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SYNAPTIC PHARMACEUTICAL CORP
Form 10-Q
August 14, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

Mark One:

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

For the quarter ended June 30, 2001

OR

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

Commission File Number 0-27324

SYNAPTIC PHARMACEUTICAL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

22-2859704
(I.R.S. Employer Identification No.)

215 College Road
Paramus, NJ
(Address of principal executive offices)

07652
(Zip Code)

(201) 261-1331
(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, as amended, during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

As of August 1, 2001, there were 10,942,222 shares of the registrant's Common Stock outstanding.

SYNAPTIC PHARMACEUTICAL CORPORATION

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JUNE 30, 2001

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SYNAPTIC PHARMACEUTICAL CORPORATION BALANCE SHEETS

(in thousands, except share and per share information)

	June 30, 2001	December 31, 2000
Assets		

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	(Unaudited)	(Audited)

Current assets:		
Cash and cash equivalents	\$ 9,990	\$ 2,037
Marketable securities--current maturities	7,467	20,627
Other current assets	855	814

Total current assets	18,312	23,478
Property and equipment, net	4,541	4,781
Marketable securities	6,066	8,938
Patent and patent application costs, net	76	227
Other assets	237	147

	\$ 29,232	\$ 37,571
=====		
Liabilities and Stockholders' Equity		

Current liabilities:		
Accounts payable	\$ 1,689	\$ 1,128
Accrued liabilities	957	648
Accrued compensation	174	348
Deferred revenue	771	354

Total current liabilities	3,591	2,478
Deferred rent obligation	704	564
Stockholders' equity:		
Preferred Stock, \$.01 par value; authorized--1,000,000 shares	-	-
Common Stock, \$.01 par value; authorized--25,000,000 shares issued and outstanding--10,940,222 shares in 2001 and 10,935,772 shares in 2000	109	109
Additional paid-in capital	99,413	99,392
Accumulated other comprehensive income--net unrealized gains (losses) on securities	76	(183)
Accumulated deficit	(74,661)	(64,789)

Total stockholders' equity	24,937	34,529

	\$ 29,232	\$ 37,571
=====		

See notes to financial statements.

SYNAPTIC PHARMACEUTICAL CORPORATION
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(in thousands, except share and per share information)
(Unaudited)

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	For the three months ended June 30,		For the six months ended June 30,	
	2001	2000	2001	2000

Revenues:				
Contract revenue	\$ 290	\$ 271	\$ 577	\$ 485
License revenue	83	83	166	83

Total revenues	354	354	743	568

Expenses:				
Research and development	4,087	3,540	8,100	6,679
General and administrative	1,757	1,474	3,547	2,838

Total expenses	5,844	5,014	11,647	9,517

Loss from operations	(5,471)	(4,660)	(10,904)	(8,949)

Other income, net:				
Interest income	356	556	778	1,134
Other	123	10	254	17

Other income, net	479	566	1,032	1,151

Net loss	\$ (4,992)	\$ (4,094)	\$ (9,872)	\$ (7,798)
=====				
Comprehensive loss:				
Net loss	\$ (4,992)	\$ (4,094)	\$ (9,872)	\$ (7,798)
Unrealized (losses) gains arising during period	(70)	46	259	70

Comprehensive loss	\$ (5,062)	\$ (4,048)	\$ (9,613)	\$ (7,728)
=====				
Basic and diluted net loss per share				
	\$ (0.46)	\$ (0.38)	\$ (0.90)	\$ (0.72)
=====				
Shares used in computation of net loss per share				
	10,938,949	10,843,647	10,938,331	10,814,183
=====				

See notes to financial statements.

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(in thousands)
(Unaudited)

For the six months ended June 30, 2001 and 2000

	2001	2000

Operating activities:		
Net loss	\$ (9,872)	\$ (7,798)
Adjustments to reconcile net loss to net cash (used in) operating activities:		
Depreciation and patent amortization	693	778
Amortization of premiums (discounts) on securities	201	237
Deferred rent, net	50	164
Changes in operating assets and liabilities:		
Increase in other current assets	(41)	(43)
Increase in accounts payable, accrued liabilities and accrued compensation	696	179
Increase in deferred revenue	417	1,083

Net cash (used in) operating activities	(7,856)	(5,400)
Investing activities:		
Proceeds from sale or maturity of investments	18,090	3,487
Purchases of investments	(2,000)	--
Purchases of property and equipment	(318)	(650)
Proceeds from sale of equipment	16	--

Net cash provided by investing activities	15,788	2,837
Financing activities:		
Issuance of common stock	21	520

Net cash provided by financing activities	21	520

Net increase (decrease) in cash and cash equivalents	7,953	(2,043)
Cash and cash equivalents at beginning of period	2,037	6,236

Cash and cash equivalents at end of period	\$ 9,990	\$ 4,193
=====		

See notes to financial statement.

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Note 1 -- Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with the instructions to Form 10-Q and may not include all information and footnotes required for a presentation in accordance with generally accepted accounting principles. In the opinion of the management of Synaptic Pharmaceutical Corporation (the "Company"), these financial statements include all normal and recurring adjustments necessary for a fair presentation of the financial position and the results of operations and cash flows of the Company for the interim periods presented. For more complete financial information, these financial statements should be read in conjunction with the audited financial statements for the fiscal year ended December 31, 2000, and notes thereto included in the Company's 2000 Annual Report on Form 10-K. The results of operations for the fiscal quarter ended June 30, 2001, are not necessarily indicative of the results of operations to be expected for the full year.

Note 2 - Subsequent Event

On August 3, 2001, the Company sold to investors (the "purchasers"), 9,438 shares of its newly designated Series B Senior Convertible Preferred Stock (the "Series B Preferred Stock") in a private equity placement led by Warburg Pincus LLC, for \$9,438,000. These shares of Series B Preferred Stock are convertible into 2,176,760 shares of common stock and have voting rights equal to those of the common stock on an as-converted basis. Each share of the Series B Preferred Stock has a liquidation preference of \$1,000 and is redeemable at the Company's option under certain market conditions that may occur after August 3, 2003. The purchasers also acquired certain anti-dilution and registration rights. Net proceeds, after giving effect to underwriting discounts and estimated offering expenses, were approximately \$8,450,000.

Additionally, the Company is seeking shareholder approval to issue additional preferred stock in an amount and at a price that, when combined with the Series B Preferred Stock described above, would result in the total issuance of preferred stock which would be convertible into 7,564,584 shares of common stock at a weighted-average price of \$5.42 per common share. The additional preferred stock would be pari passu in all material respects with the Series B Preferred Stock.

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

Overview

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Synaptic Pharmaceutical Corporation ("Synaptic" or the "Company") is a drug discovery company utilizing G protein-coupled receptors ("GPCRs") as targets for novel therapeutics. The Company is utilizing its large portfolio of patented GPCR targets as a basis for the creation of improved drugs that act through these targets. The Company and its licensees are first utilizing these receptor targets to discover their function in the body and thus specific physiological disorders with which they may be associated, and secondly, to design compounds that can potentially be developed as drugs.

The Company is currently collaborating with Grunenthal GmbH ("Grunenthal") and Kissei Pharmaceutical Co., Ltd. ("Kissei"). Concurrently with the establishment of the collaborative arrangement with Grunenthal, the Company granted a license to certain of its technology and patent rights.

In addition to ongoing collaborative arrangements, other pharmaceutical companies have licenses to certain of our technology and patent rights. For convenience of reference, the agreements pursuant to which the licenses referred to in this paragraph and the preceding paragraph have been granted are collectively referred to as the "License Agreements."

Since inception, the Company has financed its operations primarily through the sale of its stock, through contract and license revenue under certain of its License Agreements, and through interest income and capital gains resulting from its investments. We also have received monies through government grants under the Small Business Innovative Research ("SBIR") program of the National Institutes of Health and through the sale of a portion of New Jersey State net operating losses carryforwards.

Under the License Agreements, the Company may receive one or more of the following types of revenue: license revenue, contract revenue, royalty revenue or revenue from the sales of drugs. License revenue represents non-refundable payments for a license to one or more of our patents and/or a license to our technology. Payments for licenses are recognized as they are received or, if earlier, when they become guaranteed, provided they are independent of any continuing research activity, otherwise, they are recognized pro-rata during the term of the related research agreement in accordance with Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements". Contract revenue includes research funding to support a specified number of Synaptic's scientists and payments upon the achievement of specified research and development milestones. Research funding revenue is recognized ratably over the period of the collaboration to which it relates and is based upon predetermined funding requirements. Research and development milestone payment revenue is recognized when the related research or development milestone is achieved. Under each of the License Agreements (other than the Grunenthal Agreement), we are entitled to receive royalty payments based upon the sales of drugs that may be developed using our technology or that may be covered by our patents. Under the Grunenthal Agreement, Synaptic has development and marketing rights in certain geographical areas with respect to drugs, if any, that are jointly identified as part of the collaboration with Grunenthal. Accordingly, we may receive revenue from sales in our geographical areas (as defined) of drugs if we market them independently, or we may receive royalty payments if we license our marketing rights to a third party. To date, we have not received either royalty revenue or revenue from the sales of drugs and we do not expect to receive such revenues for a number of years, if at all.

To date, the Company's expenditures have been for research and development related expenses, general and administrative related expenses, fixed asset purchases and various patent related expenditures incurred in protecting our technologies. Synaptic has been historically unprofitable and had an accumulated deficit of \$74,661,000 at June 30, 2001. We expect to continue to incur operating losses for a number of years and may not become profitable, unless and

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until we receive royalty revenue or revenue from sales of drugs that may be developed with the use of our technology or patent rights.

Results of Operations

Comparison of the Three Months Ended June 30, 2001 and 2000

Revenues. The Company recognized revenue of \$373,000 and \$354,000 for the three months ended June 30, 2001 and 2000, respectively.

Research and Development Expenses. The Company incurred research and development expenses of \$4,087,000, and \$3,540,000 for the three months ended June 30, 2001 and 2000, respectively. The increase of \$547,000, or 15%, was attributable primarily to an increase in preclinical testing costs partially offset by a reduction in supply costs.

General and Administrative Expenses. The Company incurred general and administrative expenses of \$1,757,000 and \$1,474,000 for the three months ended June 30, 2001 and 2000, respectively. The increase of \$283,000, or 19%, was attributable primarily to legal expenses related to the Company's patent infringement lawsuit with Panlabs, Inc.

Other Income, Net. The Company recorded other income of \$479,000 and \$566,000 for the three months ended June 30, 2001 and 2000, respectively. The decrease of \$87,000 was primarily due to lower cash, cash equivalent and marketable securities balances during 2001 as a result of the utilization of these resources to fund the Company's operations partially offset by an increase in rental income from the Company's sublessees.

Net Loss and Basic and Diluted Net Loss Per Share. The net loss incurred by the Company was \$4,992,000 (\$0.46 per share), and \$4,094,000 (\$0.38 per share) for the three months ended June 30, 2001 and 2000, respectively. The increase in net loss per share of \$0.08 resulted primarily from higher expenses and lower other income during the second quarter of 2001 as described above.

Comparison of the Six Months Ended June 30, 2001 and 2000

Revenues. The Company recognized revenue of \$743,000 and \$568,000 for the six months ended June 30, 2001 and 2000, respectively. The increase in revenue of \$175,000 resulted from revenue derived under the second year of the Company's agreement with Kissei.

Research and Development Expenses. The Company incurred research and development expenses of \$8,100,000, and \$6,679,000 for the six months ended June 30, 2001 and 2000, respectively. The increase of \$1,421,000, or 21%, was attributable primarily to increases in preclinical testing costs and temporary staffing costs.

General and Administrative Expenses. The Company incurred general and administrative expenses of \$3,547,000 and \$2,838,000 for the six months ended June 30, 2001 and 2000, respectively. The increase of \$709,000, or 25%, was attributable primarily to legal expenses related to the Company's lawsuit and an increase in fringe benefit expense resulting from an increase in healthcare claims.

Other Income, Net. The Company recorded other income of \$1,032,000 and \$1,151,000 for the six months ended June 30, 2001 and 2000, respectively. The decrease of \$119,000 was primarily due to lower cash, cash equivalent and marketable securities balances during 2001 as a result of the utilization of these resources to fund the Company's operations offset by an increase in rental income from the Company's sublessees.

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Net Loss and Basic and Diluted Net Loss Per Share. The net loss incurred by the Company was \$9,872,000 (\$0.90 per share), and \$7,798,000 (\$0.72 per share) for the six months ended June 30, 2001 and 2000, respectively. The increase in net loss per share of \$0.18 resulted primarily from higher expenses and lower other income partially offset by higher revenues during the first half of 2001 as described above.

Operating Trends

Revenues may vary from period to period depending on numerous factors including the timing of revenue earned under the License Agreements and revenue that may be earned under future collaborative and/or license agreements. Synaptic will recognize revenue under its research and licensing agreement with Kissei Pharmaceutical Co., Ltd. during 2001 and expects to recognize additional revenues under this agreement during 2002. Under the terms of certain of the License Agreements, revenues may be recognized if certain milestones are achieved. We continue to assess the opportunity for obtaining additional funding under new collaborative and/or license agreements as well as obtaining financing through equity transactions. We continue to monitor our spending level in order to insure that we have enough cash to last at least through the year 2002.

Since late 2000, we have been pursuing a new business strategy of increasing our internal drug discovery efforts. This new strategy requires us to hire additional preclinical employees with drug development expertise and to incur additional preclinical expenses as well as to incur costs associated with clinical trials. If we obtain the anticipated net proceeds of the sale of shares to be sold at the second closing, we will increase our drug development efforts thereby incurring a greater level of expenditures. If the stockholders do not approve the sale of the shares to be sold in the second closing, expenditures related to our implementation of this strategy will increase at a slower rate.

Legal expenses are expected to be a significant expense as a result of a suit filed by the Company. See "Legal Proceedings" in PART II, Item 1, hereof.

If the stockholders do not approve the sale of shares to be sold at the second closing (see Note 2 - Subsequent Event in Part I, Item 1, hereof), other income, net is expected to decline over the remainder of 2001 and in 2002 as existing funds, including funds received from the sale of Series B Preferred Stock on August 3, 2001, are utilized to support the Company's operations. This decline will be partially offset by rental income that we expect to recognize under our existing sublease agreements.

The Company is pursuing further sales of its State net operating loss ("NOL") carryforwards and its State research and development credits under the State of New Jersey's Technology Business Tax Certificate Transfer Program (the "Program"). No assurance can be given, however, as to the amount of NOL carryforwards that may be sold under the Program in any one year. External factors that may have an effect on future NOL sales are such items as: limitations imposed by State law, the availability of buyers and related demand.

Property and equipment spending may vary from period to period depending on numerous factors, including the number of collaborations in which we are involved at any given time and replacement due to normal wear and obsolescence. Equipment spending in 2001 is expected to decline from that of 2000.

At June 30, 2001, the Company held marketable securities with an estimated fair value of \$13,533,000. The Company's primary interest rate exposure results from changes in short-term interest rates. The Company does not purchase financial instruments for trading or speculative purposes. All of the marketable securities held by the Company are classified as available-for-sale securities. The following table provides information about marketable securities held by the

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Company at June 30, 2001:

	Principal Amount and Weighted Average Stated Rate by Expected Maturity					Estimated Fair Value
(000's)	2001	2002	2003	2004	Total	(000's)
Principal	\$7,350	\$2,500	\$1,500	\$2,000	\$13,350	\$13,533
Weighted Average Stated Rates	9.03%	6.50%	6.20%	5.25%	7.67%	--

The stated rates of interest expressed in the above table may not approximate the actual yield of the securities which the Company currently holds since the Company has purchased some of its marketable securities at other than face value. Additionally, some of the securities represented in the above table may be called or redeemed, at the option of the issuer, prior to their expected due dates. If such early redemptions occur, the Company may reinvest the proceeds realized on such calls or redemptions in marketable securities with stated rates of interest or yields that are lower than those of current holdings, affecting both future cash interest streams and future earnings.

In addition to investments in marketable securities, the Company places some of its cash in money market funds in order to keep cash available to fund operations and to hold cash pending investments in marketable securities. Fluctuations in short term interest rates will affect the yield on monies invested in such money market funds. Such fluctuations can have an impact on future cash interest streams and future earnings of the Company, but the impact of such fluctuations are not expected to be material.

The Company does not believe that inflation has had a material impact on its results of operations.

Liquidity and Capital Resources

At June 30, 2001 and December 31, 2000, cash, cash equivalents and marketable securities aggregated \$23,523,000 and \$31,602,000, respectively. This decrease was a result of the utilization of these resources to fund the Company's operations.

To date, Synaptic has met its cash requirements through the sale of its stock, through contract and license revenue, through interest income and gains resulting from its investments, through SBIR grants and through the sale of a portion of its State NOL carryforwards. If the current public biotechnology financing environment remains unfavorable, raising additional capital in the public markets may be difficult.

Synaptic leases laboratory and office facilities under an agreement expiring on December 31, 2015. The minimum annual payment under the lease is currently \$2,249,000. The lease provides for fixed escalations in rent payments in the years 2005 and 2010.

At June 30, 2001, the Company had \$23,523,000 in cash, cash equivalents and marketable securities. On August 3, 2001, the Company received net proceeds of approximately \$8,450,000 from the sale of Series B Preferred Stock. If the stockholders approve the issuance of shares of preferred stock, we anticipate that we will receive net proceeds of approximately \$29,150,000 and that this closing will occur in the third or fourth quarter of 2001. The Company currently intends to utilize these funds primarily for clinical trials, to move our drug

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discovery programs forward, for patent related expenditures, for general corporate purposes, to make leasehold improvements to its facilities and to purchase property and equipment. We expect to continue to incur operating losses for a number of years. We believe that cash, cash equivalents and marketable securities on hand, including cash received from the closing of the Series B Preferred Stock sold on August 3, 2001, and cash that we expect to receive through interest payments on investments, will be sufficient to fund operations, as well as to support our share of certain development costs under the Grunenthal Agreement, through at least the year 2002.

As of December 31, 2000, the Company had NOL carryforwards ("NOL's") of approximately \$57,000,000 for Federal income tax purposes that will expire principally in the years 2002 through 2020. In addition, the Company had research and development credit carryforwards of approximately \$1,610,000, which will expire principally in 2002 through 2018. Also at December 31, 2000, Synaptic had NOL carryforwards of approximately \$41,637,000 for State income tax purposes and State research and development credit carryforwards of \$475,000. For financial reporting purposes, a valuation allowance has been recognized to offset the deferred tax assets related to these carryforwards. Due to the limitations imposed by the Tax Reform Act of 1986, and as a result of significant changes in the Company's ownership in 1993 and 1997, the utilization of \$25,000,000 of Federal NOL carryforwards is subject to annual limitation. The utilization of the research and development credits is similarly limited. If the stockholders approve the sale of the shares to be sold in the second closing, there would not be an ownership change that would further limit the utilization of these NOL's at the time of such closing.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivatives and Hedging Activities" ("SFAS 133"), which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. SFAS 133, as amended, is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. The adoption of SFAS 133 had no effect on Synaptic's results of operations, financial position or cash flows.

This Report on Form 10-Q contains "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Such statements include, but are not limited to, those relating to future cash and spending plans, amounts of future research funding, and any other statements regarding future growth, future cash needs, future operations, business plans and financial results, and any other statements which are not historical facts. When used in this document, the words "expects," "may," "believes," and similar expressions are intended to be among the words that identify forward-looking statements. Such statements involve risks and uncertainties, including, but not limited to, those risks and uncertainties detailed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 (the "2000 Form 10-K"), including in Item 1 of the 2000 Form 10-K under the captions "Patents, Proprietary Technology and Trade Secrets," "Competition" and "Government Regulation" as well as in the section entitled "Disclosure Regarding Forward-Looking Statements" under the captions "Early Stage of Product Development; Technological Uncertainty," "Dependence on Collaborative Partners and Licensees for Development, Regulatory Approvals, Manufacturing, Marketing and Other Resources" and "Uncertainties Related to Clinical Trials" or detailed from time to time in filings the Company makes with the SEC. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual outcomes may vary materially from those indicated. Although the Company believes that the expectations reflected in the forward-looking statements contained herein are

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reasonable, it can give no assurance that such expectations will prove to be correct. The Company expressly disclaims any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement contained herein to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Quantitative and qualitative disclosures about market risk (i.e., interest rate risk) are included in Item 2 of this Report.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On June 5, 2000, the Company filed suit in the United States District Court for the District of New Jersey against M.D.S. Panlabs, Inc., a Washington corporation, and Panlabs Taiwan Ltd., a Taiwanese corporation (collectively, "Panlabs"). The suit alleges that Panlabs has infringed several issued U.S. Patents owned by the Company, which relate to cloned human receptors and their use in binding assays. The suit also alleges that Panlabs has been importing, selling and offering to sell products of the Company's patented binding assay processes to pharmaceutical companies and others in the United States and particularly in New Jersey.

In the suit, the Company seeks an injunction against Panlabs' infringing activities, an award of damages for the Company's lost profits, the destruction of data obtained by the infringement of its patents, and other relief.

Company management believes that its complaint against Panlabs is well founded and necessary to protect the value of its intellectual property portfolio.

Management believes that the ultimate resolution of the above matter could have a material impact on the Company's financial position, results of

operations and cash flows.

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

On May 10, 2001, the Company held its annual meeting of stockholders for the following purposes: (i) to elect a Class II director to the Board of Directors (Proposal No. 1); and (ii) to ratify the appointment by the Board of Directors of Ernst & Young LLP as the independent auditors of the Company for the fiscal year ending December 31, 2001 (Proposal No. 2).

The stockholders elected the person named below, the Company's nominee for director, as a Class II director of the Company, casting votes for such nominee or withholding votes as indicated:

	VOTES FOR	VOTES WITHHELD
John E. Lyons.....	8,217,348	44,311

The stockholders approved Proposal No. 2 as follows:

VOTES FOR	VOTES AGAINST	VOTES ABSTAINED	BROKER NON-VOTES
8,247,690	11,031	2,938	N/A

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Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None

(b) Reports on Form 8-K

None

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SIGNATURE PAGE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SYNAPTIC PHARMACEUTICAL CORPORATION

Date: August 14, 2001

By: /s/ Kathleen P. Mullinix

Name: Kathleen P. Mullinix
Title: Chairman, President and
Chief Executive Officer

By: /s/ Robert L. Spence

Name: Robert L. Spence
Title: Senior Vice President,
Chief Financial Officer &
Treasurer

