,589,780

(g) Single Source Suppliers

FACTIVE

The Company currently obtains the active pharmaceutical ingredient (API) for its commercial requirements for FACTIVE from LG Life Sciences. The Company purchases the API pursuant to a long-term supply agreement. The disruption or termination of the supply of the commercial requirement for FACTIVE or a significant increase in the cost of the API from this source could have a material adverse effect on the Company s business, financial position and results of operations.

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ANTARA

Pursuant to the Company s license arrangement with Ethypharm, Ethypharm is responsible for the manufacture and supply of ANTARA finished product or ANTARA bulk product at the Company s option. The disruption or termination of the supply of ANTARA by Ethypharm or its third party contractors could have a material adverse effect on the Company s business, financial position and results of operations.

(h) Use of Estimates

The preparation of consolidated 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These estimates include the following: reserves for inventory obsolescence, sales and managed care rebate reserves, reserves pertaining to special promotional programs, product returns reserves and the useful lives and expected future cash flows for intangible assets.

(i) Financial Instruments

The estimated fair value of the Company s financial instruments, including cash, cash equivalents and accounts receivable, approximates the carrying values of these instruments.

In connection with financing the acquisition of ANTARA, the Company recognized an embedded derivative instrument related to a put/call liability. In connection with the convertible debt exchange, the Company recognized an embedded derivative instrument related to an interest make-whole provision. Both are recognized in the accompanying consolidated financial statements at fair value and are recorded as other long-term liabilities in the accompanying consolidated balance sheets. Changes in fair value are recorded in the accompanying consolidated statements of operations. See Note 4.

(j) Comprehensive (Loss) Income

The Company follows the provisions of Statement of Financial Accounting Standards (SFAS) No. 130, Reporting Comprehensive Income (SFAS No. 130). SFAS No. 130 requires disclosure of all components of comprehensive (loss) income on an annual and interim basis. Comprehensive (loss) income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. For the six month period ended June 30, 2008 and 2007, the net loss is equal to the comprehensive (loss) income.

(k) 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). Under SFAS No. 144, long-lived assets and identifiable intangible assets with finite lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If indicators of impairment exist, recoverability of assets to be held and used is assessed by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. Recoverability measurement and estimating the undiscounted cash flows is done at the lowest possible level for which there are identifiable assets. If the aggregate undiscounted cash flows are less than the carrying value of the asset, then the resulting impairment charge to be recorded is calculated based on the amount by which the carrying amount of the asset exceeds its fair value. Any write-downs are recorded as permanent reductions in the carrying amount of the asset.

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During 2007, events and circumstances, primarily a reduction in projected long term cash flows, indicated that the FACTIVE intangible asset could become impaired. However, at December 31, 2007, the Company s estimate of undiscounted cash flows indicated that such carrying amounts were expected to be recovered and therefore the assets were not impaired. The Company reviewed its cash flow projections as of June 30, 2008, which indicated that the carrying amounts are expected to be recovered and therefore the intangible assets of FACTIVE are not impaired. Nonetheless, it is reasonably possible that the estimate of undiscounted cash flows may change in the near term resulting in the need to write down the intangible asset associated with FACTIVE to fair value. The Company s estimate of undiscounted cash flows is based upon several significant assumptions including, but not limited to, estimated domestic sales growth, the ability to significantly penetrate international markets and the ability to satisfy its minimum requirements under the agreement with the licensor, LG Life Science.

The Company also follows the provisions of SFAS No. 142, Goodwill and Other Intangible Assets, (SFAS No. 142). Under SFAS No. 142, goodwill and purchased intangible assets with indefinite lives are not amortized but are reviewed periodically for impairment. The Company performs an annual evaluation of goodwill at the end of each fiscal year to test for impairment or more frequently if events or circumstances indicate that goodwill may be impaired. Because the Company has a single operating segment, which is its sole reporting unit, the Company performs this test by comparing the fair value of the entity as measured by the quoted market price of its common stock with its book value, including goodwill, which at present is a deficit. If the fair value exceeds the book value, goodwill is not impaired. If the book value exceeds the fair value, then the Company would calculate the potential impairment loss by comparing the implied fair value of goodwill with the book value. If the implied fair value of goodwill is less than the book value, then an impairment charge would be recorded.

As of June 30, 2008, the Company does not believe that any of its long-lived assets, goodwill, or intangible assets are impaired.

(l) Stock-Based Compensation

The Company records stock-based compensation expense in accordance with SFAS No. 123 (Revised 2004), Share-Based Payment (SFAS No. 123R). SFAS No. 123R requires companies to expense the fair value of employee stock options and other forms of stock-based employee compensation over the employees service periods. Compensation cost is measured at the fair value of the award at the grant date, including estimated forfeitures, and is adjusted to reflect actual forfeitures and the outcomes of certain conditions. See Note 5.

(m) Income Taxes

The Company applies SFAS No. 109, Accounting for Income Taxes (SFAS No. 109), which requires the Company to recognize deferred tax assets and liabilities for expected future tax consequences of events that have been recognized in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using the enacted tax rates in effect for the year in which the differences are expected to reverse. SFAS No. 109 requires deferred tax assets and liabilities to be adjusted when the tax rates or other provisions of the income tax laws change.

In accordance with FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (the Interpretation) (FIN 48), the Company s historical practice was

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and will continue to be to recognize any interest and penalties related to unrecognized tax benefits in income tax expense. As of June 30, 2008, there were no unrecognized tax benefits, and as such, the Company has not recorded interest and penalties related to unrecognized tax benefits.

The Company s income tax expense of approximately $210,000 and $215,000 for the six-month periods ending June 30, 2008 and 2007, respectively, is comprised of deferred federal and state taxes which relates to the tax effects of the Company s indefinite lived intangible that cannot be offset against the Company s deferred tax assets.

The Company files income tax returns in the U.S. federal and various state jurisdictions. The Company is generally no longer subject to income tax examinations by U.S. federal, state and local tax authorities for years before 1992.

(n) Recent Accounting Pronouncements

Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133

In March 2008, the Financial Accounting Standard Board (FASB) issued FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS No. 161). SFAS No. 161 requires entities to provide greater transparency about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, results of operations, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Management is in the process of studying the impact of this standard on the Company s financial accounting and reporting.

Business Combinations

In December 2007, the FASB issued Statement No. 141R, Business Combinations (SFAS No. 141R). SFAS No. 141R improves consistency and comparability of information about the nature and effect of a business combination by establishing principles and requirements for how an acquirer (a) recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed and any noncontrolling interest in the acquiree; (b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R applies prospectively to all business combination transactions for which the acquisition date is on or after January 1, 2009. The impact of the Company s adoption of SFAS No. 141R will depend upon the nature and terms of business combinations, if any, that it consummates on or after January 1, 2009.

Accounting for Collaborative Arrangements

In November 2007, EITF issued EITF Issue No. 07-01 Accounting for Collaborative Arrangements (EITF No. 07-01). EITF No. 07-01 requires collaborators to present the results of activities for which they act as the principal on a gross basis and report any payments received from (made to) other collaborators based on other applicable generally accepted accounting principles (GAAP) or, in the absence of other applicable GAAP, based on analogy to authoritative accounting literature or a reasonable, rational, and consistently applied accounting policy election. Further, EITF No. 07-01 clarified that the determination of whether transactions within a collaborative arrangement are part of a vendor-customer (or analogous) relationship subject to Issue No. 01-9, Accounting for Consideration Given by a Vendor to a Customer . EITF No. 07-01 is effective for fiscal years

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beginning after December 15, 2008. The Company has not yet completed its evaluation of EIFT No. 07-01, but does not currently believe that it will have a material impact on the results of operations, financial position or cash flows.

Accounting for Convertible Debt Instruments that may be Settled Upon Conversion

In May 2008, the FASB issued Staff Position No. APB 14-1 Accounting for Convertible Debt Instruments that may be Settled in Cash Upon Conversion (FSP APB14-1). FSP APB 14-1 requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) on conversion to separately account for the liability and equity components of the instrument in a manner that reflects the issuer s nonconvertible debt borrowing rate. Further, FSP ABP 14-1 clarifies the appropriate economics of the conversion options as borrowing costs and their potential dilutive effects in earnings per share. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008. The Company has not yet completed its evaluation of FSP APB 14-1, but does not currently believe that it will have a material impact on the results of operations, financial position or cash flows.

(3) Restructuring Plans

At the time of acquisition of GeneSoft Pharmaceuticals (Genesoft) in 2004, management approved a plan to integrate certain Genesoft facilities into existing operations. In connection with the integration activities, the Company included in the purchase price allocation a restructuring liability of approximately $18,306,000, which includes $1,419,000 in severance-related costs and $16,887,000 in facility lease impairment costs pertaining to 68,000 square feet of leased space which expires on February 28, 2011. Interest accretion has been recorded as interest expense in the accompanying consolidated statements of operations.

The following table summarizes the liability activity related to the Genesoft acquisition during the six-month period ended June 30, 2008 (in thousands):

	Balance at December 31, 2007	Net Cash Payments	Interest Accretion	Balance at June 30, 2008
Assumed facility lease liability	$ 10,959	$ (1,213)	$ 211	$ 9,957

(4) Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. SFAS No. 157 codifies the definition of fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those years. The Company adopted SFAS No. 157 on January 1, 2008. The three levels of the fair value hierarchy under SFAS No. 157 are described below:

Level 1 Relates to observable inputs such as quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

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Level 2 Relates to other inputs that are observable, directly or indirectly, such as quoted prices for similar assets and liabilities or market corroborated inputs.

Level 3 Relates to unobservable inputs used when little or no market data is available and requires the Company to develop its own assumptions about how market participants would price the assets or liabilities. The fair value hierarchy gives the lowest priority to Level 3 inputs.

The primary objective of the Company s investment activities is to preserve principal and fulfill liquidity needs while at the same time maximizing the income the Company receives from the Company s investments without significantly increasing risk. To achieve this objective, the Company maintains the majority of its portfolio of cash equivalents in money market funds to maximize investment income and minimize investment risk. As of June 30, 2008, the Company believes that its cash equivalents reflect the carrying value which is not subject to any loss or write-down.

As of June 30, 2008, the Company s cash equivalents were classified as level 1 assets where inputs are quoted in active markets for identical assets or liabilities that the Company has the ability to assess the measurement date. An active market for the Company s cash equivalents is available in which transactions for the asset occur with sufficient frequency and volume which provide pricing information on an ongoing basis.

For derivative liabilities that use Level 2 inputs, the Company utilizes information obtained directly from observable market inputs which include the Company s stock price, volatility, market value of debt and risk free interest rate. For the six-month period ended June 30, 2008, the Company has recorded approximately $48,000 as a gain on derivative liabilities that use Level 2 inputs. For derivative liabilities that use Level 3 inputs, the Company developed its own assumptions and decision point related to a put/call premium that does not have any observable inputs or available market data to support the fair value. For the six-month period ended June 30, 2008, the Company has recorded approximately $67,000 as a gain on derivative liabilities that use Level 3 inputs. Both of these are recorded as gains in the accompanying consolidated statements of operations.

The following table represents, by level within the fair value hierarchy, a summary of the fair market value of assets and liabilities the Company held as of June 30, 2008:

June 30, 2008	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	$ 25,647,000	$	$	$ 25,647,000
Liabilities:				
Derivative liabilities	$	$ 20,000	$ 919,000	$ 939,000

The reconciliation of the Company s liabilities measured at fair value on a recurring basis using unobservable inputs (Level 3) is as follows:

	Derivative Liability
Balance at January 1, 2008	$ 986,000
Gain on derivative related to convertible notes	67,000

Balance at June 30, 2008	$ 919,000

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(5) Stockholder s Equity

Equity Plans

The Company has granted stock options to key employees and consultants under its 1991, 1993, 1995 and 1997 Stock Option Plans, and continues to grant stock-based awards under its 2001 Incentive Plan (collectively, the Option Plans). On August 13, 2007, the Board of Directors approved the Company s 2007 Employment Inducement Award Plan (the 2007 Inducement Plan) and authorized 500,000 shares of Common Stock for issuance under the 2007 Inducement Plan. The Compensation Committee of the Board of Directors determines the purchase price and vesting schedule applicable to each option grant. As of June 30, 2008, there were no shares reserved for future grants under the 1991, 1993, 1995 and 1997 Plans. The 2001 Incentive Plan, as amended and restated, provides for the grant of non-qualified stock options, incentive stock options, restricted stock, stock appreciation rights, unrestricted stock, deferred stock, convertible securities, and cash and equity-based performance awards. The 2007 Inducement Plan provides for the grant of non-qualified stock options and restricted stock. As of June 30, 2008, there were 2,687,607 shares authorized and 1,071,349 shares available for future issuance under the 2001 Incentive Plan and 500,000 shares authorized and 100,956 shares available for future issuance under the 2007 Inducement Plan. In addition, under separate agreements not covered by any plan, the Company has granted certain key employees and directors of the Company an aggregate of 65,506 options to purchase common stock. The Company also has an Employee Stock Purchase Plan (ESPP), which was adopted in February 2000, although it was suspended following June 30, 2008. As of June 30, 2008, 431,250 shares were authorized and 25 shares were available for future issuance under this plan.

Stock-Based Compensation

The Company accounts for all employee share-based payments, including grants of stock options, restricted stock and stock issued under the ESPP, in accordance with SFAS No. 123 (Revised 2004), Share-Based Payment (SFAS No. 123R).

The Company s policy is to recognize compensation cost for awards with service conditions and graded vesting using the straight-line method. Additionally, its policy is to issue authorized but previously unissued shares to satisfy share option exercises, the issuance of restricted stock and stock issued under the ESPP. The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. In addition, the requisite service period is generally equal to the vesting term. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term forfeitures is distinct from cancellations or expirations and represents only the unvested portion of the surrendered option. Ultimately, the actual expense recognized over the vesting period will only be for those shares that vest.

Stock compensation expense recorded in the six month periods ended June 30, 2008 and 2007 was $792,000 and $1,379,000, respectively. The compensation expense under SFAS No. 123R is recorded in cost of product sales, research and development expense, selling and marketing expense, and general and administrative expense based on the specific allocation of employees receiving the equity awards.

As of June 30, 2008, the Company estimates there is approximately $1,654,000 of total unrecognized compensation cost related to unvested share based awards. These costs are expected to be recognized over a weighted average remaining requisite service period of 1.45 years. The Company expects approximately 842,000 in unvested options to vest at some point in the future. The value of options expected to vest is calculated by applying an estimated forfeiture rate to the unvested options.

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(6) Cash and Cash Equivalents

The Company applies the provisions of SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS No. 115). Cash equivalents are short-term, highly liquid investments with maturities of 90 days or less. Cash equivalents are carried at cost, which approximates fair value. The fair value of the Company s cash equivalents is determined based on market value. At June 30, 2008 and December 31, 2007, cash and cash equivalents totaled $27,555,000 and $48,268,000, respectively.

(7) Long-Term Obligations

Long-term obligations consist of the following (in thousands):

	As of June 30, 2008	As of December 31, 2007
3.5% Senior convertible promissory notes	$ 185,652	$ 179,508
3 1/2% Senior convertible promissory notes	829	829
5% Convertible promissory notes	13,300	13,300
Revenue interest assignment	40,745	39,129
12% Senior secured note	20,000	20,000
Capital lease	112	131
	260,638	252,897
Less short term obligations	13,337	38
	$ 247,301	$ 252,859

(a) Debt Obligations

On February 6, 2004, in connection with its merger with Genesoft, the Company issued approximately $22,310,000 in principal amount of its 5% convertible five year promissory notes due February 6, 2009 (the 2009 Notes). Following the exchange offer completed in May 2007 described below, there are approximately $13,300,000 principal amount of the 2009 Notes outstanding at June 30, 2008 which have been classified as short-term obligations on the accompanying consolidated balance sheets. The 2009 Notes are convertible into the Company s common stock at the option of the holders, at a conversion price of $53.13 per share.

On June 26, 2004, the Company issued $152,750,000 in principal amount of its 3 1/2% senior convertible promissory notes due in April 2011 (the Original 2011 Notes). Following the exchange offer completed in May 2007 described below, there are approximately $829,000 principal amount of the Original 2011 Notes outstanding at June 30, 2008. These notes are convertible into the Company s common stock at the option of the holders at a conversion price of $53.14 per share. The Company may not redeem the outstanding Original 2011 Notes at its election before May 10, 2010. After this date, the Company can redeem all or a part of the Original 2011 for cash at a price equal to 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest. The holders right of repurchase under the Original 2011 Notes is identical to the right of repurchase under the New Notes (defined below) and is described below.

In May 2007, the Company completed (i) an exchange offer with certain holders of the Original 2011 Notes in which the Company exchanged $151,921,000 aggregate principal amount of its new 3.50% Convertible Senior Notes due 2011 (the New Notes) for $151,921,000 aggregate principal amount of its then outstanding Original 2011 Notes; and (ii) an exchange offer with holders of the 2009 Notes in which the Company exchanged

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approximately $10,574,000 aggregate principal and accrued interest amounts of its then outstanding 2009 Notes for approximately $13,746,000 aggregate principal amount of the New Notes. The Company also issued an additional $60,000,000 of New Notes to the public for cash at a public offering price of 77.5% of principal, resulting in $46,500,000 in gross proceeds to the Company.

The New Notes are initially convertible into approximately 16,718,000 common shares at a conversion rate of 74.074 shares of the Company s common stock per $1,000 principal amount of New Notes, which is equivalent to a conversion price of approximately $13.50 per share. The New Notes are convertible at any time by the holder. In the event of a fundamental change, holders of the Original 2011 Notes and the New Notes have the right to require the Company to repurchase all or any portion of their notes at a price equal to 100% of the principal amount plus accrued and unpaid interest. Under the indenture for the Original 2011 Notes and the New Notes, a fundamental change will be deemed to occur if (i) a change of control transaction occurs in which substantially all of the Company s common stock is exchanged either for consideration other than common stock that is listed on a U.S. national securities exchange or is exchanged for consideration other than common stock that is approved for quotation on a U.S. system of automated dissemination of quotations of securities or (ii) the Company s common stock is neither listed for trading on a U.S. national securities exchange nor approved for listing on any U.S. system of automated dissemination of quotations of securities prices.

Before May 10, 2010, the Company may not redeem the New Notes. On or after May 10, 2010, the Company may redeem any or all of the New Notes at 100% of the principal amount, plus accrued and unpaid interest. In addition, the Company may automatically convert some or all of the New Notes on or prior to the maturity date if the closing price of its common shares has exceeded 130% of the conversion price then in effect for at least 20 trading days during any consecutive 30 trading day period ending within five trading days prior to the notice of auto-conversion (the auto-conversion feature). If a holder elects to voluntary convert their New Notes or the Company elects to automatically convert some or all of the New Notes on or prior to May 10, 2010, the Company will pay additional interest to holders of New Notes being converted. This additional interest will be equal to the amount of interest that would have been payable on the New Notes from the last day interest was paid on the New Notes, through and including May 10, 2010. Additional interest, if any, will be paid in cash or in common shares of the Company, at the Company s option. If the Company pays additional interest upon a voluntary conversion with its common shares, such shares will be valued at the conversion price that is in effect at that time. If the Company pays additional interest upon an automatic conversion with its common shares, such shares will be valued at 90% of the automatic conversion price that is in effect at that time.

The additional interest payment described above, which may be issued upon conversion, is considered an embedded derivative under SFAS No. 133 and requires bifurcation from the host debt. The Company also considered the provisions of EITF No. 05-2, and concluded that this is not conventional convertible debt.

In accordance with SFAS No. 133, the Company has separately accounted for the additional interest payment feature of the New Notes as an embedded derivative instrument, which is measured at fair value and classified on the accompanying consolidated balance sheets as other long term liabilities. Changes in the fair value of the embedded derivative are recognized in earnings. The derivative liability is revalued quarterly and changes in the fair value through either the date the additional interest payment provisions expire, at which the liability will be zero, or the date at which the additional interest payment provision is triggered, are recorded as other expense or income. For the purpose of accounting for the New Notes issued in the exchange offer, the fair value of the embedded derivative upon issuance was subtracted from the carrying value of the debt and reflected as a debt discount. The debt discount is amortized as interest expense using the effective interest method through the date the notes are scheduled to mature.

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Convertible debt upon the exchange and new offering on May 1, 2007 consisted of the following (in thousands):

3.50% Convertible senior notes	$ 225,692
Discount on convertible notes	(50,781)
Embedded derivative	(3,077)
Total	$ 171,834

The additional New Notes generated gross proceeds of $46,500,000. Debt issuance costs, related to the New Notes, of approximately $6,057,000 are being amortized to interest expense, on a straight-line basis over the 48 month period to maturity of the notes. As of June 30, 2008, the fair value of the derivative is approximately $20,000 which reflects a change in the fair value of approximately $48,000 which is included as gain on derivative in the accompanying consolidated statements of operations.

For the six month period ended June 30, 2008, the Company incurred approximately $3,929,000 in interest expense on its convertible debt, which is payable on a semi-annual basis. Additionally, the Company amortized approximately $6,189,000 as non-cash interest expense related to the accretion of the bond discount and approximately $757,000 in new debt issuance costs.

(b) Other Financial Arrangements

To finance the acquisition of ANTARA in August 2006, the Company, together with its wholly-owned subsidiary Guardian II Acquisition Corporation (Guardian II) (the entity which holds all of the ANTARA assets), entered into several financing agreements with Paul Royalty Fund Holdings II, LP, an affiliate of Paul Capital Partners, or Paul Capital, including the Revenue Interests Assignment Agreement, the Note Purchase Agreement and the Common Stock and Warrant Purchase Agreement, in consideration for an aggregate amount of $70 million.

Revenue Interests Assignment Agreement

The Company and Guardian II entered into the Revenue Interests Assignment Agreement (the Revenue Agreement), pursuant to which the Company sold to Paul Capital the right to receive specified royalties on Oscient s net sales in the United States (and the net sales of its affiliates and licensees) of FACTIVE tablets and Guardian II sold to Paul Capital the right to receive specified royalties on Guardian II s net sales in the United States (and the net sales of its affiliates and licensees) of ANTARA capsules, in each case until December 31, 2016 in exchange for an aggregate of $40 million from Paul Capital. The royalty payable to Paul Capital on net sales of ANTARA and FACTIVE are tiered as follows: 9% for the first $75 million in annual net revenues, 6% for annual net revenues in excess of $75M, but less than $150 million, and 2% for annual net revenues which exceed $150 million. Once the cumulative royalty payments to Paul Capital exceed $100 million, the royalties become nominal.

In connection with the Revenue Agreement, the Company recorded a liability, referred to as the revenue interest liability, of approximately $40 million in accordance with EITF No. 88-18, Sales of Future Revenues (EITF No. 88-18). The Company imputes interest expense associated with this liability using the effective interest rate method and has recorded a corresponding accrued interest liability. The effective interest rate is calculated based on the rate that would enable the debt to be repaid in full over the life of the arrangement. The interest rate on this liability may vary during the term of the agreement depending on a number of factors, including the level of ANTARA and FACTIVE sales. Payments made to Paul Capital as a result of ANTARA and FACTIVE sales

OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(Unaudited)

levels will reduce the accrued interest liability and the principal amount of the revenue interest liability. The Company currently estimates that the imputed interest rate associated with this liability will be approximately 19.97%. The Company recorded approximately $3,825,000 and $3,188,000 in interest expense related to this agreement in the six month periods ended June 30, 2008 and 2007, respectively. Through June 30, 2008, there have been no principal payments made to Paul Capital as a result of ANTARA or FACTIVE sales.

In the event of (i) a change of control of Oscient or Guardian II, (ii) a bankruptcy of Oscient or Guardian II, (iii) a transfer by Oscient or any of its subsidiaries of substantially all of either ANTARA or FACTIVE, (iv) subject to a cure period, breach of certain material covenants and representations in the Revenue Agreement and (v) in the event the sale of ANTARA is suspended due to a court issued injunction or the Company elects to suspend sales of ANTARA, in each case as a result of a lawsuit by certain third parties (each a Put Event), Paul Capital has the right to require the Company and Guardian II to repurchase from Paul Capital its royalty interest at a price in cash which equals the greater of (a) 200% of cumulative payments made by Paul Capital under the Revenue Agreement less the cumulative royalties previously paid to Paul Capital; or (b) the amount which will provide Paul Capital, when taken together with the royalties previously paid, a 22% internal rate of return (the Put/Call Price). As of June 30, 2008, the Company and Guardian II have paid approximately $12.3 million in royalty payments to Paul Capital. Upon a bankruptcy event, the Company and Guardian II are automatically required to repurchase the Paul Capital royalty interest at the Put/Call Price. In the event of a change of control of Oscient, the Company has the right to repurchase the Paul Capital royalty interest for an amount equal to the Put/Call Price. The Company has determined that Paul Capital s put option and the Company s call option meet the criteria to be considered an embedded derivative and should be accounted for as such. The Company initially recorded a net liability of $1,005,000 related to the put/call option to reflect its estimated fair value as of the date of the agreement, in accordance with SFAS No. 133. This liability is revalued on a quarterly basis to reflect any changes in the fair value and any gain or loss resulting from the revaluation is recorded in earnings. As of June 30, 2008, the fair value of the derivative is approximately $919,000 which reflects a change in the fair value of approximately $67,000 which has been recorded as a gain on derivative in the accompanying consolidated statements of operations.

During the first two fiscal years immediately following the fiscal year in which combined annual net sales of ANTARA and FACTIVE are equal to or greater than $125 million, the Company and Guardian II have the right, but not the obligation, to reduce the royalty percentages due under the Revenue Agreement to Paul Capital by fifty percent (50%) by paying Paul Capital a price in cash which will provide Paul Capital, when taken together with the royalties previously paid, a 22% internal rate of return. During the first two fiscal years immediately following the fiscal year in which combined annual net sales of ANTARA and FACTIVE are equal to or greater than $250 million, the Company and Guardian II have the right, but not the obligation, to repurchase the Paul Capital royalty interest at a price in cash which will provide Paul Capital, when taken together with the royalties previously paid, a 22% internal rate of return.

Note Purchase Agreement

Guardian II entered into a Note Purchase Agreement (the Note Purchase Agreement) with Paul Capital pursuant to which Guardian II issued and sold a $20,000,000 aggregate principal amount of 12% senior secured note (the Note), due on the fourth anniversary of the closing date, subject to Guardian II s option to extend the maturity to the sixth anniversary of the closing date, provided (i) there are no defaults under the Note at the time, and (ii) the Company issues to Paul Capital, at the time of the exercise of such option, a warrant for such number of shares of common stock equal to 10% of the principal balance plus accrued interest divided by $6.94, with an

OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(Unaudited)

exercise price of $6.94 per share. If the Company exercises such option, the number of shares subject to the warrant issuable to Paul Capital would be between 288,018 shares and 367,529 shares, depending upon the amount, if any, of the interest payable on the Note the Company elects to have added to the principal of the Note rather than paid in cash as described below.

Interest is payable semi-annually in arrears on the last day of each of March and September. Guardian II has the option to pay interest in cash or to have 50% of the interest paid in cash and 50% of the interest added to principal. In the event of a change of control of Oscient or on or after the second anniversary of the closing, the Company may at its option prepay all or any part of the Note at a premium which declines over time. In the event of default, with event of default defined as a continuing Put Event under the Revenue Agreement as described in more detail above, the outstanding principal and interest in the Note shall become immediately due and payable. From inception of the Note Purchase Agreement, the Company exercised its option to add interest expense payable to the principal of the Note. As of June 30, 2008, the amount added to the principal was approximately $2,345,000. This amount is recorded as other long-term liabilities on the accompanying consolidated balance sheets.

Subject to the Revenue Agreement and the Note Purchase Agreement, without the prior written consent of Paul Capital, the Company has agreed not to (i) amend, waive any rights under, or terminate any material license agreements, including the agreements relating to the ANTARA and FACTIVE products, (ii) enter into any new agreement or amend or fail to exercise any of its material rights under existing agreements that would have a material adverse effect on Paul Capital s royalty interest, and (iii) sell any material assets related to ANTARA or FACTIVE.

Pursuant to the terms of the Revenue Agreement and the Note Purchase Agreement, Guardian II and Paul Capital entered into a Security Agreement (the Security Agreement) under which Guardian II granted to Paul Capital a security interest in and to substantially all assets owned by Guardian II (including rights to the ANTARA products) in order to secure its performance under each of the Revenue Agreement, the Note Purchase Agreement and the Note. To the extent the indebtedness under certain of its pre-existing debt obligations is refinanced or replaced and such replacement or refinancing indebtedness is secured, the Company has agreed to equally and ratably secure its obligations under the Revenue Agreement.

Common Stock and Warrant Purchase Agreement

As part of the financing, the Company and Paul Capital also entered into a Common Stock and Warrant Purchase Agreement (the Stock and Warrant Purchase Agreement), pursuant to which, in exchange for $10 million, the Company sold to Paul Capital 1,388,889 shares (the Shares) of the Common Stock, at a price of $7.20 per share (the Private Placement) and issued Paul Capital a warrant (the Warrant) to purchase 288,018 shares of Common Stock (the Warrant Shares) at an exercise price of $6.94 per share. The Warrant is exercisable for seven years from the date of closing. The Warrant contains a net share settlement feature and penalties if the Company does not deliver the applicable amount of Warrant Shares within three trading days of exercise of a Warrant by Paul Capital. The Warrant also contains provisions providing that, at Paul Capital s election, the Company must repurchase the Warrant from Paul Capital upon a sale of the Company in which the consideration for such sale is solely cash. The warrant has not been exercised as of June 30, 2008. The Company agreed, pursuant to the Stock and Warrant Purchase Agreement, to elect one person designated by Paul Capital to its Board of Directors following the closing and to continue to nominate one person designated by Paul Capital for election to its Board of Directors by its shareholders. The director designated by Paul Capital shall resign and the Company shall no longer be required to nominate a director designated by Paul Capital upon the later of the

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(Unaudited)

following events: (1) if Paul Capital ceases to own at least five percent of the Company s Common Stock or securities convertible into its Common Stock; (2) if the Company owes Paul Capital less than $5,000,000 under the Note pursuant to the Note Purchase Agreement; (3) the cumulative payments to Paul Capital made by the Company under the terms of the Revenue Agreement first exceed 250% of the consideration paid to the Company by Paul Capital; or (4) if the amounts due by the Company pursuant to the Revenue Agreement cease to be due. If at any time Paul Capital s designee is not elected to the Company s Board of Directors, Paul Capital s designee will have a right to participate in all meetings of the Company s Board of Directors in a nonvoting observer capacity.

The following table presents future maturities of the Company s debt (in thousands):

Year-Ending December 31,	
2008	$ 19
2009	13,338
2010	20,038
2011	186,498
2012	
Thereafter	40,745
Total	$ 260,638

(8) Supply Agreement for ANTARA

In accordance with the acquisition of ANTARA in August of 2006, the Company was assigned rights to and assumed certain obligations under an exclusive license to the rights to ANTARA licensed from Ethypharm S.A. In order to maintain the exclusivity of these rights, the Company must achieve minimum annual sales in the United States until February 2012 or pay amounts to Ethypharm to compensate for any shortfall. As of June 30, 2008, the Company has recorded approximately $605,000 related to the potential minimum royalty obligation to Ethypharm. During the term of the agreement, the Company is obligated to pay Ethypharm a royalty on sales of ANTARA in the U.S. including a royalty on other fenofibrate monotherapy products in formulations and dosage forms that may be substantially similar or identical to ANTARA developed by the Company. The license term expires in February 2020 and, absent notice of termination by either party, automatically renews for additional two year periods. Under the terms of the agreement, at the Company s option, Ethypharm is obligated to either manufacture and deliver to the Company finished fenofibrate product or deliver API to the Company for encapsulation and packaging. Ethypharm also has a right of first refusal on any divestiture of the ANTARA rights by the Company. Additional Company obligations under the Ethypharm agreement include funding a portion of the active pharmaceutical ingredient safety stock that Ethypharm is required to maintain.

(9) Supply Agreement for FACTIVE

The Company licenses from LG Life Sciences the right to develop and commercialize gemifloxacin (FACTIVE) tablets, a novel fluoroquinolone antibiotic, in North America, France, Germany, the United Kingdom, Luxembourg, Ireland, Italy, Spain, Portugal, Belgium, the Netherlands, Austria, Greece, Sweden, Denmark, Finland, Norway, Iceland, Switzerland, Andorra, Monaco, San Marino, Vatican City, Poland, Czech Republic, Slovakia, Slovenia, Hungary, Estonia, Latvia, Lithuania, Liechtenstein, Malta, Cyprus, Romania, Bulgaria, Croatia, Serbia and Montenegro, Bosnia and Herzegovina, Albania and the Former Yugoslav Republic of Macedonia. The term of the agreement with respect to each country extends at least through the life of the patents covering gemifloxacin in such country. In the United States, the last of the issued patents for composition

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(Unaudited)

of matter expires in 2018. The patent term could extend further in countries outside of the U.S. depending upon several factors, including whether the Company obtains patent extensions and the timing of its commercial sale of the product in a particular country.

Under the terms of the agreement, LG Life Sciences has agreed to supply and the Company is obligated to purchase from LG Life Sciences all of its anticipated commercial requirements for the FACTIVE active pharmaceutical ingredient (API). LG Life Sciences currently supplies the FACTIVE API from its manufacturing facility in South Korea.

The agreement with LG Life Sciences also requires the Company to achieve minimum gross sales level of $30 million from its licensed territories over a 12-month period of time starting in approximately the third quarter of 2007 to the third quarter of 2008, which if not met, LG Life Sciences could elect to terminate the agreement and have the technology be returned to LG Life Sciences. Based on data available at the time of this filing, including unaudited data from the Company s logistics provider and sublicensees, the Company believes that it has achieved the minimum gross sales threshold level. Under this agreement, the Company is responsible, at its expense and through consultation with LG Life Sciences, for the clinical and commercial development of gemifloxacin in the countries covered by the license, including conducting clinical trials, filing drug approval applications with the FDA and other applicable regulatory authorities and marketing, distributing and selling of gemifloxacin in its territory.

The Company is obligated to pay a royalty on sales of FACTIVE in North America and the territories covered by the license in Europe. These royalty obligations expire with respect to each country covered by the agreement on the later of (i) the expiration of the patents covering FACTIVE in such country or (ii) the expiration of data exclusivity in Mexico, Canada or the European Union respectively, or 2014 in the U.S. The Company is also obligated to make aggregate milestone payments of up to $40 million to LG Life Sciences upon achievement of additional regulatory approvals and sales thresholds.

(10) Subsequent Event

(Unaudited)

On October 3, 2008, the Company received a notification from The NASDAQ Listings Qualifications of The NASDAQ Stock Market LLC that, as of October 2, 2008, the Company s market value of publicly held shares (MVPHS) had closed below the minimum $15 million threshold set forth in Marketplace Rule 4450(b)(3) for the previous thirty (30) consecutive business days, a requirement for continued listing. For NASDAQ purposes, MVPHS is the market value of the Company s publicly held shares, which is calculated by subtracting all shares held by officers, directors or beneficial owners of 10% or more of an issuer s common stock from the issuer s total shares outstanding.

Pursuant to Marketplace Rule 4310(c)(8)(B), the Company has ninety (90) calendar days, or until January 2, 2009, to regain compliance with the MVPHS requirement by evidencing a minimum $15 million MVPHS for ten (10) consecutive business days. If the Company does not regain compliance with the MVPHS requirement by January 2, 2009, the Company will receive written notification of delisting from NASDAQ and at that time will be entitled to request a hearing before a NASDAQ Listing Qualifications Panel (Panel) to present its plan to evidence compliance with the MVPHS requirement.

The Company has filed a registration statement with the Securities and Exchange Commission on September 10, 2008 relating to a proposed exchange offer with the holders of its 3.50% Convertible Senior Notes due 2011 (2011 Notes). The offer proposes, among other items, to exchange all of the 2011 Notes for new notes and equity. If successful, the exchange would increase the amount of outstanding shares of the Company s common stock.

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OSCIENT PHARMACEUTICALS CORPORATION

Notes to Consolidated Financial Statements (Continued)

(Unaudited)

If the Company s efforts to regain compliance are successful and the MVPHS exceeds $15 million for ten (10) consecutive days before January 2, 2009, the Company will regain compliance with respect to the MVPHS requirement. In the event the Company does not regain compliance, it may appeal the determination to a Panel. In the event that the Company fails to regain compliance and is unsuccessful in an appeal to the Panel, the Company s securities will be delisted from The NASDAQ Global Market. In the event that the Company s securities are delisted from The NASDAQ Global Market, the Company may not be able to meet the requirements necessary for its common stock (i) to transfer to, or list on, a U.S. national securities exchange, including The NASDAQ Capital Market or (ii) be approved for listing on a U.S. system of automated dissemination of quotations. If such event occurred, holders of the Company s 2011 Notes have the right to require the Company to repurchase for cash the outstanding principal amount of the 2011 Notes plus accrued and unpaid interest through such date. There is currently approximately $225 million principal amount of 2011 Notes outstanding. The Company may not have sufficient cash or be able to raise sufficient additional capital to repay the 2011 Notes requested by the holders.

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The exchange agent:

U.S. BANK NATIONAL ASSOCIATION

By Mail or Overnight Courier

U.S. Bank National Association

Attn. Specialized Finance

60 Livingston Avenue

St. Paul, MN 55107

By Facsimile Transmission:

(617) 603-6683

Phone:

Confirm by Telephone:

(617) 603-6553

The Information Agent:

THE ALTMAN GROUP, INC.

1200 Wall Street West, 3rd Floor

Lyndhurst, New Jersey 07071

Holders call toll-free: (866) 751-6316

Banks and Brokers call: (201) 806-7300

Fax: (201) 460-0050

Any questions or requests for assistance with tendering your existing 2011 notes or additional copies of this prospectus and the letter of transmittal may be directed to the information agent at its telephone number and location set forth above. You may also contact your broker, dealer, commercial bank or trust company or other nominee for assistance concerning the exchange offer.

The Dealer Managers for the Exchange Offer:

LAZARD CAPITAL MARKETS LLC
30 Rockefeller Plaza
New York, New York 10020

4 Embarcadero Center

MTS SECURITIES, LLC
623 Fifth Avenue, 15th floor
New York, New York 10020

San Francisco, CA 94111
(415) 281-3420
Attention: Convertible Securities Desk
Simon Manning

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PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION

The following table sets forth the various expenses in connection with the sale and distribution of the securities being registered. All amounts shown are estimates, except the Securities and Exchange Commission registration fee and the Financial Industry Regulatory Authority, or FINRA filing fee. The registrant has agreed to pay these costs and expenses.

Securities and Exchange Commission registration fee	$ 5,714
FINRA filing fee	$ 15,039
Printing and engraving expenses	$ 80,000
Legal fees and expenses	$ 875,000
Accounting fees and expenses	$ 75,000
Trustee, exchange agent and transfer agent fees	$ 25,000
Information agent fees	$ 10,000
Miscellaneous	$ 50,000
Total	$ 1,135,753

INDEMNIFICATION OF DIRECTORS AND OFFICERS

Section 2.02(b)(4) of the Massachusetts Business Corporation Act (the MBCA) provides that a corporation may, in its articles of organization, eliminate or limit a director s personal liability to the corporation and its shareholders for monetary damages for breaches of fiduciary duty, except in circumstances involving (1) a breach of the director s duty of loyalty to the corporation or its shareholders, (2) acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (3) improper distributions, and (4) transactions from which the director derived an improper personal benefit. Our Restated Articles of Organization, as amended to date, provide that our directors shall not be liable to the company or its stockholders for monetary damages for breach of fiduciary duty as a director, except to the extent that the exculpation from liabilities is not permitted under the Massachusetts Business Corporation Act as in effect at the time such liability is determined.

Section 8.51 of the MBCA permits the a corporation to indemnify a director if the individual (1) acted in good faith, (2) reasonably believed that his or her conduct was (a) in the best interests of the corporation or (b) at least not opposed to the best interest of the corporation, and (3) in the case of a criminal proceeding, had no reasonable cause to believe his or her conduct was unlawful. Section 8.51 also permits the Registrant to indemnify a director for conduct for which such individual is or would be exculpated under the charter provision referred to above, whether or not the director satisfied a particular standard of conduct. Section 8.56 of the MBCA permits a corporation to indemnify an officer (i) under those circumstances in which the corporation would be allowed to indemnify a director and (ii) to such further extent as the corporation chooses provided that the liability does not arise out of acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law. This broader permissible indemnification for officers also is available for a director who is an officer if the individual becomes party to a proceeding on the basis of an act or omission solely as an officer. Section 8.55 of the MBCA mandates that the determination that an award of indemnification is appropriate in a particular circumstance be made by (A) a majority vote of all disinterested directors or a majority of a committee of disinterested directors (in each case, if there are at least two disinterested directors), (B) special legal counsel, or (C) the shareholders.

Prior to the final disposition of a proceeding involving a director or officer, Sections 8.53 and 8.56 of the MBCA allow a corporation to pay for or reimburse reasonable expenses. As a condition, the director or officer must deliver a written undertaking to repay the funds if the individual is determined not to have met the relevant

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standard of conduct, which determination is made in the same manner as the determination of whether an individual is entitled to indemnification. This undertaking may be accepted without security and without regard to the individual s financial ability to make repayment. Another condition to advancement of expenses is that the individual submit a written affirmation of his or her good faith that he or she has met the standard of conduct necessary for indemnification (or that the matter involved conduct for which liability has been eliminated pursuant to the charter exculpation provision referred to above).

The MBCA allows a corporation to obligate itself (1) to indemnify a director or officer and (2) to provide advancement of expenses to such an individual. Such a commitment may be made in the corporation s charter or bylaws or in a resolution adopted, or a contract approved, by the board of directors or the shareholders. Our By-Laws provide that we shall indemnify our directors and officers to the full extent legally permissible, except that no indemnification may be provided for any director or officer with respect to any matter as to which such director or officer shall have been adjudicated in any proceeding not to have acted in good faith in the reasonable belief that his action was in the best interest of the corporation. In addition, we hold a Directors and Officer Liability and Corporate Indemnification Policy.

Sections 8.52 and 8.56(c) of the MBCA mandate indemnification for reasonable expenses, regardless of whether an individual has met a particular standard of conduct, in connection with proceedings in which a director or officer is wholly successful, on the merits or otherwise. Furthermore, Section 8.54 of the MBCA provides that a court may direct a corporation to indemnify a director or officer if the court determines that (1) the director or officer is entitled to mandatory indemnification under the MBCA, (2) the director or officer is entitled to indemnification pursuant to a provision in the corporation s charter or bylaws or in a contract or a board or shareholder resolution, or (3) it is fair and reasonable to indemnify the director or officer, regardless of whether he or she met the relevant standard of conduct.

Sections 8.30 and 8.42 of the MBCA provide that if an officer or director discharges his duties in good faith and with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the officer or director reasonably believes to be in the best interests of the corporation, he or she will not be liable for such actions.

RECENT SALES OF UNREGISTERED SECURITIES

During the three years preceding the filing of these registration statements, we have issued the following securities which were not registered under the Securities Act of 1993, as amended:

Private Placement to Paul Royalty Fund Holdings II, LP in August 2006

To finance its acquisition of exclusive rights to the cardiovascular product ANTARA (fenofibrate) capsules in the United States and its territories, Oscient and its wholly-owned subsidiary, Guardian II Acquisition Corporation entered into several financing agreements with Paul Royalty Fund Holdings II, LP (PRF) on July 21, 2006. Guardian II entered into a Note Purchase Agreement with PRF pursuant to which it issued and sold a $20,000,000 aggregate principal amount of 12% senior secured note due four years from the closing date. Oscient also entered into a Common Stock and Warrant Purchase Agreement pursuant to which, in exchange for $10,000,000, Oscient sold to PRF 11,111,111 shares (the Shares) (not adjusted to reflect the 1-for-8 reverse stock split) of Common Stock, at a price of $.90 per share and issued PRF a warrant (the Warrant) (not adjusted to reflect the 1-for-8 reverse stock split) to purchase 2,304,147 shares (not adjusted to reflect the 1-for-8 reverse stock split) of Common Stock at an exercise price of $0.8680. The Warrant is exercisable for seven years from the closing date.

The Shares and Warrant were offered and sold in the Private Placement to PRF, an accredited investor, without registration under the Securities Act, or state securities laws, in reliance on the exemptions provided by Section 4(2) of the Securities Act of 1933, as amended (the Securities Act), and Regulation D promulgated

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thereunder and in reliance on similar exemptions under applicable state laws. Accordingly, the securities issued in the Private Placement were not registered under the Securities Act, and until so registered the securities may not be offered or sold in the United States absent registration or availability of an applicable exemption from registration.

Private Placement in April 2006

On April 6, 2006, Oscient entered into Purchase Agreements with institutional and other accredited investors pursuant to which it sold an aggregate of 18,035,216 shares (the Shares) of Oscient s common stock at a price of $1.93 per share (the Private Placement) and warrants (the Warrants) to purchase 9,017,608 shares (not adjusted to reflect the 1-for-8 reverse stock split) of Common Stock (the Warrant Shares) at an exercise price of $2.22 per share. The Warrants were sold at a price of $0.125 per share of Common Stock issuable pursuant to such Warrants. The closing of the Private Placement occurred on April 11, 2006. The Private Placement of the Shares and Warrants resulted in gross proceeds to Oscient of approximately $35.9 million before deducting fees payable to placement agents and other transaction expenses payable by Oscient, which resulted in Oscient s receipt of approximately $33.6 million in net proceeds.

Oscient agreed to pay aggregate placement agent fees of approximately $2.1 million to the placement agents for the Private Placement. In addition, Oscient agreed to reimburse JMP Securities LLC and Thomas Weisel LLP for their reasonable out of pocket expenses incurred in connection with the Private Placement. As part of their compensation, JMP Securities LLC and Thomas Weisel LLP also received warrants to purchase an aggregate of 180,352 shares (not adjusted to reflect the 1-for-8 reverse stock split) of Common Stock at an exercise price of $2.22 per share.

The Shares and Warrants were offered and sold in the Private Placement to certain institutional and other accredited investors without registration under the Securities Act, or state securities laws, in reliance on the exemptions provided by Section 4(2) of the Securities Act and Regulation D promulgated thereunder and in reliance on similar exemptions under applicable state laws. Accordingly, the securities issued in the Private Placement were not registered under the Securities Act, and until so registered the securities may not be offered or sold in the United States absent registration or availability of an applicable exemption from registration.

Issuance of Convertible Notes in May 2004

On May 10, 2004, May 25, 2004 and June 4, 2004, the Company sold $125 million, $24.75 million and $3 million, respectively, of its 3 1/2% senior convertible notes due in April 2011 in a private placement under Section 4(2) of the Securities Act of 1933, as amended, to qualified institutional buyers as defined by Rule 144A of the Securities Act. These notes, $152,750,000 in the aggregate principal amount, are convertible into the Company s common stock at the option of the holders at a conversion price of $53.1361 per share, as adjusted pursuant to the reverse stock split which we effectuated in November 2006. The Company may not redeem the notes at its election before May 10, 2010. After this date, the Company can redeem all or a part of the notes for cash at a price equal to 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest.

A portion of the net proceeds from this note offering was used to purchase U.S. government securities as pledged collateral to secure the first six scheduled interest payments on the notes, which are classified as restricted cash on the December 31, 2006 and December 31, 2005 consolidated balance sheets. Following the issuance, the Company filed a shelf registration statement on Form S-3 relating to the resale of the notes and the common stock issuable upon conversion.

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EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Exhibit No.	Description
1.1	Form of Dealer Manager Agreement
2.1	Agreement and Plan of Merger and Reorganization dated November 17, 2003(11)
2.2	Asset Purchase Agreement by and among Reliant Pharmaceuticals, Inc., Guardian II Acquisition Corporation and Oscient Pharmaceuticals Corporation dated July 21, 2006*(24)
3.1	Articles of Organization (as amended through November 15, 2006)(26)
3.2	By-Laws (as amended to date)(19)
4.1	Form of Purchase Warrant issued to Smithfield Fiduciary LLC and the Tail Wind Fund Ltd.(9)
4.2	Form of Common Stock Purchase Warrant dated as of September 29, 2003(10)
4.3	Registration Rights Agreement dated September 29, 2003(10)
4.4	Registration Rights Agreement dated November 17, 2003, by and between Genome Therapeutics Corp. and certain creditors of GeneSoft Pharmaceuticals, Inc.(12)
4.5	Form of Indenture dated as of May 10, 2004(17)
4.6	Pledge Agreement dated as of May 10, 2004(17)
4.7	Registration Rights Agreement dated May 10, 2004(17)
4.8	Form of Indenture dated as of May 10, 2004(17)
4.9	Pledge Agreement dated May 10, 2004(17)
4.10	Registration Rights Agreement dated May 10, 2004(17)
4.11	Form of Common Stock Purchase Warrant dated April 5, 2006(20)
4.12	Form of Common Stock Purchase Warrant dated August 18, 2006(26)
4.13	Registration Rights Agreement dated August 18, 2006(26)
4.14	Form of Indenture dated May 1, 2007(28)
4.15	Form of Indenture
5.1	Opinion of Ropes & Gray LLP
8.1	Form of opinion of Ropes & Gray LLP regarding certain federal income tax consequences discussed in this registration statement.
10.1	Incentive Stock Option Plan and Form of Stock Option Certificate(1)
10.2	Genome Therapeutics Corp. (f/k/a Collaborative Research) Incentive Savings Plan(2)
10.3	Amendment dated November 4, 1986 to the Genome Therapeutics Corp. (f/k/a Collaborative Research) Incentive Savings Plan dated March 1, 1985(3)
10.4	1991 Stock Option Plan and Form of Stock Option Certificate(4)
10.5	Lease dated June 23, 2004 relating to certain property in Waltham, Massachusetts(26)
10.6	1993 Stock Option Plan and Form of Stock Option Certificate(5)
10.7	1997 Directors Deferred Stock Plan(6)
10.8	1997 Stock Option Plan(6)
10.9	Amended and Restated 2001 Incentive Plan(23)

10.10 Stock Option Agreements with Steven M. Rauscher[7]

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Exhibit No.	Description
10.11	Employment Letter with Steven M. Rauscher[8]
10.12	2007 Employment Inducement Award Plan[29]
10.13	Amendment, Redemption and Exchange Agreement between the Company and The Tail Wind Fund, dated June 4, 2003[9]
10.14	Note Amendment and Exchange Agreement dated November 17, 2003, by and between Genome Therapeutics Corp. and certain creditors of GeneSoft Pharmaceuticals, Inc.[13]
10.15	Amendment to Employment Agreement dated as February 5, 2004 between Genome Therapeutics Corp. and Steven M. Rauscher[13]
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FINANCIAL STATEMENT SCHEDULES

SCHEDULE 2

Valuation and Qualifying Accounts

December 31, 2007

(in thousands)

	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Product Sales	Deductions	Balance at End of Period
Year Ended December 31, 2007					
Deducted from assets accounts:					
Allowance for doubtful accounts	$ 349	$	$	$ 314(1)	$ 35
Reserve for cash discounts	202		1,980	1,839(2)	343
Total	$ 551	$	$ 1,980	$ 2,153	$ 378
Year Ended December 31, 2006					
Deducted from assets accounts:					
Allowance for doubtful accounts	$	$ 349	$	$ (1)	$ 349
Reserve for cash discounts	50		953	801(2)	202
Total	$ 50	$ 349	$ 953	$ 801	$ 551
Year Ended December 31, 2005					
Deducted from assets accounts:					
Allowance for doubtful accounts	$	$	$	$ (1)	$
Reserve for cash discounts	79		466	495(2)	50
Total	$ 79	$	$ 466	$ 495	$ 50

(1) Uncollectible accounts written off, net of recoveries.
(2) Discounts taken by customers during year.

UNDERTAKINGS

The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the Calculation of Registration Fee table in the

effective registration statement;

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement;

That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial *bona fide* offering thereof.

To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

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That, for the purpose of determining liability of the registrant under the Securities Act of 1933 to any purchaser in the initial distribution of the securities:

The undersigned registrant undertakes that in a primary offering of securities of the undersigned registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned registrant will be a seller to the purchaser and will be considered to offer or sell such securities to such purchaser:

(i) Any preliminary prospectus or prospectus of the undersigned registrant relating to the offering required to be filed pursuant to Rule 424 (§ 230.424 of this chapter);

(ii) Any free writing prospectus relating to the offering prepared by or on behalf of the undersigned registrant or used or referred to by the undersigned registrant;

(iii) The portion of any other free writing prospectus relating to the offering containing material information about the undersigned registrant or its securities provided by or on behalf of the undersigned registrant; and

(iv) Any other communication that is an offer in the offering made by the undersigned registrant to the purchaser.

The undersigned Registrant hereby undertakes that, for purposes of determining any liability under the Securities Act of 1933, as amended, each filing of the Registrant s annual report pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 (and, where applicable, each filing of an employee benefit plan s annual report pursuant to Section 15(d) of the Securities Exchange Act of 1934) that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

The undersigned Registrant hereby undertakes as follows: that prior to any public reoffering of the securities registered hereunder through use of a prospectus which is a part of this registration statement, by any person or party who is deemed to be an underwriter within the meaning of Rule 145(c), the issuer undertakes that such reoffering prospectus will contain the information called for by the applicable registration form with respect to reofferings by persons who may be deemed underwriters, in addition to the information called for by the other Items of the applicable form.

The Registrant undertakes that every prospectus (i) that is filed pursuant to paragraph (1) immediately preceding, or (ii) that purports to meet the requirements of section 10(a)(3) of the Act and is used in connection with an offering of securities subject to Rule 415(ss.230.415 of this chapter), will be filed as a part of an amendment to the registration statement and will not be used until such amendment is effective, and that, for purposes of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the Registrant pursuant to the foregoing provisions or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Waltham, The Commonwealth of Massachusetts, on October 7, 2008.

OSCIENT PHARMACEUTICALS CORPORATION

/s/ Steven M. Rauscher
Name: **Steven M. Rauscher**
Title: **Director, President and Chief Executive Officer**

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Pursuant to the requirements of the Securities Act of 1933, as amended, this registration statement has been signed by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Steven M. Rauscher **Steven M. Rauscher**	Director, President and Chief Executive Officer (Principal Executive Officer)	October 7, 2008
/s/ Philippe M. Maitre **Philippe M. Maitre**	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	October 7, 2008
* **David K. Stone**	Director and Chairman of the Board	October 7, 2008
* **Gregory B. Brown**	Director	October 7, 2008
* **Robert J. Hennessey**	Director	October 7, 2008
* **John R. Leone**	Director	October 7, 2008
* **William R. Mattson**	Director	October 7, 2008
* **Gary Patou**	Director	October 7, 2008
* **William S. Reardon**	Director	October 7, 2008
* **Norbert G. Riedel**	Director	October 7, 2008

*By: /s/ Philippe M. Maitre
Philippe M. Maitre

Attorney-in-fact

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EXHIBIT INDEX

Exhibit No.	Description
1.1	Form of Dealer Manager Agreement
2.1	Agreement and Plan of Merger and Reorganization dated November 17, 2003(11)
2.2	Asset Purchase Agreement by and among Reliant Pharmaceuticals, Inc., Guardian II Acquisition Corporation and Oscient Pharmaceuticals Corporation dated July 21, 2006*(24)
3.1	Articles of Organization (as amended through November 15, 2006)(26)
3.2	By-Laws (as amended to date)(19)
4.1	Form of Purchase Warrant issued to Smithfield Fiduciary LLC and the Tail Wind Fund Ltd.(9)
4.2	Form of Common Stock Purchase Warrant dated as of September 29, 2003(10)
4.3	Registration Rights Agreement dated September 29, 2003(10)
4.4	Registration Rights Agreement dated November 17, 2003, by and between Genome Therapeutics Corp. and certain creditors of GeneSoft Pharmaceuticals, Inc.(12)
4.5	Form of Indenture dated as of May 10, 2004(17)
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4.15	Form of Indenture
5.1	Opinion of Ropes & Gray LLP
8.1	Form of opinion of Ropes & Gray LLP regarding certain federal income tax consequences discussed in this registration statement.
10.1	Incentive Stock Option Plan and Form of Stock Option Certificate(1)
10.2	Genome Therapeutics Corp. (f/k/a Collaborative Research) Incentive Savings Plan(2)
10.3	Amendment dated November 4, 1986 to the Genome Therapeutics Corp. (f/k/a Collaborative Research) Incentive Savings Plan dated March 1, 1985(3)
10.4	1991 Stock Option Plan and Form of Stock Option Certificate(4)
10.5	Lease dated June 23, 2004 relating to certain property in Waltham, Massachusetts(26)
10.6	1993 Stock Option Plan and Form of Stock Option Certificate(5)
10.7	1997 Directors Deferred Stock Plan(6)
10.8	1997 Stock Option Plan(6)
10.9	Amended and Restated 2001 Incentive Plan(23)

10.10	Stock Option Agreements with Steven M. Rauscher[7]
10.11	Employment Letter with Steven M. Rauscher[8]

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10.13	Amendment, Redemption and Exchange Agreement between the Company and The Tail Wind Fund, dated June 4, 2003[9]
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