

CELL THERAPEUTICS INC
Form S-3
May 15, 2006
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As filed with the Securities and Exchange Commission on May 15, 2006

Registration No. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-3
REGISTRATION STATEMENT

Under

The Securities Act of 1933

CELL THERAPEUTICS, INC.

(Exact name of Registrant as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

2834
(Primary Standard Industrial Classification Code Number)

91-1533912
(I.R.S. Employer

Identification Number)

501 Elliott Avenue West, Suite 400

Seattle, Washington 98119

(206) 282-7100

(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

James A. Bianco

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President and Chief Executive Officer

Cell Therapeutics, Inc.

501 Elliott Avenue West, Suite 400

Seattle, Washington 98119

(206) 282-7100

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Michael J. Kennedy, Esq.

O Melveny & Myers LLP

Embarcadero Center West

275 Battery Street, Suite 2600

San Francisco, California 94111-3305

Approximate date of commencement of proposed sale to the public: From time to time after the effective date of this Registration Statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 (hereinafter the Securities Act), other than securities offered only in connection with dividend or interest reinvestment plans, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box.

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box.

CALCULATION OF REGISTRATION FEE

Title of Each Class of	Amount	Proposed Maximum	Aggregate	Amount of
Securities to be Registered	to be	Offering Price	Offering	Registration

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	Registered (1)	Per Security(2)	Price	Fee
\$33,156,000 7.5% Convertible Senior Notes due April 30, 2011	\$ 33,156,000(3)	100%	\$ 33,156,000	\$ 3,548
Common Stock, no par value per share(4)	23,266,669(5)(6)	\$ (7)	\$ 13,247,598(7)	\$ 1,418(8)

- (1) Pursuant to Rule 416 of the Securities Act, such number of shares of common stock registered hereby shall include an indeterminate number of shares of common stock that may be issued in connection with a stock split, stock dividend, recapitalization or similar event, including, without limitation, such indeterminate additional shares as may become issuable from time to time upon conversion of the notes as a result of the anti-dilution provisions in connection with the notes.
- (2) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(o) under the Securities Act of 1933 and exclusive of accrued interest and distributions, if any.
- (3) Represents the aggregate principal amount of the notes issued by the Registrant.
- (4) Shares of the registrant's common stock being registered hereby are accompanied by the registrant's preferred stock purchase rights. Until the occurrence of certain prescribed events, such rights are not exercisable, are evidenced by each certificate for common stock and will be transferred along with and only with the common stock.
- (5) The shares of common stock that are being registered include 15,865,776 shares of common stock issuable upon conversion of the notes at the conversion rate of 478.519 shares per each \$1,000 principal amount of notes, subject to adjustment in certain circumstances, which is equivalent to an initial conversion price of approximately \$2.09 per share of common stock.
- (6) The shares of common stock that are being registered include 7,400,893 shares of common stock representing an estimate of the maximum number of shares of common stock that would be issued if the Registrant elects, under the terms of the notes, to make all the payments of interest and make-whole amounts that may be due on the notes in common stock. As provided in the indenture governing the notes, any shares of common stock to be issued in payment of interest and make-whole amounts will be valued at 95% of the volume weighted average price for the five consecutive trading days ending on the trade day immediately preceding any interest payment or make-whole interest payment date. For the purposes of calculating the estimated number of shares that would be issued if the Registrant elects to make all the payments of interest and make-whole amounts in common stock, we have assumed a per share value of \$1.68, which is equal to 95% of the last reported sale price for the Registrant's common stock as reported on the Nasdaq National Market on May 10, 2006. However, the number of shares of common stock that may ultimately be issued if the Registrant elects to make the payments of interest and make-whole amounts in common stock will vary depending on the volume-weighted average price for the five consecutive trading days ending on the trading day immediately preceding any interest payment or make-whole payment date, as provided in the indenture governing the notes.
- (7) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) under the Securities Act, based on the average of the high and low prices for the registrant's common stock as reported on the Nasdaq National Market on May 10, 2006, which was \$1.79.
- (8) Pursuant to Rule 457(i), no additional filing fee is payable with respect to the 15,865,776 shares of common stock issuable upon conversion of the notes because no additional consideration will be received in connection with the exercise of the conversion privilege.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. The selling securityholders may not sell these securities until the registration statement relating to these securities that has been filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and selling securityholders named in this prospectus are not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to Completion,

Dated May 15, 2006

PRELIMINARY PROSPECTUS

\$33,156,000

7.5% Convertible Senior Notes due April 30, 2011

and the common stock issuable upon conversion of the notes and for payments of interest

and make-whole amounts that may become due on the notes

We issued the notes offered by this prospectus in a private placement in April 2006. This prospectus will be used by selling securityholders to resell their notes and the common stock issuable upon conversion of the notes and for payments of interest and make-whole amounts that may be due on the notes. We will not receive any proceeds from this offering.

You may convert the notes into shares of our common stock at any time before their maturity unless we have previously redeemed or repurchased them. The notes will be due on April 30, 2011. The conversion rate is 478.519 shares per each \$1,000 principal amount of notes, subject to adjustment in certain circumstances. This is equivalent to an initial conversion price of approximately \$2.09 per share.

We will pay interest on the notes on April 30 and October 31 of each year. The first interest payment will be made on October 31, 2006. The notes will be senior in right of payment to our 5.75% Convertible Subordinated Notes due 2008, our 5.75% Convertible Senior Subordinated Notes due 2008 and our 4% Convertible Senior Subordinated Notes due 2010, and will be equal in right of payment to our 6.75% Convertible Senior Notes due 2010.

The notes are not listed on any securities exchange or included in any automated quotation system. The notes are eligible for trading in the PORTALSM Market of the National Association of Securities Dealers, Inc. Our common stock is quoted on the Nasdaq National Market under the symbol CTIC. On May 10, 2006, the last reported sale price for our common stock on the Nasdaq National Market was \$1.77 per share.

Investing in the notes involves risk. See **Risk Factors** beginning on page 7.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

This prospectus is dated _____, 2006

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

In addition to the other information contained or incorporated by reference in this prospectus, you should carefully consider the risk factors contained in and incorporated by reference into this prospectus when evaluating an investment in our common stock. This prospectus and the documents incorporated by reference into this prospectus include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (Exchange Act). All statements other than statements of historical fact are forward-looking statements for purposes of these provisions, including:

any projections of earnings, revenues or other financial items;

any statements of the plans and objectives of management for future operations;

any statements concerning proposed new products or services;

any statements regarding future operations, plans, regulatory filings or approvals;

any statements on plans regarding proposed or potential clinical trials or new drug filing strategies;

any statements concerning proposed new products or services, any statements regarding pending or future mergers or acquisitions; and

any statements regarding future economic conditions or performance, and any statement of assumptions underlying any of the foregoing.

In some cases, forward-looking statements can be identified by the use of terminology such as may , will , expects , plans , anticipates , estimate , potential , or continue or the negative thereof or other comparable terminology. There can be no assurance that such expectations or any of the forward-looking statements will prove to be correct, and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including, but not limited to, the risk factors set forth in this prospectus. All forward-looking statements and reasons why results may differ included in this prospectus are made as of the date hereof, and we assume no obligation to update any such forward-looking statement or reason why actual results might differ.

This prospectus contains and incorporates by reference market data, industry statistics and other data that have been obtained from, or compiled from, information made available by third parties. We have not independently verified their data.

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PROSPECTUS SUMMARY

The following summary highlights information contained elsewhere, or incorporated by reference, in this prospectus. The following summary does not contain all the information that you should consider before investing in the notes. To understand this offering fully, you should read this entire prospectus carefully, including the financial statements and the documents that we have incorporated by reference into this prospectus. Unless otherwise indicated, CTI, Company, we, us, our and similar terms refer to Cell Therapeutics, Inc. and its subsidiaries.

Our Company

We develop, acquire and commercialize novel treatments for cancer. Our goal is to build a leading biopharmaceutical company with a diversified portfolio of proprietary oncology drugs. Our research, development, acquisition and in-licensing activities concentrate on identifying and developing new, less toxic and more effective ways to treat cancer. We are developing XYOTAX, paclitaxel poliglumex, for the treatment of non-small cell lung cancer, or NSCLC, and ovarian cancer. Our STELLAR 2, 3, and 4 phase III clinical studies for XYOTAX did not meet our primary endpoints of superior overall survival. However, we believe a pooled analysis of STELLAR 3 and 4 demonstrates a statistically significant survival advantage among women receiving XYOTAX when compared to women or men receiving standard chemotherapy. A survival advantage for women over men was also demonstrated in a first-line phase II clinical trial of XYOTAX and carboplatin, known as the PGT2O2 trial, supporting the potential benefit observed in the STELLAR first-line trials. We believe the lack of safe and effective treatments for women with advanced first-line NSCLC who are performance status 2, or PS2, represents an unmet medical need. We plan to submit a new drug application, or NDA, with the U.S. Food and Drug Administration, or FDA, for XYOTAX as first-line monotherapy for women with advanced NSCLC who are PS2 based on data from the pooled analysis of our STELLAR 3 and 4 first-line trials and our PGT2O2 study. To support this application, we have initiated an additional study, known as the PIONEER, or PGT3O5, study, for XYOTAX as first-line monotherapy in PS2 women with NSCLC, with a target of having interim results available from this study at the time of FDA review of that NDA, as an alternative to waiting for the completion of the study. In Europe, we plan to submit a marketing authorization application, or MAA, based on a non inferior survival and improved side effect profile which we believe was demonstrated in our STELLAR 2, 3, and 4 pivotal trials. We will need additional positive input from the scientific committee of the European Medicines Agency, or EMEA, prior to submitting an MAA on this basis. We are developing pixantrone, a novel anthracycline derivative, for the treatment of non-Hodgkin's lymphoma, or NHL. We are targeting an interim analysis from our ongoing phase III study of pixantrone in the third quarter of 2006, and depending on the results of this analysis, a second interim analysis may be performed in the first half of 2007. We also are developing CT-2106, polyglutamate camptothecin, which is in the phase II component of a phase I/II trial in combination with 5FU/LV for the treatment of colorectal cancer relapsing following FOLFOX therapy and a phase II trial in ovarian cancer.

Other Information

We were incorporated in Washington in 1991. Our principal executive offices are located at 501 Elliott Avenue West, Seattle, Washington 98119. Our telephone number is (206) 282-7100. Our website can be found at www.cticseattle.com. We make available free of charge on our website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other filings pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and amendments to such filings, as soon as reasonably practicable after each is electronically filed with, or furnished to, the Securities and Exchange Commission, or the SEC. Information on our website does not constitute part of this prospectus unless it is otherwise specifically incorporated by reference herein.

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CTI and XYOTAX are our proprietary marks. All other product names, trademarks and trade names referred to in this prospectus are the property of their respective owners.

The Offering

The following is a brief summary of some of the terms of the notes and shares of common stock offered for resale in this prospectus. For a more complete description of the terms of the notes, see the Description of Notes section in this prospectus. For a more complete description of the terms of the common stock, see the Description of Capital Stock section in this prospectus.

Securities Offered	\$33,156,000 aggregate principal amount of 7.5% Convertible Senior Notes due April 30, 2011, and common stock issuable upon conversion of the notes and for payments of interest and make-whole amounts that may be due on the notes.
Issuer	Cell Therapeutics, Inc.
Maturity	April 30, 2011
Offering Price	100% of the principal amount.
Interest	Interest is payable on the notes at a rate of 7.5% per annum, payable in cash, common stock or some combination of cash and common stock having a fair market value equal to the interest payment due, semi-annually on April 30 and October 31 of each year, beginning October 31, 2006. For the purposes of this provision, the fair market value of our common stock shall be equal to 95% of its volume-weighted average price for the five consecutive trading days ending on the trading day immediately preceding the interest payment date.
Conversion	You have the option to convert the notes into shares of our common stock at a conversion rate of 478.519 shares of common stock per \$1,000 principal amount of our notes, which is equivalent to a conversion price of approximately \$2.09 per share. The conversion rate is subject to adjustment as described more fully in the Description of the Notes Conversion Rights.
Optional Redemption	You may convert the notes at any time before the close of business on the maturity date, unless we have previously redeemed or repurchased the notes; provided, however, that if a note is subject to redemption, you will be entitled to convert the note at any time before the close of business on the date immediately preceding the date fixed for redemption. See Description of Notes Conversion Rights.
Automatic Conversion	Prior to April 30, 2009, we will not have the right to redeem any notes at our option. On or after April 30, 2009, we may redeem some or all of the notes for cash at any time at a redemption price equal to par plus accrued and unpaid interest to, but not including, the redemption date. See Description of Notes Conversion Rights.
Repurchase at Option of Holders	Subject to certain conditions, the notes will automatically convert if, at any time after June 26, 2006 and prior to maturity, the closing price per share of our common stock has exceeded 125% of the conversion price then in effect for at least 20 trading days within any 30-consecutive trading day period.
Upon a Change in Control	Upon certain changes in control (as defined in the indenture), you will have the right, subject to certain conditions and restrictions, to require us to

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repurchase your notes, in whole or in part, at 100% of their principal amount, plus accrued and unpaid interest to, but not including, the repurchase date. The repurchase price is payable, at our option, in cash, common stock or a combination of cash and common stock. However, we, or the successor entity in the change in control transaction, may pay the repurchase price in common stock only if the conditions provided in the indenture governing the notes are satisfied. If the repurchase price is paid in common stock, the common stock shall be equal to 95% of the average of the volume-weighted average price per share of our common stock for each of the five consecutive trading days ending on the trading day immediately preceding the repurchase date. A change in control could be an event of default under our senior debt. See Description of Notes Repurchase at Option of Holders Upon a Change in Control.

Make-Whole Provision Upon any automatic conversion of the notes, or if you exercise your right to require us to repurchase your notes in connection with a non-stock change of control (as defined in the indenture), we will pay to you an amount equal to \$225 per \$1,000 principal amount of your notes so converted or repurchased less the amount of any interest paid on such notes prior to the conversion or repurchase date. This payment may be made in cash, common stock or some combination of cash and common stock. For the purposes of this provision, the fair market value of our common stock shall be equal to 95% of its volume-weighted average price for the five consecutive trading days ending on the trading day immediately preceding the conversion or repurchase date. No make-whole amount shall be payable upon any conversion, repurchase or redemption of the notes other than in connection with an automatic conversion of the notes or repurchase of the notes in connection with a non-stock change of control as set forth in the indenture governing the notes.

Ranking The notes will rank pari passu in right of payment with all existing and future senior indebtedness, including our existing 6.75% Convertible Senior Notes due 2010. The notes will be senior to our existing 5.75% Convertible Subordinated Notes due 2008, our 5.75% Convertible Senior Subordinated Notes due 2008 and our 4% Convertible Senior Subordinated Notes due 2010. The notes will also be structurally subordinated in right of payment to the liabilities of our subsidiaries. The indenture governing the notes restricts our incurrence of indebtedness and our subsidiaries incurrence of indebtedness. See Description of Notes Ranking.

Use of Proceeds We will not receive any proceeds from the sale by any selling securityholder of the notes or the shares offered by this prospectus.

Covenants We have agreed not to incur or suffer to exist, and to not permit our subsidiaries to incur or suffer to exist (i) any indebtedness that is structurally senior or senior by its terms to these notes, or (ii) secured indebtedness, in an aggregate principal amount for both clauses (i) and (ii) exceeding \$10,000,000 unless, in the case of clause (ii), these notes are equally and ratably secured with such secured indebtedness, except that we may incur liens or encumbrances in connection with biopharmaceutical licensing and/or partnering arrangements without any such limitations.

We have also agreed not to issue any preferred equity or debt security convertible into or exchangeable for our common stock for 60 days after the date on which the registration statement of which this prospectus is a part is first declared effective and available for use, subject to certain exceptions.

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Blocker Provision We will not knowingly effect any conversion of any of these notes or make any interest payment or make-whole payment in shares of our common stock in respect of any of these notes, and you will not have the right to convert any portion of these notes, in any such case to the extent that after giving effect to such conversion or payment you would beneficially own 9.5% or more of the number of shares of our common stock outstanding immediately after giving effect to such conversion or payment. To the extent that this blocker provision prevents us from issuing to you sufficient shares of our common stock to satisfy in full any conversion or interest or make-whole payment obligation, we shall issue to you a number of warrants with an exercise price of zero, or zero strike price warrants, equal to the number of shares of our common stock that we are precluded by the terms of this blocker provision from issuing to you. Such zero strike price warrants shall have an expiration date of April 30, 2011 and will themselves contain provisions similar to this blocker provision.

Events of Default The following will be events of default under the indenture for the notes:

we fail to pay the principal of or any premium on the notes when due;

we fail to pay any interest on the notes when due and that default continues for 30 days; we fail to give the notice that we are required to give if there is a change in control;

we fail to perform any other covenant in the indenture and that failure continues for 60 days after written notice to us by the trustee or the holders of at least 25% in aggregate principal amount of outstanding notes;

we fail to pay when due the principal of any indebtedness for money borrowed by us or any of our subsidiaries in excess of \$10 million if the indebtedness is not discharged and such failure continues for 30 days or more, or, if such indebtedness has been accelerated and such acceleration is not annulled, within 30 days after written notice to us by the trustee or the holders of at least 25% in aggregate principal amount of the outstanding notes; and

certain events of bankruptcy, insolvency or reorganization with respect to Cell Therapeutics, Inc. and its significant subsidiaries specified in the indenture

See Description of Notes Events of Default.

Nasdaq National Market
Symbol for Our Common
Stock CTIC

Risk Factors

You should read the Risk Factors section, beginning on page 7 of this prospectus, so that you understand the risks associated with an investment in the notes.

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The ratio of earnings to fixed charges for each of the periods indicated is as follows:

	Year Ended December 31,					Three Months Ended March 31,	
	2001	2002	2003	2004	2005	2005	2006
Ratio of earnings to fixed charges(1)							

- (1) For the purposes of computing ratio of earnings to fixed charges, earnings consist of income (loss) before provision for income taxes plus fixed charges. Fixed charges consist of interest charges and that portion of rental payments under operating leases we believe to be representative of interest. Earnings for the years ended December 31, 2001, 2002, 2003, 2004 and 2005, and for the three months ended March 31, 2005 and 2006, were insufficient to cover fixed charges by \$80,273, \$49,903, \$130,031, \$252,298, \$102,505, \$39,132 and \$53,203 (in thousands) respectively.

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RISK FACTORS

You should carefully consider the risks described below and other information in this prospectus and in the documents incorporated by reference into this prospectus before deciding to invest in the notes or the common stock issuable upon conversion of the notes and for payments of interest and make-whole amounts that may be due on the notes. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties that we do not presently know or that we currently deem immaterial may also impair our business, financial condition, operating results and prospects. If any of the following risks actually occur, they could materially adversely affect our business, financial condition, operating results or prospects. In that case, the trading price of our securities could decline.

Risks Related To Our Business and the Securities Markets

Please see the information provided under the heading **Risk Factors** on page 27 of our Quarterly Report on Form 10-Q filed on May 10, 2006, which are incorporated by reference herein.

Risks Related To Our Notes

The notes will be subordinated to all of our existing and future secured indebtedness.

The notes will be unsecured and effectively subordinated in right of payment to all our existing and future secured indebtedness to the extent of the value of the assets secured by such assets. The notes are equal in right of payment to all of our other existing and future senior debt, including our 6.75% Convertible Senior Notes due 2010. In the event of our bankruptcy, liquidation or reorganization, or upon acceleration of the notes and other existing and future senior debt due to an event of default and in specific other events, our assets will be available to pay obligations on the notes and other existing and future senior debt only after any secured debt has been paid in full. There may not be sufficient assets remaining to pay amounts due on any of the notes that are then outstanding. The incurrence of additional secured or senior debt and other liabilities by us or our subsidiaries could impede our ability to pay obligations on the notes.

We anticipate that from time to time we will incur additional debt, including senior indebtedness. See **Description of Notes Ranking**.

The notes are effectively subordinated to all liabilities of our subsidiaries.

None of our subsidiaries has guaranteed or otherwise become obligated with respect to the notes. Accordingly, our right to receive assets from any of our subsidiaries upon its bankruptcy, liquidation or reorganization, and the right of holders of the notes to participate in those assets, is effectively subordinated to claims of that subsidiary's creditors, including trade creditors and lease obligations. Even if we were a creditor of any of our subsidiaries, our rights as creditor would be subordinate to any security interest in the assets of that subsidiary and any indebtedness of that subsidiary senior to that held by us. Furthermore, none of our subsidiaries is under any obligation to make payments to us, and any payments to us would depend on the earnings or financial condition of our subsidiaries and various other business considerations. Statutory, contractual or other restrictions may also limit our subsidiaries' ability to pay dividends or make distributions, loans or advances to us. For these reasons, we may not have access to any assets or cash flows of our subsidiaries to make payments on the notes.

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We may not have sufficient funds to repurchase or redeem the notes.

At maturity, the entire outstanding principal amount of the notes and any accrued and unpaid interest will become due and payable. If we experience a change in control, each holder of the notes may require us to repurchase all or a portion of that holder's notes. Upon any such repurchase of the notes in connection with a non-stock change of control or upon any automatic conversion of the notes, we will be required to pay holders of the notes repurchased or converted a make-whole payment in an amount equal to \$225 per \$1,000 principal amount of the notes less the amount of interest paid on such notes prior to the repurchase date or conversion date. Payment of principal at maturity must be in cash, while any make-whole payment or payment to repurchase notes in the event of a change of control may be made in cash, common stock or some combination of cash and common stock. At maturity, upon automatic conversion or if we experience a change in control and are unable to make any required payment in common stock, we may not have sufficient funds or may be unable to arrange for additional financing to pay the principal amount or repurchase price due on the notes then outstanding.

In addition, our borrowing arrangements or agreements relating to senior debt to which we become a party may contain restrictions on, or prohibitions against, our repurchases or redemptions of the notes. If the maturity date or change in control occurs at a time when our other arrangements prohibit us from repurchasing or redeeming the notes, we could try to obtain the consent of the lenders under those arrangements to purchase the notes, or we could attempt to refinance the borrowings that contain the restrictions. If we do not obtain the necessary consents or refinance these borrowings, we will be unable to repurchase or redeem the notes. In that case, our failure to repurchase or redeem any tendered notes or notes due upon maturity would constitute an event of default under the indenture governing the notes and other indebtedness. Any such default, in turn, may cause a default under the terms of our senior debt.

We may be unable to generate sufficient cash flow from which to make payments on the notes.

We expect to incur substantial net operating losses for the foreseeable future. We may not become profitable or sustain profitability in the future. Accordingly, if we are unable to make payments in common stock pursuant to the indenture or otherwise, we may not have sufficient funds to make payments on the notes.

There is no public market for the notes which may significantly impair the liquidity of the notes.

The notes were sold to the initial purchaser pursuant to an exemption from registration under the Securities Act and applicable state or foreign securities laws and neither the notes nor the common stock issuable upon conversion of the notes may be resold by purchasers unless the notes and the common stock issuable upon conversion of the notes are subsequently registered under the Securities Act or an exemption for the registration requirements of the Securities Act and applicable state or foreign securities laws is available for such resale.

Prior to the sale of the notes offered by this prospectus, there has been no public market for any of the notes offered by this prospectus, and there can be no assurance as to:

the liquidity of any such market that may develop

the ability of the holders to sell their notes or

the price at which the holder would be able to sell their notes

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If such a market were to exist, the notes could trade at prices that may be higher or lower than the principal amount or purchase price, depending on many factors, including prevailing interest rates, the market for similar notes, and our financial performance. We do not presently intend to apply for the listing of the notes on any securities exchange or for inclusion of the notes in the automated quotation system of the NASD.

The initial purchaser has advised us that it intends to make a market in the notes. The initial purchaser is not obligated, however, to make a market in the notes, and any such market-making may be discontinued at any time at the sole discretion of the initial purchaser. In addition, such market-making activity will be subject to the limits imposed by the Securities Act and the Exchange Act. Accordingly, no assurance can be given as to the development or liquidity of any market for the notes.

The notes may not be rated or may receive a lower rating than anticipated.

We believe it is unlikely that the notes will be rated. However, if one or more rating agencies rate the notes and assign the notes a rating lower than the rating expected by investors, or reduce the rating of the notes in the future, the market price of the notes and our common stock may be adversely affected.

If you convert any notes, the value of the common stock you receive may fluctuate significantly.

The market price of our common stock has fluctuated significantly and may continue to do so in the future. For the 12 months ended April 30, 2006, the closing sale price of our common stock has ranged from a low of \$1.83 to a high of \$2.97 per share. Because the notes are convertible into shares of common stock, fluctuations in the stock price may affect the trading price of the notes. The risk of price fluctuations of our common stock also applies to holders who receive shares of common stock upon conversion of the notes. Significant fluctuations in the market price of our common stock underlying the notes may occur in response to various factors and events, including, among other things:

the depth and liquidity of the trading market for our common stock;

quarterly variations in our actual or anticipated operating results;

changes in estimates of our financial results and prospects by securities analysts;

market conditions in the drug industry;

announcements and performance by our competitors;

regulatory actions; and

general economic conditions

In the past, our common stock has experienced volatility not necessarily related to announcements of our financial performance. Broad market fluctuations may also adversely affect the market price of the underlying common stock.

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LEGAL PROCEEDINGS

Please see the information provided under the heading "Legal Proceedings" on page 26 of our Quarterly Report on Form 10-Q filed May 10, 2006, which is incorporated by reference herein.

USE OF PROCEEDS

We will not receive any proceeds from the sale by any selling securityholder of the notes or the shares of common stock issuable upon conversion of the notes, for payments of interest and make-whole payments on the notes or upon exercise of the warrants.

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DESCRIPTION OF NOTES

The 7.5% Convertible Senior Notes due April 30, 2011 are issued under, and are governed by, an indenture, between us and U.S. Bank National Association, as trustee. Because this section is a summary, it does not describe every aspect of the notes, the indenture or the registration rights agreement. This summary is subject to, and qualified in its entirety by, reference to all the provisions of the indenture and the registration rights agreement, including definitions of certain terms used in the indenture or the registration rights agreement.

General

Ranking. The notes are our general, unsecured obligations. The notes are senior in right of payment, which means that they rank in right of payment equal to certain of our indebtedness, including our 6.75% Convertible Senior Notes due 2011, but are senior in right of payment to our 5.75% Convertible Subordinated Notes due 2008, our 5.75% Convertible Senior Subordinated Notes due 2008 and our 4% Convertible Senior Subordinated Notes due 2010. The notes will mature after our 6.75% Convertible Senior Notes due 2011. We are required to repay the full principal amount of the notes on April 30, 2011, unless they are previously converted, redeemed or repurchased.

Interest. The notes bear interest at the rate of 7.5% per annum from the date of issuance of the notes. We will pay interest twice a year, on each April 30 and October 31, beginning October 31, 2006, until the principal is paid or made available for payment or the notes have been converted. We will pay interest to the persons in whose name the note is registered at the close of business on the immediately preceding March 31 or September 30, as the case may be, which we refer to as a regular record date. Interest will be calculated on the basis of a 360-day year consisting of twelve 30-day months.

Interest on the notes is payable, at our option, in cash, common stock or some combination of cash and common stock having a fair market value equal to the interest payment due. For the purposes of payment in common stock, the fair market value of our common stock shall be equal to 95% of its volume-weighted average price for the five consecutive trading days ending on the trading day immediately preceding the interest payment date. Any such payment in common stock shall be in compliance with Nasdaq shareholder approval rules.

Conversion. You may convert the notes into shares of our common stock at any time before the close of business on April 30, 2011, unless the notes have been previously redeemed or repurchased. The initial conversion rate for the notes is 478.519 shares of common stock per \$1,000 principal amount of notes. This conversion rate is equivalent to a conversion price of approximately \$2.09 per share. The conversion rate is subject to adjustment as described below. Holders of notes submitted for redemption are entitled to convert the notes up to and including the business day immediately preceding the date fixed for redemption.

Optional Redemption. Prior to April 30, 2009, we will not have the right to redeem any notes at our option. On or after April 30, 2009, we shall have the right to redeem some or all of the notes for cash at any time. Such redemption will be at a price equal to the par value of the notes plus accrued and unpaid interest to, but not including, the redemption date.

Automatic Conversion. Subject to certain conditions, the notes will automatically convert if, at any time after June 26, 2006, and prior to maturity, the closing price per share of our common stock has exceeded 125% of the conversion price then in effect for at least 20 trading days within any 30-consecutive trading day period.

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Repurchase Upon Change in Control. If we experience a change in control, as described below, you will have the right to require us to repurchase your notes as described below under Repurchase at Option of Holders Upon a Change in Control.

Make-Whole Payments. Upon any automatic conversion of the notes, or if you exercise your right to require us to repurchase your notes in connection with a non-stock change of control (as defined in the indenture), we will pay to you an amount equal to \$225 per \$1,000 principal amount of your notes so converted or repurchased less the amount of any interest paid on such notes prior to the conversion or repurchase date. This payment may be made in cash, common stock or some combination of cash and common stock having a fair market value equal to the interest payment due. For the purposes of payment in common stock, the fair market value of our common stock shall be equal to 95% of its volume-weighted average price for the five consecutive trading days ending on the trading day immediately preceding the conversion or repurchase date. Any such payment in common stock shall be in compliance with Nasdaq shareholder approval rules.

Sinking Fund. No sinking fund is provided for the notes, which means that the indenture does not require us to redeem or retire the notes periodically.

Form, Denomination, Transfer, Exchange and Book-Entry Procedures

The notes are issued:

only in fully registered form;

without interest coupons; and

in denominations of \$1,000 and integral multiples thereof.

Principal of, premium, if any, and interest on the notes will be payable, and the notes may be presented for registration or exchange, at the office or agency we maintain for such purpose in the Borough of Manhattan, The City of New York. Until we designate otherwise, our office or agency will be the trustee's corporate trust office presently located in the Borough of Manhattan, The City of New York.

The notes are currently evidenced by one or more global notes that are deposited with the trustee as custodian for DTC and registered in the name of Cede & Co., as nominee of DTC. Except as set forth below, record ownership of the global note may be transferred, in whole or in part, only to another nominee of DTC or to a successor of DTC or its nominee.

The global note is not registered in the name of any person, nor can it be exchanged for notes that are registered in the name of any person, other than DTC or its nominee, unless either of the following occurs:

DTC has notified us that it is unwilling or unable to continue as depository for the global note or has ceased to be a clearing agency registered as such under the Exchange Act or announces an intention permanently to cease business or does in fact do so; or

an event of default with respect to the notes represented by the global note has occurred and is continuing.

In those circumstances, DTC will determine in whose names any notes issued in exchange for the global note will be registered.

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So long as the notes are registered in the name of Cede & Co. as nominee for DTC, DTC or its nominee will be considered the sole owner and holder of the global note for all purposes, and as a result:

you cannot receive notes registered in such holder's name if they are represented by the global notes;

you cannot receive certificated (physical) notes in exchange for your beneficial interest in the global notes;

you will not be considered to be the owner or holder of the global note or any note it represents for any purpose; and

all payments on the global note will be made to DTC or its nominee.

The laws of some jurisdictions require that certain kinds of purchasers can only own securities in physical, certificated form. These laws may limit your ability to acquire interest in the notes and to transfer or encumber your beneficial interests in the global note to these types of purchasers.

Only institutions, such as a securities broker or dealer, that have accounts with DTC or its nominee, called participants, and persons that may hold beneficial interests through participants can own a beneficial interest in the global note. The only place where the ownership of beneficial interests in the global note appears and the only way the transfer of those interests can be made is on the records kept by DTC (for its participants' interests) and the records kept by those participants (for interests participants hold on behalf of other persons).

Secondary trading in bonds and notes of corporate issuers is generally settled in clearinghouse (that is, next day) funds. In contrast, beneficial interests in a global note usually trade in DTC's same day funds settlement system, and settle in immediately available funds. We make no representation as to the effect that settlement in immediately available funds will have on trading activity in those beneficial interests.

So long as DTC through Cede & Co. is the sole registered holder of the notes, we will make payments of interest on, and the redemption or repurchase price of, the global note only to Cede & Co., the nominee for DTC, as the registered owner of the global notes. We will make these payments by wire transfer of immediately available funds or in shares of Common Stock on each payment date.

We understand that that, with respect to any payment of interest on, principal of, or repurchase price of, the global note, DTC's practice is to credit participants' accounts on the payment date with payments in amounts proportionate to their respective beneficial interests in the notes represented by the global note as shown on DTC's records, unless DTC has reason to believe that it will not receive payment on that payment date. Payments by participants to owners of beneficial interests in notes represented by the global notes held through participants are the responsibility of those participants, as is now the case with securities held for the accounts of customers registered in street name.

We also understand that neither DTC nor Cede & Co. will consent or vote with respect to the notes. We have been advised that under its usual procedures, DTC will mail an omnibus proxy to us as soon as possible after the record date. The omnibus proxy assigns Cede & Co.'s consenting or voting rights to those participants to whose accounts the notes are credited on the record date identified in a listing attached to the omnibus proxy.

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Because DTC can only act on behalf of participants, who in turn act on behalf of indirect participants, the ability of a person having a beneficial interest in the principal amount represented by the global note to pledge or otherwise encumber their interest in the note to persons or entities that do not participate in the DTC book entry system, or otherwise take actions in respect of that interest, may be adversely affected by the lack of a physical certificate evidencing its interest.

We understand that DTC will take any action permitted to be taken by a holder of notes (including the presentation of notes for exchange) only at the direction of one or more participants to whose account with DTC interests in the global note are credited and only in respect of such portion of the principal amount of the notes represented by the global note as to which such participant has, or participants have, given such direction.

We also understand that DTC is:

a limited purpose trust company organized under the laws of the State of New York;

a member of the Federal Reserve System;

a clearing corporation within the meaning of the Uniform Commercial Code, as amended; and

a clearing agency registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934.

DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between participants through electronic book-entry changes in accounts of its participants. Participants include securities brokers and dealers, banks, trust companies and clearing corporations and may include certain other organizations. Certain of such participants (or their representatives), together with other entities, own DTC. Indirect access to the DTC system is available to other entities such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a participant, either directly or indirectly.

DTC's policies and procedures, which may change periodically, will apply to payments, transfers, exchanges and other matters relating to beneficial interests in the global note. The trustee and we have no responsibility or liability for any aspect of DTC's or any participant's records relating to beneficial interests in the global note, including for payments made on the global note, and we and the trustee are not responsible for maintaining, supervising or reviewing any of those records.

Conversion Rights

You may, at your option, convert the principal amount of any note that is an integral multiple of \$1,000 into shares of our common stock at any time prior to the close of business on the maturity date, unless the note has been previously redeemed or repurchased. If the notes are called for redemption, you may convert your notes at any time before the close of business on the business day immediately preceding the date fixed for redemption. In each case, the initial conversion rate is equal to 478.519 shares per \$1,000 principal amount of notes, which is equivalent to a conversion price of approximately \$2.09 per share. The conversion rate is subject to adjustment as described below.

You can convert the note by delivering the note to the trustee's corporate trust office, accompanied by a duly signed and completed notice of conversion, a copy of which is attached to the indenture and may be obtained from the trustee. In the case of a global note, we have been informed that

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DTC will effect the conversion upon notice from the holder of a beneficial interest in the global note in accordance with DTC's rules and procedures. The conversion date will be the date on which the note and the duly signed and completed notice of conversion are so delivered to the trustee. As promptly as practicable on or after the conversion date, we will issue and deliver to the trustee a certificate or certificates for the number of full shares of common stock issuable upon conversion, together with payment in lieu of any fractional shares, and the trustee shall deliver the certificate(s) to the conversion agent for delivery to the holder of the note being converted. The shares of our common stock issuable upon conversion of the notes will be fully paid and nonassessable.

If you surrender a note for conversion on a date that is not an interest payment date, you will not be entitled to receive any interest for the period from the preceding interest payment date to the date of conversion, except as described below. However, if you are a holder of a note on a regular record date, including a note that is subsequently surrendered for conversion after the regular record date, you will receive the interest payable on such note on the next interest payment date. To correct for this resulting overpayment of interest, we will require that any note surrendered for conversion during the period from the close of business on a regular record date to the opening of business on the next interest payment date be accompanied by payment of an amount equal to the interest payable on such interest payment date on the principal amount of notes being surrendered for conversion. However, you will not be required to make that payment if you are converting a note, or a portion of a note, that we have called for redemption, or that you are entitled to require us to repurchase from you, if your conversion right would terminate because of the redemption or repurchase between the regular record date and the close of business on the next interest payment date.

In addition, if we distribute rights or warrants (other than those referred to in clause (2) below) pro rata to holders of common stock, so long as any such rights or warrants have not expired or been redeemed by us, the holder of any note surrendered for conversion will be entitled to receive upon such conversion, in addition to the shares of common stock issuable upon such conversion (which we refer to in this prospectus as the "conversion shares"), a number of rights or warrants to be determined as follows:

if such conversion occurs on or prior to the date for the distribution to the holders of rights or warrants of separate certificates evidencing such rights or warrants (which we refer to in this prospectus as the "distribution date"), the same number of rights or warrants to which a holder of a number of shares of common stock equal to the number of conversion shares is entitled at the time of such conversion in accordance with the terms and provisions of, and applicable to, the rights or warrants; and

if such conversion occurs after such distribution date, the same number of rights or warrants to which a holder of the number of shares of common stock into which such note was convertible immediately prior to such distribution date would have been entitled on such distribution date in accordance with the terms and provisions of, and applicable to, the rights or warrants.

No other payment or adjustment for interest, or for any dividends on our common stock, will be made upon conversion. If you receive common stock upon conversion of a note, you will not be entitled to receive any dividends payable to holders of common stock as of any record date before the close of business on the conversion date. We will not issue fractional shares upon conversion of notes. Instead, we will pay an amount in cash based on the closing sales price of our common stock on the conversion date.

If you deliver a note for conversion, you are not required to pay any taxes or duties in respect of the issuance or delivery of common stock on conversion. However, you are required to pay any tax or duty that may be payable in respect of any transfer involved in the issuance or delivery of our common

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stock in a name other than yours. We will not issue or deliver certificates representing shares of common stock unless the person requesting the issuance or delivery has paid to us the amount of any such tax or duty or has established to our satisfaction that no such tax or duty is payable.

The conversion rate is subject to adjustment if, among other things:

- (1) there is a dividend or other distribution payable in common stock on shares of our common stock;
- (2) we issue to all holders of common stock rights, options or warrants entitling them to subscribe for or purchase common stock at less than the then current market price, calculated as described in the indenture, of our common stock; however, if those rights, options or warrants are only exercisable upon the occurrence of specified triggering events, then the conversion rate will not be adjusted until the triggering events occur;
- (3) we subdivide, reclassify or combine our common stock;
- (4) we distribute to all holders of our common stock evidences of our indebtedness, shares of capital stock, cash or assets, including securities, but excluding:

those dividends, rights, options, warrants and distributions referred to in paragraphs (1) and (2) above;

dividends and distributions paid in cash (except as set forth in paragraphs (5) and (6) below); and

distributions upon a merger or consolidation as discussed below;

(5) we make a distribution consisting exclusively of cash (excluding portions of distributions referred to in clause (4) above and cash distributed upon a merger or consolidation as discussed below) to all holders of our common stock if the aggregate amount of the distribution combined together with (A) other such all cash distributions to all holders of our common stock made within the preceding 365-day period in respect of which no adjustment has been made and (B) any cash and the fair market value of other consideration payable in respect of any tender offer by us or any of our subsidiaries for our common stock concluded within the preceding 365-day period in respect of which no adjustment has been made, exceeds 10% of our market capitalization, being the product of the current market price per share of our common stock on the record date for such distribution and the number of shares of common stock then outstanding; or

(6) the successful completion of a tender offer made by us or any of our subsidiaries for our common stock that involves aggregate consideration that, together with (A) any cash and the fair market value of other consideration payable in a tender offer by us or any of our subsidiaries for our common stock concluded within the 365-day period preceding the completion of such tender offer in respect of which no adjustment has been made and (B) the aggregate amount of any such all cash distributions referred to in paragraph (5) above to all holders of common stock within the 365-day period preceding the expiration of such tender offer in respect of which no adjustments have been made, exceeds 10% of our market capitalization on the expiration of such tender offer.

To the extent that our rights plan is still in effect, upon conversion of the notes into common stock, the holders will receive, in addition to the common stock, the rights described in our rights plan, whether or not the rights have separated from the common stock at the time of conversion, subject to

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certain limited exceptions. See the section of this prospectus entitled "Description of Capital Stock" for more information. If we implement a new rights plan, we are required under the indenture to provide that the holder of notes receives the rights upon conversion of the notes, whether or not these rights were separated from the common stock prior to conversion, subject to certain limited exceptions.

We reserve the right to make such increases in the conversion rate in addition to those required by the provisions described above as we may consider to be advisable so that any event treated for United States federal income tax purposes as a dividend of stock or stock rights will not be taxable to the recipients. We are not required to make any adjustment to the conversion rate until the cumulative required adjustments amount to 1.0% or more of the conversion rate. We will compute any adjustments to the conversion rate and give notice to the holders of any such adjustments.

If we merge into or consolidate with another person or sell or transfer all or substantially all of our assets, each note then outstanding will, without the consent of the holder of any note, become convertible only into the kind and amount of securities, cash and other property receivable upon such consolidation, merger, sale or transfer by a holder of the number of shares of common stock into which the note was convertible immediately prior to the merger, consolidation or sale. This calculation will be made based on the assumption that the holder of common stock failed to exercise any rights of election that the holder may have had to select a particular type of consideration. The adjustment will not be made for a merger that does not result in any reclassification, conversion, exchange or cancellation of our common stock.

Ranking

The payment of the principal of, and premium, if any, and interest on the notes, and any amounts payable upon the repurchase of the notes, is equal in right of payment to the extent set forth in the indenture to the payment of our senior debt, as defined in the indenture.

With respect to the notes, "senior debt" means the principal of, and premium, if any, and interest" style="font-size:10.0pt;">

THE DAYTON FAMILY TRUST OF 1999

By:

/s/ Sky Dayton

Sky Dayton, Trustee

THE DAYTON CHILDREN S TRUST D/T/D 3/11/02

By:

/s/ Sky Dayton

Sky Dayton, Trustee