

Cyclacel Pharmaceuticals, Inc.
Form 10-Q
May 09, 2007
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from _____ to _____

Commission file number 0-50626

CYCLACEL PHARMACEUTICALS, INC.

(Exact name of Registrant as Specified in Its Charter)

DELAWARE
(State or Other Jurisdiction
of Incorporation or Organization)
200 CONNELL DRIVE, SUITE 1500, BERKELEY HEIGHTS, NJ
(Address of principal executive offices)

91-1707622
(I.R.S. Employer
Identification No.)
07922
(Zip Code)

Registrant's telephone number, including area code: (908) 517 7330

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" as defined in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Edgar Filing: Cyclacel Pharmaceuticals, Inc. - Form 10-Q

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

As of May 9, 2007 there were 20,407,659 shares of the registrant's common stock outstanding.

CYCLACEL PHARMACEUTICALS, INC.

INDEX

	Page
PART I FINANCIAL INFORMATION	
<u>Item 1.</u> <u>Financial Statements</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets as of March 31, 2007</u> <u>(unaudited) and December 31, 2006</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the three months</u> <u>ended March 31, 2007 and 2006 (unaudited) and the period from</u> <u>August 13, 1996 (inception) to March 31, 2007 (unaudited)</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Loss for the</u> <u>three months ended March 31, 2007 and 2006 (unaudited) and the</u> <u>period from August 13, 1996 (inception) to March 31, 2007 (unaudited)</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the three months</u> <u>ended March 31, 2007 and 2006 (unaudited) and the period from</u> <u>August 13, 1996 (inception) to March 31, 2007 (unaudited)</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	<u>8</u>
<u>Item 2.</u> <u>Management's Discussion and Analysis of Financial Condition and</u> <u>Results of Operations</u>	<u>14</u>
<u>Item 3.</u> <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>24</u>
<u>Item 4.</u> <u>Controls and Procedures</u>	<u>25</u>
PART II OTHER INFORMATION	
<u>Item 1.</u> <u>Legal Proceedings</u>	<u>26</u>
<u>Item 1A.</u> <u>Risk Factors</u>	<u>26</u>
<u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>42</u>
<u>Item 3.</u> <u>Defaults Upon Senior Securities</u>	<u>42</u>
<u>Item 4.</u> <u>Submission of Matters to a Vote of Security Holders</u>	<u>42</u>
<u>Item 5.</u> <u>Other Information</u>	<u>42</u>
<u>Item 6.</u> <u>Exhibits</u>	<u>42</u>
<u>Signature</u>	<u>43</u>

Table of Contents

PART I. FINANCIAL INFORMATION

CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED BALANCE SHEETS

	As of December 31, 2006 (Note 1) \$000	As of March 31, 2007 (Unaudited) \$000
ASSETS		
Current assets:		
Cash and cash equivalents	44,238	75,215
Short-term investments	9,764	5,536
Prepaid expenses and other current assets	4,163	4,480
Total current assets	58,165	85,231
Property, plant and equipment (net)	2,121	2,025
Deposits and other assets	241	241
Goodwill	2,749	2,749
Total assets	63,276	90,246
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	2,175	2,076
Accrued liabilities	3,324	2,468
Other current liabilities	290	173
Derivative liability	1,135	867
Current portion of other accrued restructuring charges	908	976
Current portion of equipment financing	89	19
Total current liabilities	7,921	6,579
Other accrued restructuring charges, net of current	1,436	1,229
Warrants liability	—	6,292
Total liabilities	9,357	14,100
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized at December 31, 2006 and March 31, 2007, respectively; 2,046,813 shares issued and outstanding at December 31, 2006 and March 31, 2007, respectively. Aggregate preference in liquidation of \$20,673,000 at December 31, 2006 and March 31, 2007	2	2
Common stock, \$0.001 par value; 100,000,000 shares authorized at December 31, 2006 and March 31, 2007, respectively; 16,157,953 and 20,407,659 shares issued and outstanding at December 31, 2006 and March 31, 2007, respectively	16	20
Additional paid-in capital	194,714	221,861
Accumulated other comprehensive loss	(2,537)	(2,571)

Edgar Filing: Cyclacel Pharmaceuticals, Inc. - Form 10-Q

Deficit accumulated during the development stage	(138,276)	(143,166)
Total stockholders' equity	53,919	76,146
Total liabilities and stockholders' equity	63,276	90,246

SEE NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3

Table of Contents

CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	For the three months ended		Period from
	March 31		August 13,
	2006	2007	1996
			(inception)
			to
			March 31,
			2007
	\$000, except per share and share amounts		
Revenues:			
Collaboration and research and development revenue	95	10	3,000
Grant revenue	56	42	3,519
	151	52	6,519
Operating expenses: ⁽²⁾			
Research and development	(8,004)	(3,977)	(125,952)
General and administrative	(3,915)	(2,632)	(38,585)
Other restructuring costs	—	(80)	(305)
Total operating expenses	(11,919)	(6,689)	(164,842)
Operating loss	(11,768)	(6,637)	(158,323)
Other income (expense):			
Costs associated with aborted 2004 IPO	—	—	(3,550)
Change in valuation of derivative	—	(40)	(255)
Change in valuation of warrants	—	458	458
Interest income	127	828	9,435
Interest expense	(68)	(51)	(3,967)
Total other income (expense)	59	1,195	2,121
Loss before taxes	(11,709)	(5,442)	(156,202)
Income tax benefit	360	552	13,036
Net loss	(11,349)	(4,890)	(143,166)
Dividends on Preferred Ordinary shares	(2,827)	—	(38,123)
Net loss applicable to ordinary shareholders	(14,176)	(4,890)	(181,289)
Net loss per share – basic and diluted	\$ (2.09)	\$ (0.27)	

Edgar Filing: Cyclacel Pharmaceuticals, Inc. - Form 10-Q

Weighted average shares⁽¹⁾ 6,793,293 18,188,350

(1) Weighted average shares have been adjusted to reflect the equivalent Xcyte shares and equity structure.

(2) Amounts include stock-based compensation, consisting of stock-based compensation expense under SFAS 123R, the amortization of deferred stock-based compensation and the value of options issued to non-employees for services rendered, allocated as shown below:

	For the three months ended March 31,		Period from August 13, 1996 (inception) to March 31,
	2006	2007	2007
	\$000	\$000	\$000
Research and development	4,546	290	8,386
General and administrative	2,425	253	4,310
	6,971	543	12,696

SEE NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4

Table of Contents

CYCLACEL PHARMACEUTICALS, INC.

(A Development Stage Company)

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

	For the three months ended March 31,		Period from August 13, 1996 (inception) to March 31,
	2006	2007	2007
	\$000	\$000	\$000
Net loss	(11,349)	(4,890)	(143,166)
Currency translation	(1,853)	(34)	(2,576)
Comprehensive loss	(13,202)	(4,924)	(145,742)

SEE NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5

Table of Contents

CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the three months ended March 31,		Period from August 13, 1996 (inception) to March 31,
	2006	2007	2007
	\$000	\$000	\$000
Cash flows from operating activities:			
Net loss	(11,349)	(4,890)	(143,166)
Adjustments to reconcile net loss to net cash used in operating activities:			
Amortization of investment premiums, net	—	(20)	(49)
Change in valuation of derivative	—	40	255
Change in valuation of warrants	—	(458)	(458)
Depreciation and amortization	274	241	9,330
Unrealized foreign exchange loss	—	8	3,377
Deferred revenue	—	—	(98)
Compensation for warrants issued to non employees	—	—	1,215
Shares issued for IP rights	—	—	446
Loss on disposal of property, plant and equipment	—	—	27
Stock based compensation	6,971	543	12,697
Provision for restructuring	—	80	305
Amortization of issuance costs of Preferred Ordinary "C" shares	—	—	2,517
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(10)	(308)	(3,855)
Accounts payable and other current liabilities	1,778	(1,299)	(1,629)
Net cash used in operating activities	(2,336)	(6,063)	(119,086)
Investing activities:			
Purchase of property, plant and equipment	(46)	(142)	(6,811)
Proceeds from sale of property, plant and equipment	—	—	26
Short-term investments on deposit, net of maturities	7,181	4,249	(1,709)
Net cash provided by (used in) investing activities	7,135	4,107	(8,494)
Financing activities:			
Payment of capital lease obligations	(62)	(71)	(3,691)
Proceeds from issuance of ordinary and preferred ordinary shares, net of issuance costs	—	—	90,858
Proceeds from issuance of common stock and warrants, net of issuance costs	—	33,358	75,984
Payment of preferred stock dividend	—	(307)	(1,228)
Repayment of government loan	—	—	(455)

Edgar Filing: Cyclacel Pharmaceuticals, Inc. - Form 10-Q

Government loan received	—	—	414
Loan received from Cyclacel Group Plc	—	—	9,103
Proceeds of committable loan notes issued from shareholders	—	—	8,883

6

Table of Contents

	For the three months ended March 31,		Period from August 13, 1996 (inception) to March 31,
	2006	2007	2007
	\$000	\$000	\$000
Loans received from shareholders	—	—	1,645
Cash and cash equivalents assumed on stock purchase	17,915	—	17,915
Costs associated with stock purchase	(1,951)	—	(1,951)
Net cash provided by financing activities	15,902	32,980	197,477
Effect of exchange rate changes on cash and cash equivalents	(111)	(47)	5,318
Net increase in cash and cash equivalents	20,701	31,024	69,897
Cash and cash equivalents at beginning of period	3,117	44,238	—
Cash and cash equivalents at end of period	23,707	75,215	75,215
Supplemental disclosure of cash flows information:			
Cash received during the period for:			
Interest	364	800	9,285
Taxes	—	—	10,739
Cash paid during the period for:			
Interest	(119)	(45)	(868)
Schedule of non-cash transactions:			
Acquisitions of equipment purchased through capital leases	—	—	3,470
Issuance of Ordinary shares in connection with license agreements	—	—	592
Issuance of Ordinary shares on conversion of bridging loan	—	—	1,638
Issuance of Preferred Ordinary "C" shares on conversion of secured convertible loan notes and accrued interest	—	—	8,893
Issuance of Ordinary shares in lieu of cash bonus	—	—	164

SEE NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

7

Table of Contents

CYCLACEL PHARMACEUTICALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2007
(Unaudited)

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

The Company is a development-stage biopharmaceutical company dedicated to the discovery, development and eventual commercialization of novel, mechanism-targeted drugs to treat human cancers and other serious disorders. As a development stage enterprise, substantially all efforts of the Company to date have been devoted to performing research and development, conducting clinical trials, developing and acquiring intellectual properties, raising capital and recruiting and training personnel. The Company was incorporated in the state of Delaware in 1996 and is headquartered in Berkeley Heights, New Jersey with research facilities located in the United Kingdom.

The accompanying unaudited condensed consolidated financial statements as of March 31, 2007 and for the three month periods ended March 31, 2006 and 2007 have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The unaudited condensed interim financial statements have been prepared on the same basis as the annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the financial position and results of operations of Cyclacel Pharmaceuticals, Inc. have been included. Operating results for the three month period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These unaudited condensed financial statements should be read in conjunction with the Company's audited financial statements and footnotes related thereto for the year ended December 31, 2006 included in the Company's annual report on Form 10-K filed with the SEC on March 16, 2007.

2. Registered Direct Equity Offering

On February 16, 2007, the Company raised \$36 million in gross proceeds, before deducting placement agent fees and estimated offering expenses of \$2.6 million, in a "registered direct" offering through the sale of shares of its common stock and warrants. The Company entered into subscription agreements with these investors pursuant to which it has sold approximately 4.2 million units, each unit consisting of one share of common stock and a seven-year warrant to purchase 0.25 shares of common stock, at a purchase price of \$8.47125 per unit. The purchase price for the shares and the exercise price for the warrants was \$8.44 per share, the closing bid price for the Company's common stock on February 12, 2007. Investors in the financing paid \$0.125 per warrant. The Company has issued 4,249,668 shares of common stock and warrants to purchase 1,062,412 shares of common stock.

The Company has valued the warrants at \$6.3 million using a Black-Scholes pricing model with the following factors: risk free interest rate of 4.58%, volatility of 85%, dividend yield of 0% and a life of 6.88 years. Emerging Issues Task Force ("EITF") 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" requires freestanding contracts that are settled in a Company's own stock, including common stock warrants to be designated as an equity instrument, asset or liability. Under the provisions of EITF 00-19, a contract designated as an asset or a liability must be carried at fair value until exercised or expired, with any changes in fair value recorded in the results of operations. A contract designated as an equity instrument must be included within equity, and no fair value adjustments are required. The Company reviews the classification of its contracts at each balance sheet date.

Pursuant to EITF Issue No. 00-19, since the Company is unable to control all the events or actions necessary to settle the warrants in registered shares the warrants have been recorded as long-term liabilities at fair value. The fair value of

the outstanding warrants is evaluated at each reporting period with any resulting change in the fair value being reflected in the consolidated statements of operations. The change in fair value recognized in the financial statements during the first quarter of 2007 was \$458,000.

8

Table of Contents

In connection with the issuance of the common stock and warrants, the Company incurred placement agent fees, legal fees and other expenses of approximately \$2.6 million which have been charged to Additional Paid in Capital on the consolidated balance sheet.

3. STOCK BASED COMPENSATION

On January 1, 2006, the Company adopted Financial Accounting Standards Board Statement (“FASB”), Statement No. 123R, “Share-Based Payment” (“SFAS 123R”). SFAS 123R requires the Company to measure all share-based payment awards, including those with employees, granted, modified, repurchased or cancelled after, or that were unvested as of, January 1, 2006 at fair value. Under SFAS 123R, the fair value of stock options and other equity-based compensation must be recognized as expense in the statements of operations over the requisite service period of each award.

There are 1,615,795 shares of Cyclacel common stock reserved for issue under the equity incentive plans. A resolution to approve the amendment of the 2006 Equity Incentive Plan, (“2006 Plan”), to increase the number of shares of common stock issuable thereunder by an additional 1,384,205 shares, to an aggregate of 3,000,000 shares will be voted on by stockholders at the annual meeting of the Company in May 2007.

As of the date of this report, a total of 1,592,091 options have been granted pursuant to the equity incentive plans. In the first quarter of 2007, we granted 256,250 stock options to our non-executive directors under the 2006 Plan which vest ratably over the four years to March 8, 2011. The total fair value of all options granted under the 2006 Plan is \$6,704,000. In respect of these options, \$3,642,000 of compensation expense has not been recognized at March 31, 2007. A summary of activity for the options under our share option plans for the three months ended March 31, 2007 is as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in millions)
Balance as of January 1, 2007	1,335,841	\$ 6.72	9.44	—
Granted	256,250	\$ 7.80	10.00	—
Exercised	—	—	—	—
Expired	—	—	—	—
Cancelled/forfeited	—	—	—	—
Balance as of March 31, 2007	1,592,091	\$ 5.62	9.32	—
Unvested at March 31, 2007	828,528	\$ 7.05	9.41	—

Vested and exercisable at March 31, 2007	763,563	\$ 6.69	9.22	—
------------------------------------------	---------	---------	------	---

The fair value of the stock options granted during the quarter is calculated at each reporting date using the Black-Scholes option-pricing model prescribed by SFAS 123R using the following assumptions:

	For the three months ended March 31, 2007
Expected term	4.25 years
Risk free interest rate	4.56%
Volatility	70%
Dividends	0.00%
Resulting weighted average grant date fair value	\$ 4.48

The expected term assumption was estimated using past history of early exercise behavior and expectations about future behaviors.

9

Table of Contents

The expected volatility assumption was based on the historical volatility of our common stock since the merger with Xcyte Therapies, Inc. on March 27, 2006 together with an analysis of the historical volatilities of a peer group of similar biotechnology companies.

The weighted average risk-free interest rate represents interest rate for treasury constant maturities published by the Federal Reserve Board. If the term of available treasury constant maturity instruments is not equal to the expected term of an employee option, we use the weighted average of the two Federal Reserve securities closest to the expected term of the employee option.

Dividend yield has been assumed to be zero as (a) we have never declared or paid any dividends and (b) do not currently anticipate paying any cash dividends on our outstanding shares of common stock in the foreseeable future.

There were no stock option exercises for the period ended March 31, 2007. No income tax benefits would have been recorded if there had been stock option exercises. SFAS 123R prohibits recognition of tax benefits for exercised stock options until such benefits are realized. As the Company presently has tax loss carry forwards from prior periods and expects to incur tax losses in 2007, the Company would not be able to benefit from the deduction for exercised stock options in the current reporting period.

Cash used to settle equity instruments granted under share-based payment arrangements amounted to \$Nil during all periods presented.

4. COMMITMENTS AND CONTINGENCIES

In 2005, the Company recorded an accrued restructuring liability associated with abandoning the facility in Bothell, Washington. The lease term on this space expires December 2010. The restructuring liability was computed as the present value of the difference between the remaining lease payments due less the estimate of net sublease income and expenses. The accrual balance was adjusted in 2006 to reflect a change in estimate due to continued deterioration in the local real estate market. As of March 31, 2007 the accrued restructuring liability was \$2.2 million. This represents the Company's best estimate of the fair value of the liability. Subsequent changes in the liability due to accretion, or changes in estimates of sublease assumptions, etc. will be recognized as adjustments to restructuring charges in future periods.

The Company records payments of rent related to the Bothell facility as a reduction in the amount of the accrued restructuring liability. Accretion expense is recognized due to the passage of time, which is also reflected as a restructuring charge. Based on our current projections of estimated sublease income and a discount rate of 7.8%, the Company expects to record additional accretion expense of approximately \$269,000 over the remaining term of the lease.

In connection with the abandonment of the Seattle and Bothell facilities and the related sale of assets in late 2005 the Company has been subjected to a State sales tax audit by the Department of Revenue of the State of Washington. In this connection the Company accrued \$270,000 in the year ended December 31, 2006 as a State tax assessment. There has been no change in the Company's assessment of the liability and the \$270,000 remains included in the accompanying balance sheet as a component of accrued liabilities.

5. MERGER

On March 27, 2006, Xcyte Therapies, Inc., or Xcyte, completed the Stock Purchase Agreement with Cyclacel Group plc whereby Xcyte acquired all of Cyclacel Limited's, ("Limited"), outstanding shares of common stock from Cyclacel Group plc. Xcyte changed its name to Cyclacel Pharmaceuticals, Inc., or Cyclacel, and Cyclacel was listed on the Nasdaq Global Market under the ticker symbol CYCC. The transaction was considered a "reverse merger" and was accounted for as a purchase by Cyclacel under accounting principles generally accepted in the United States. Accordingly, the purchase price was allocated among the fair values of the assets and liabilities of Xcyte, while the historical results of Limited are reflected in the results of the combined company. The 1,967,966 shares of Xcyte common stock outstanding, the 2,046,813 preferred stock outstanding and the outstanding Xcyte options, were considered as the basis for determining the consideration in the reverse merger transaction.

10

Table of Contents

Merger Purchase Price

The consolidated financial statements reflect the merger of Limited with Xcyte as a reverse acquisition wherein Limited is deemed to be the acquiring entity from an accounting perspective. Under the purchase method of accounting, Xcyte's outstanding shares of common and preferred stock were valued using the average closing price on Nasdaq for the two days prior to through the two days subsequent to the announcement of the transaction date of December 15, 2005 of \$4.38 (as adjusted for a reverse stock split) and \$3.72 per share for common stock and preferred stock, respectively. There were 1,967,967 shares of common stock and 2,046,813 shares of preferred stock outstanding as of March 27, 2006. The fair values of the Xcyte outstanding stock options were determined using the Black-Scholes option pricing model with the following assumptions: stock price of \$4.38 (as adjusted for the reverse stock split), volatility of 0.97; risk-free interest rate of 4.0%; and an expected life of three months.

The purchase price is summarized as follows (in thousands):

Fair value of Xcyte outstanding common stock	\$ 8,620
Fair value of Xcyte outstanding preferred stock	7,618
Fair value of Xcyte outstanding stock options	17
Merger costs	1,951
Total purchase price	\$ 18,206

Merger Purchase Price Allocation

The purchase price allocation is as follows (in thousands):

Current assets	\$ 21,267
Property, plant and equipment	108
Other assets	259
Current liabilities	(4,400)
Non-current liabilities	(1,777)
Goodwill	2,749
	\$ 18,206

Pro Forma Results of Operations

The results of operations of Xcyte are included in Cyclacel's condensed consolidated financial statements from the date of the business combination transaction as of March 27, 2006. The following table presents pro forma results of operations and gives effect to the business combination transaction as if the business combination was consummated at the beginning of the period presented. The unaudited pro forma results of operations are not necessarily indicative of what would have occurred had the business combination been completed at the beginning of the retrospective periods or of the results that may occur in the future.

11

Table of Contents

	For the three months ended March 31,	
	2006	2007 (Actual)
	\$000	\$000
Revenues	5,151	52
Loss before taxes	(9,457)	(5,442)
Net loss applicable to ordinary shareholders	(14,751)	(4,890)
Net loss per share-basic and diluted	\$ (2.17)	(0.27)
Weighted average shares	6,793,293	18,188,350

6. STOCKHOLDERS' EQUITY

2006 Equity Incentive Plan

As of March 31, 2007, a total of 1,568,591 options, of the aggregate of 1,615,795 common stock issuable, have been issued under the 2006 Plan. The annual meeting of Cyclacel Pharmaceuticals, Inc. will be held on May 21, at which time the stockholders are being requested to approve the amendment of the 2006 Plan to increase the number of shares of common stock issuable thereunder by an additional 1,384,205 shares, to an aggregate of 3,000,000 shares.

Registered Direct Equity Offering

On February 16, 2007, the Company raised \$36 million in gross proceeds, before deducting placement agent fees and estimated offering expenses of \$2.6 million, in a “registered direct” offering through the sale of shares of its common stock and warrants. The Company entered into subscription agreements with these investors pursuant to which it has sold approximately 4.2 million units, each unit consisting of one share of common stock and a seven-year warrant to purchase 0.25 shares of common stock, at a purchase price of \$8.47125 per unit. The purchase price for the shares and the exercise price for the warrants was \$8.44 per share, the closing bid price for the Company’s common stock on February 12, 2007. Investors in the financing paid \$0.125 per warrant. The Company has issued 4,249,668 shares of common stock and warrants to purchase 1,062,412 shares of common stock.

Because the warrants issued in the “registered direct” are classified as a liability, the net proceeds received from offering must be allocated using a residual approach (based on the guidance in DIG Issue B-6). Under this approach, the fair value of the warrants is first determined using a Black-Scholes-Merton model. Then, any remaining proceeds (net of transaction costs) are allocated to the shares that were issued in the offering.

In connection with the issuance of the common stock and warrants, the Company incurred placement agent fees, legal fees and other expenses of approximately \$2.6 million which have been charged to Additional Paid-in Capital on the consolidated balance sheet.

7. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes”, an interpretation of SFAS 109, “Accounting for Income Taxes” (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company’s financial statements by prescribing a minimum probability threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides related guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006 and the Company adopted FIN 48 as of January 1, 2007. Due to the relatively simple operational nature of the Company, as well as the fact that the Company has incurred net operating losses since inception, the Company believes that its tax filing positions and deductions are more likely than not to be sustained on audit and does not anticipate any adjustments that will result in a material change in its financial

12

Table of Contents

position. Therefore, no reserves for uncertain tax positions have been recorded pursuant to FIN 48. In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48, nor has the Company recognized any interest or penalties related to uncertain tax positions in the statement of operations for the period ended March 31, 2007. Although no interest and penalties have been recognized, the Company, upon adoption of FIN

48, has elected a policy to classify any future interest and penalties as a component of interest expense. Tax years that remain subject to examination by taxing authorities include:

- 2005 and 2006 in the UK
- 2006 in the US

In September 2006, the FASB issued Statement of Financial Standards No. 157, “Fair Value Measurements” (“SFAS 157”). SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years and will be adopted by the Company as of January 1, 2008. SFAS 157 may impact our balance sheet and statement of operations in areas including the fair value measurements for derivative instruments. The Company is currently reviewing the provisions of SFAS 157 and has not yet determined the effect, if any, that adoption of SFAS 157 will have.

In February 2007, the FASB issued Statement of Financial Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (“SFAS 159”) which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 will be effective on January 1, 2008. The Company is currently evaluating the impact of adopting SFAS 159 on its financial position, cash flows and results of operations.

13

Table of Contents

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This report contains certain statements that may be deemed “forward-looking statements” within the meaning of United States securities laws. All statements, other than statements of historical fact, that address activities, events or developments that we intend, expect, project, believe or anticipate will or may occur in the future are forward-looking statements. Such statements are based upon certain assumptions and assessments made by our management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. Factors that could cause results to differ materially from those projected or implied in the forward looking statements are set forth in our Annual Report on Form 10-K for the year ended December 31, 2006, as updated below under the caption “Item 1A — Risk factors”.

We encourage you to read those descriptions carefully. We caution you not to place undue reliance on the forward-looking statements contained in this report. These statements, like all statements in this report, speak only as of the date of this report (unless an earlier date is indicated) and we undertake no obligation to update or revise the statements except as required by law. Such forward-looking statements are not guarantees of future performance and actual results will likely differ, perhaps materially, from those suggested by such forward-looking statements.

In this report, “Cyclacel,” the “Company,” “we,” “us,” and “our” refer to Cyclacel Pharmaceuticals, Inc.

Overview

We are a development-stage biopharmaceutical company dedicated to the discovery, development and eventual

commercialization of novel, mechanism-targeted drugs to treat human cancers and other serious disorders. Our core area of expertise is in cell cycle biology, or the processes by which cells divide and multiply. We focus primarily on the discovery and development of orally available anticancer agents that target the cell cycle with the aim of slowing the progression or shrinking the size of tumors, and enhancing quality of life and improving survival rates of cancer patients. We are generating several families of anticancer drugs that act on the cell cycle including Cyclin Dependent kinase (CDK) and Aurora kinase (AK) inhibitors. Although a number of pharmaceutical and biotechnology companies are currently attempting to develop CDK inhibitor drugs, we believe that our drug candidate, seliciclib, is the only orally available CDK inhibitor drug candidate currently in Phase IIb trials.

We are advancing three of our anticancer drug candidates, seliciclib, sapacitabine and CYC116 through in-house research and development activities. Seliciclib is currently being studied in a Phase IIb, multi-center, randomized, double-blinded trial to evaluate the efficacy and safety of seliciclib as a third line treatment in patients with non-small cell lung cancer (NSCLC). The APPRAISE study builds on the observation of prolonged stable disease experienced by heavily-pretreated NSCLC patients enrolled in a Phase I study of single agent seliciclib. We also plan to commence in 2007 a Phase II study of single agent seliciclib in nasopharyngeal carcinoma. Sapacitabine, our orally available nucleoside analog, has completed Phase I studies in approximately 150 patients at five centers in the United States. Sapacitabine has completed two Phase I studies evaluating 87 patients in refractory solid tumors. We are currently conducting a Phase Ib dose escalation clinical trial with sapacitabine for the treatment of patients with advanced malignancies with approximately 38 patients enrolled to date. Sapacitabine is planned to begin enter Phase II studies in 2007 in both hematological cancers and solid tumors. We announced the first study on April 30, 2007, when we initiated a Phase II clinical trial in patients with advanced cutaneous T-cell lymphoma. We are also developing CYC116, a novel inhibitor of Aurora kinases A and B and VEGFR2 for the treatment of cancer and we plan to commence Phase I clinical trials following the recent submission of an investigational new drug application to the Federal Drug Application. We have worldwide rights to commercialize seliciclib, sapacitabine and CYC116 and our business strategy is to enter into selective partnership arrangements with these programs. We are also progressing further novel drug series, principally for cancer, which are at earlier stages. Taken together, our pipeline covers all four phases of the cell cycle, which we

14

Table of Contents

believe will improve the chances of successfully developing and commercializing novel drugs that work on their own or in combination with approved conventional chemotherapies or with other targeted drugs to treat human cancers.

Our corporate headquarters is located in Berkeley Heights, New Jersey, with our main research facility located in the United Kingdom.

From our inception in 1996 through March 31, 2007, we have devoted substantially all our efforts and resources to our research and development activities. We have incurred significant net losses since inception. As of March 31, 2007, our accumulated deficit during the development stage was \$143.2 million. We expect to continue incurring substantial losses for the next several years as we continue to develop our clinical, pre-clinical and other drugs currently in development. Our operating expenses comprise research and development expenses and general and administrative expenses.

To date, we have not generated any product revenue but have financed our operations and internal growth through private placements, licensing revenue, interest on investments, government grants and research and development tax credits. We have received proceeds from the issuances of equity interests of \$166.8 million from inception through

March 31, 2007 which includes \$33.4 million raised from the registered direct offering through the sale of shares of common stock and warrants in the first quarter of 2007. Our revenue has consisted of collaboration and grant revenue. We have recognized revenues from inception through March 31, 2007 of \$6.5 million of which \$3.0 million is derived from fees under collaborative agreements and \$3.5 million of grant revenue from various United Kingdom and European government grant awards. We have not generated any revenue from sales of commercial products and do not expect to generate any product revenue for the foreseeable future. We have also received \$10.7 million from H.M. Revenue & Customs for research and development tax credits since inception.

Results of Operations

As explained in detail above in “5. Merger” the transaction with Xcyte was accounted for as a reverse merger and Cyclacel Limited was considered to have acquired Xcyte on March 27, 2006. As a consequence the comparative period for the three-month period ended March 31, 2006 reflects the results of Cyclacel Limited only while the current three-month period ended March 31, 2007 reflects the results of the combined companies from January 1, 2007 through March 31, 2007.

Revenues

The following table summarizes the components of our revenues for the three-month periods ended March 31, 2006 and 2007:

	Three months ended March 31,			
	2006	2007	\$	%
	(unaudited)	(unaudited)	Difference	Difference
	(in thousands)			
Collaboration and research and development revenue	\$ 95	\$ 10	\$ (85)	(89.5)%
Grant revenue	56	42	(14)	(25.0)%
Total revenue	\$ 151	\$ 52	\$ (99)	(65.6)%

Collaboration and research and development revenue is derived from several agreements under which the Company provides compounds for evaluation for an agreed consideration.

Grant revenue is recognized as we incur and pay for qualifying costs and services under the applicable grant. Grant revenue is primarily derived from various United Kingdom government grant awards.

Research and development expenses

To date, we have focused on drug discovery and development programs, with particular emphasis on orally available anticancer agents. Research and development expense represents costs incurred to

Edgar Filing: Cyclacel Pharmaceuticals, Inc. - Form 10-Q

discover and develop novel small molecule therapeutics, including clinical trial costs for seliciclib and sapacitabine, to advance product candidates toward clinical trials, to develop in-house research and preclinical study capabilities and to advance our biomarker program and technology platforms. We expense all research and development costs as they are incurred. Research and development expenses primarily include:

- payroll and personnel-related expenses, including consultants and contract research;
- clinical trial and regulatory-related costs;
- preclinical studies;
- screening and identification of drug candidates;
- laboratory supplies and materials;
- technology license costs;
- rent and facility expenses for our laboratories; and
- scientific consulting fees.

The following table provides information with respect to our research and development expenditure for the three-month periods ended March 31, 2006 and 2007:

	Three months ended March 31,			
	2006	2007	\$	%
	(unaudited)	(unaudited)	Difference	Difference
	(in thousands)			
Seliciclib	\$ 249	\$ 902	\$ 653	262.2%
Sapacitabine	428	432	4	0.9%
CYC116	1,831	481	(1,350)	(73.7)%
Other costs related to research and development programs, management and exploratory research	5,496	2,162	(3,334)	(60.7)%
Total research and development expenses	\$ 8,004	\$ 3,977	\$ (4,027)	(50.3)%

Total research and development expenses represented 67.2% and 59.5% of our operating expenses for the three-month periods ended March 31, 2006, and 2007, respectively.

Research and development expenditure decreased 50.3% or \$4.0 million from \$8.0 million in the three-month period ended March 31, 2006 to \$4.0 million in the three-month period ended March 31, 2007. The overall reduction relates primarily to; a decrease in the charge for stock-based compensation of \$4.2 million (see further explanation below) and expenditure on CYC116 as the program was in full preclinical studies during 2006 offset by increases in seliciclib expenditure which commenced Phase IIb trials in June 2006.

Stock-based compensation expense attributable to research and development was \$4.5 million and \$0.3 million for the three-month periods ended March 31, 2006 and 2007, respectively. Stock-based compensation is discussed below in greater detail.

The future

We plan to increase our investment in our research and development programs to further enhance our clinical and regulatory capabilities to allow us to advance the development of our drug candidates.

General and administrative expenses

General and administrative expenses include costs for administrative personnel, legal and other professional expenses and general corporate expenses. These costs are not broken out for reporting

16

Table of Contents

purposes. The following table summarizes the general and administrative expenses for the three-month periods ended March 31, 2006 and 2007:

	Three months ended March 31,			
	2006	2007	\$	%
	(unaudited)	(unaudited)	Difference	Difference
	(in thousands)			
Total general and administrative expenses	\$ 3,915	\$ 2,632	\$ (1,283)	(32.8)

Total general and administrative expenses represented 32.8% and 39.3% of our operating expenses for the three-month periods ended March 31, 2006 and 2007, respectively.

Our general and administrative expenditure decreased \$1.3 million from \$3.9 million in the three-month period ended March 31, 2006 to \$2.6 million in the three-month period ended March 31, 2007. The reduction in expenses was primarily attributable to a reduction in stock-based compensation cost of \$2.1 million offset by an increase in other general and administrative expenses primarily related to the increased costs of operating as a public company of \$0.8 million. This increase in costs was primarily due to \$0.3 million for audit, accountancy and other costs related to regulatory filings, \$0.2 million for compensation and recruitment.

There was an increase in restructuring costs of \$0.1 million for additional accretion expense related to the Bothell lease.

Stock-based compensation related to general and administrative expense for the three-month periods ended March 31, 2006 and 2007 was \$2.4 million and \$0.3 million, respectively. Stock-based compensation is discussed below in greater detail.

The future

As a public company, we operate in an increasingly demanding regulatory environment that requires us to comply with the Sarbanes-Oxley Act of 2002 and the related rules and regulations of the Securities and Exchange Commission, or SEC, and the Nasdaq Global Market for our common stock and Nasdaq Capital Market for our preferred stock, including those related to expanded disclosures, accelerated reporting requirements and more complex accounting rules. We expect that our general and administrative expenses will continue to increase in subsequent periods due to these requirements.

Stock based compensation expenses

We adopted SFAS 123R on January 1, 2006. Stock based compensation expenses includes charges/(credits) related to options issued to employees, directors and non-employees.

The following table summarizes the components of our stock based compensation for the three-month periods ended March 31, 2006 and 2007:

	Three months ended March 31,			
	2006	2007	\$	%
	(unaudited)	(unaudited)	Difference	difference
	(in thousands)			
Research and development related	\$ 4,546	\$ 290	\$ (4,256)	(93.6)%
General and administrative related	2,425	253	(2,172)	(89.6)%
Total stock based compensation	\$ 6,971	\$ 543	\$ (6,428)	(92.2)%

For the three-month periods ended March 31, 2006 and 2007 we recognized a stock-based compensation charge of \$7.0 million and \$0.5 million, respectively.

Our stock-based compensation charge for the three-month period ended March 31, 2006 of \$7.0 million, is comprised of (i) \$5.2 million related to restricted stock granted to certain employees and directors and (ii) \$1.8 million due to the acceleration of vesting of options due to the Stock Purchase.

17

Table of Contents

In the first quarter of 2007, we granted 256,250 stock options to our non-executive directors under the 2006 Plans which vest ratably over the four years to March 8, 2011. Our stock-based compensation charge for the three-month period ended March 31, 2007 of \$0.5 million, relates to options granted in 2006 and the first quarter of 2007 under the 2006 Plans.

The future

We may from time to time continue to grant options or other stock-based awards, which will result in an expense, to our employees, directors and, as appropriate, to non-employee service providers. In addition, previously-granted options will continue to vest in accordance with their terms. The total fair value of all options granted under the 2006 Plans is \$6,704,000. In respect of these options, \$3,642,000 of compensation expense has not been recognized at March 31, 2007.

Restructuring charge

The following table summarizes the restructuring charges for the three-month periods ended March 31, 2006 and 2007:

	Three months ended March 31,			
	2006	2007	\$	%
	(unaudited)	(unaudited)	Difference	difference
	(in thousands)			
Total restructuring charge	\$ —	\$ 80	\$ 80	—

In March 2006, the Company assumed an accrued restructuring liability in relation to the Bothell manufacturing facility, calculated as the net present value of the difference between the remaining lease payments due less the estimate of net sublease income and expenses. In September 2006, the Company entered into an Exclusive Subleasing Agency Agreement in an attempt to achieve the successful sublet of the facility. The current market assessment from our real estate agent is that it remains difficult to lease space in the Bothell area and the original estimate of obtaining an early tenant was optimistic. On the basis that the real estate agents projected an improvement in the real estate market in 2007 we assessed that the facility may have a possibility of being sub let by the beginning of 2008, albeit at a reduced capacity. As a result of this, we have recorded an additional provision in the first quarter of 2007 of \$80,000 in recognition of reduced projected sub-lease income sublease agreement. No such restructuring expense was recognized in the three-month period ended March 31, 2006.

Future

As at March 31, 2007 the restructuring liability associated with exiting the Bothell facility was \$2.2 million accounting for the estimated fair value of the remaining lease payments, net of estimated sub-lease income. The restructuring liability is subject to a variety of assumptions and estimates. We review these assumptions and estimates on a quarterly basis and will adjust the accrual if necessary. These changes can be material.

18

Table of Contents

Other income (expense)

Other income (expense) is comprised of the change in valuation of the derivative, change in the valuation of the warrants, interest income and interest expense. The following table summarizes the other income (expense) for the three-month periods ended March 31, 2006 and 2007:

	Three months ended March 31,			
	2006	2007	\$	%
	(unaudited)	(unaudited)	Difference	difference
	(in thousands)			
Change in valuation of derivative	\$ —	\$ (40)	\$ (40)	(100.0)%
Change in valuation of warrants	—	458	458	100.0%
Interest income	127	828	701	552.0%
Interest expense	(68)	(51)	17	(25.0)%
Total other income (expense)	\$ 59	\$ 1,195	\$ 1,136	1,925.4%

The change in derivative value of \$40,000 during the three-month period ended March 31, 2007 is associated with the dividend make-whole payment on our outstanding convertible exchangeable preferred stock. No such derivative valuation expense was recognized during the three-month period ended March 31, 2006.

The change in valuation of warrants relates to the issue of warrants to purchase shares of common stock under the registered direct financing completed in February 2007. We have concluded that the warrants must be liability-classified and the Company recorded the fair value of the warrants as long-term liabilities. The fair value of the outstanding warrants is evaluated at each reporting period with any resulting change in the fair value being reflected in the consolidated statements of operations. The change in fair value recognized in the financial statements during the first quarter of 2007 was \$458,000.

The increase in interest income of \$0.7 million from \$0.1 million during the three-month period ended March 31, 2006 to \$0.8 million during the three-month period ended March 31, 2007 is primarily attributable to higher average balances of cash and cash equivalents and short-term investments throughout the second, third and fourth quarters of 2006 following receipt of \$42.6 million, being the proceeds of our private placement in the second quarter and the \$21.6 million of cash and cash equivalents and short-term investments assumed on the Stock Purchase, and the first quarter of 2007 following the receipt of \$33.4 million being the proceeds of our registered direct offering in February 2007.

Interest expense in the three-month period ended March 31, 2007 has decreased by \$17,000 as compared to the same period in 2006. During the three-month period ended March 31, 2006 interest expenses resulted primarily from interest associated with a government loan, the principal of which was repaid in the fourth quarter of 2005. No such interest expense was recognized in the three-month period ended March 31, 2006. During the three-month period ended March 31, 2007 interest expenses resulted primarily from accretion expense associated with the Bothell lease restructuring provision. No such accretion expense was recognized in the three-month period ended March 31, 2006.

The future

The valuation of the dividend make-whole payment will continue to be re-measured at the end of each reporting period. The valuation of the derivative is dependent upon many factors, including estimated market volatility, and may fluctuate significantly, which may have a significant impact on our statement of operations.

The valuation of the liability-classified warrants will continue to be re-measured at the end of each reporting period. The valuation of the warrants is dependent upon many factors, including estimated market volatility, and may fluctuate significantly, which may have a significant impact on our statement of operations.

19

Table of Contents

A further \$0.3 million of accretion expense associated with the Bothell lease restructuring charge will be recognized over the remaining life of the lease through November 2010.

Income tax benefit

Credit is taken for research and development tax credits, which are claimed from the United Kingdom's taxation and customs authority, in respect of qualifying research and development costs incurred.

Edgar Filing: Cyclacel Pharmaceuticals, Inc. - Form 10-Q

The following table summarizes research and development tax credits for the three-month periods ended March 31, 2006 and 2007:

	Three months ended March 31,			
	2006	2007	\$	%
	(unaudited)	(unaudited)	Difference	difference
	(in thousands)			
Total income tax benefit	\$ 360	\$ 552	\$ 192	53.3%

Research and development tax credits recoverable have increased by \$0.2 million from \$0.4 million during the three-month period ended March 31, 2006 to \$0.6 million during the three-month period ended March 31, 2007. This increase was a reflection of an increase in income taxes available for recovery. The increased income taxes available to recover relate to taxes paid in connection with bonuses accrued in 2006 and paid to directors and employees in the first quarter of 2007.

Future

We expect the company to continue to be eligible to receive United Kingdom research and development tax credits for the foreseeable future and will elect to do so.

Liquidity and Capital Resources

The following is a summary of our key liquidity measures as at March 31, 2006 and 2007:

	March 31,	March 31,	\$	%
	2006	2007	Difference	Difference
	(Unaudited)	(Unaudited)	(in thousands)	
Cash and cash equivalents	\$ 23,707	\$ 75,215	\$ 51,508	217.3%
Short-term investments, available for sale	6,918	5,536	(1,382)	(20.0)%
Total cash and cash equivalents and short-term investments, available for sale	\$ 30,625	\$ 80,751	\$ 50,126	163.7%
Current assets	\$ 34,003	\$ 85,231	\$ 51,228	150.7%
Current liabilities	10,951	6,579	(4,372)	(39.9)%
Working capital	\$ 23,052	\$ 78,652	\$ 55,600	241.2%

We believe that existing funds together with cash generated from operations are sufficient to satisfy our planned working capital, capital expenditures, debt service and other financial commitments at least through 2008.

At March 31, 2007, we had cash and cash equivalents and short-term investments of \$80.8 million. Since our inception, we have not generated any significant product revenue and have relied primarily on the proceeds from sales of equity and preferred securities to finance our operations and internal growth. Additional funding has come through interest on investments, licensing revenue, government grants and research and development tax credits. We have incurred significant losses since our inception. As of March 31, 2007, Cyclacel had an accumulated deficit of \$143.2 million.

At March 31, 2006, we had cash and cash equivalents and short-term investments of \$30.6 million, as compared to \$80.8 million at March 31, 2007. This higher balance at March 31, 2007 was primarily due

20

Table of Contents

to the receipt of net proceeds of \$42.6 million from the private placement in the second quarter of 2006 and the receipt of net proceeds of \$33.4 million from the registered direct offering in the first quarter of 2007.

The following is a summary of our contractual obligations and other commitments relating to our facilities, equipment leases and purchases as at March 31, 2007, and the effect such obligations could have on our liquidity:

	Total	Payments due by period			
		Less than 1 year	1-3 years	4-5 years	After 5 years
		(in thousands)			
Capital lease obligations	\$ 19	\$ 19	\$ —	\$ —	\$ —
Operating lease obligations	9,198	2,154	4,336	2,196	512
Purchase obligations	2,146	2,146	—	—	—
Total	\$ 11,363	\$ 4,319	\$ 4,336	\$ 2,196	\$ 512

We also currently have a number of contractual arrangements with our partners under which milestone payments totaling \$23.4 million would be payable subject to achievement of all the specific contractual milestones and our decision to continue with these projects. Under these contractual arrangements, we make annual payments that do not and will not exceed \$0.1 million.

Cash provided by (used in) operating, investing and financing activities for the three-month periods ended March 31, 2006 and 2007, is summarized as follows:

	Three months ended March 31,	
	2006 (Unaudited)	2007 (Unaudited)
	(in thousands)	
Net cash used in operating activities	\$ (2,336)	\$ (6,063)
Net cash provided by investing activities	\$ 7,135	\$ 4,107
Net cash provided by financing activities	\$ 15,902	\$ 32,980

Operating activities

Net cash used in operating activities increased \$3.7 million, from \$2.3 million in the three-month period ended March 31, 2006 to \$6.0 million in the three-month period ended March 31, 2007.

Net cash used in operating activities during the three-month period ended March 31, 2006 of \$2.3 million resulted from our net operating loss of \$11.3 million, adjusted for material non-cash activities comprising depreciation and amortization, and non-cash stock based compensation expense, amounting to \$7.2 million, and net increase in working capital of \$1.8 million, primarily due to a net increase in accounts payable and accrued expenses.

Net cash used in operating activities during the three-month period ended March 31, 2007 of \$6.1 million resulted from our net operating loss of \$4.9 million, adjusted for material non-cash activities comprising amortization of investment premiums (discounts), change in valuation of derivative, change in valuation of liability-classified warrants, depreciation and amortization, non-cash stock based compensation expense and provision for restructuring costs, amounting to \$0.4 million and net decrease in working capital due to a decrease in amounts receivable combined with a net decrease in accounts payable and accrued expenses.

Investing activities

Net cash provided by investing activities decreased \$3.0 million, from \$7.1 million in the three-month period ended March 31, 2006 to \$4.1 million in the three-month period ended March 31, 2007.

Net cash provided by investing activities during the three-month periods ended March 31, 2006 and 2007 resulted primarily from the sale and maturity of our short-term investments, the proceeds of which were used to fund our operating activities.

21

Table of Contents

Capital spending is vital to our research and development initiatives and to maintain our operational capabilities. During the three-month periods ended March 31, 2006 and 2007 we used cash of \$0.1 million in each period to develop our research facilities in both Dundee, Scotland and Cambridge, England, to acquire smaller, but key items, of research and development equipment and replacement items essential to support our information technology function and to complete the refurbishment of our new corporate head quarters in Berkeley Heights, New Jersey.

Financing activities

Net cash provided by financing activities increased \$17.1 million, from \$15.9 million in the three-month period ended March 31, 2006 to \$33.0 million in the three-month period ended March 31, 2007.

During the three-month period ended March 31, 2006 the net cash provided by financing activities related primarily to the \$21.6 million of cash, cash equivalents and short term investments assumed on the Stock Purchase offset by costs associated with the Stock purchase of \$2.0 million and the payment of capital lease obligations.

During the three-month period ended March 31, 2007 the net cash provided by financing activities related to \$33.4 million in net proceeds from our registered direct financing, offset by the payment of our preferred stock dividend of \$0.3 million and by payment of capital lease obligations.

Operating Capital and Capital Expenditure Requirements

We expect to continue to incur substantial operating losses in the future. We will not receive any product revenue until a product candidate has been approved by the U.S. Food and Drug Administration (“FDA”) or similar regulatory

agencies in other countries and successfully commercialized. We currently anticipate that our cash, cash equivalents, marketable securities and proceeds from the private placement will be sufficient to fund our operations at least through 2008. However, we will need to raise substantial additional funds to continue our operations. We cannot be certain that any of our programs will be successful or that we will be able to raise sufficient funds to complete the development and commercialize any of our product candidates currently in development, should they succeed. Additionally, we plan to continue to evaluate in-licensing and acquisition opportunities to gain access to new drugs or drug targets that would fit with our strategy. Any such transaction would likely increase our funding needs in the future.

Our future funding requirements will depend on many factors, including but not limited to:

- the rate of progress and cost of our clinical trials, preclinical studies and other discovery and research and development activities;
- the costs associated with establishing manufacturing and commercialization capabilities;
- the costs of acquiring or investing in businesses, product candidates and technologies;
- the costs of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights;
- the costs and timing of seeking and obtaining FDA and other regulatory approvals;
- the effect of competing technological and market developments; and
- the economic and other terms and timing of any collaboration, licensing or other arrangements into which we may enter.

Until we can generate a sufficient amount of product revenue to finance our cash requirements, which we may never do, we expect to finance future cash needs primarily through public or private equity offerings, debt financings or strategic collaborations. We do not know whether additional funding will be available on acceptable terms, or at all. If we are not able to secure additional funding when needed, we may have to delay, reduce the scope of or eliminate one or more of our clinical trials or research and development programs. In addition, we may have to partner one or more of our product candidate programs at an earlier stage of development, which would lower the economic value of those programs to our company.

22

Table of Contents

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses and related disclosure of contingent assets and liabilities. We review our estimates on an ongoing basis. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. While our significant accounting policies are described in more detail in the notes to our financial statements included in this document, we believe the judgments and estimates required by the following accounting policies to be critical in the preparation of our financial statements.

Stock-based Compensation

On January 1, 2006, we adopted SFAS 123R. Under SFAS 123R, the fair value of stock options and other equity-based compensation must be recognized as expense in the statements of operations over the requisite service period of each award. Prior to January 1, 2006, we accounted for stock-based employee compensation arrangements in accordance with the provisions of APB No. 25, SFAS No. 123 and complied with the disclosure requirements of SFAS No. 148. Under APB No. 25, compensation expense is based on the difference, if any, on the date of grant, between the estimated fair value of our ordinary shares and the exercise price. SFAS 123R defines a “fair value” based method of accounting for an employee stock option or similar equity investment.

Derivative Instruments

The terms of our November 2004 convertible preferred stock offering include a dividend make-whole payment feature. If we elect to automatically convert, or the holder elects to voluntarily convert, some or all of the convertible preferred stock into shares of our common stock prior to November 3, 2007, we will make an additional payment on the convertible preferred stock equal to the aggregate amount of dividends that would have been payable on the convertible preferred stock through and including November 3, 2007, less any dividends already paid on the convertible preferred stock. This additional payment is payable in cash or, at our option, in shares of our common stock, or a combination of cash and shares of common stock. This dividend make-whole payment feature is considered to be an embedded derivative and has been recorded on the balance sheet at fair value as a current liability. We will be required to recognize other income (expense) in our statements of operations as the fair value of this derivative fluctuates from period to period.

The accounting for derivatives is complex, and requires significant judgments and estimates in determining the fair value in the absence of quoted market values. These estimates are based on valuation methodologies and assumptions deemed appropriate in the circumstances. The fair value of the dividend make-whole payment feature is based on various assumptions, including the estimated market volatility and discount rates used in determination of fair value. The use of different assumptions may have a material effect on the estimated fair value amount and our results of operations.

Goodwill

Goodwill represents the difference between the purchase price and the fair value of net tangible and identifiable intangible assets acquired in the business combination.

In July 2001, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 141, “Business Combinations,” and SFAS No. 142, “Goodwill and Other Intangible Assets”. Under SFAS No. 141, all business combinations initiated after June 30, 2001 must be accounted for using the purchase method. Under SFAS No. 142, goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed annually (or more frequently if

23

Table of Contents

there are indicators such assets may be impaired) for impairment. Separable intangible assets that are not deemed to have indefinite lives will continue to be amortized over their estimated useful lives. There were no triggering events calling into question the recoverability of goodwill during the three-month period ended March 31, 2007.

Warrants liability

Emerging Issues Task Force (“EITF”) 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock” requires freestanding contracts that are settled in a Company’s own stock, including common stock warrants to be designated as an equity instrument, asset or liability. Under the provisions of EITF 00-19, a contract designated as an asset or a liability must be carried at fair value until exercised or expired, with any changes in fair value recorded in the results of operations. A contract designated as an equity instrument must be included within equity, and no fair value adjustments are required. The Company reviews the classification of its contracts at each balance sheet date.

Pursuant to EITF Issue No. 00-19, since the Company is unable to control all the events or actions necessary to settle the warrants in registered shares the warrants have been recorded as long-term liabilities at fair value. The fair value of the outstanding warrants is evaluated at each reporting period with any resulting change in the fair value being reflected in the consolidated statements of operations. The change in fair value recognized in the financial statements during the first quarter of 2007 was \$458,000.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk related to fluctuations in interest rates and in foreign currency exchange rates.

Interest Rate Risk

Our short-term investments as of March 31, 2007 consisted of \$1.9 million in corporate bonds and \$3.6 million in federal agency obligations with contractual maturities of one year or less. Due to the short-term nature of our investments, we believe that our exposure to market interest rate fluctuations is minimal. The corporate bonds in which we invest are rated “A” or better by both Moody’s and Standard and Poor’s. Our cash and cash equivalents are held primarily in highly liquid money market accounts. A hypothetical 10% change in short-term interest rates from those in effect at March 31, 2007 would not have a significant impact on our financial position or our expected results of operations. We do not currently hold any derivative financial instruments with interest rate risk.

Foreign Currency Risk

We are exposed to foreign currency rate fluctuations related to the operation of our subsidiary in the United Kingdom. At the end of each reporting period, income and expenses of the subsidiary are remeasured into U.S. dollars using the average currency rate in effect for the period and assets and liabilities are remeasured into U.S. dollars using either historical rates or the exchange rate in effect at the end of the relevant period. We currently do not engage in foreign currency hedging; however, we have entered into certain contracts denominated in foreign currencies and therefore, we are subject to currency exchange risks. As of March 31, 2007 differences on foreign currency translation of \$34,000 are shown as a movement in other comprehensive income. In the three months ended March 31, 2007 exchange rate differences of \$63,000 were charged in the statement of operations.

Valuation Risk

Derivate instruments

The Company’s convertible exchangeable preferred stock issued in November 2004 remained in place following completion of the Stock Purchase. The terms of the convertible exchangeable preferred stock include a dividend make-whole payment feature. This feature is considered to be an embedded

Table of Contents

derivative and was valued on the balance sheet at \$867,000 at March 31, 2007. As the fair value of this derivative may fluctuate significantly from period to period, the resulting change in valuation may have a significant impact on our results of operations.

Warrants

On February 16, 2007, the Company issued common stock and warrants. Pursuant to EITF Issue No. 00-19 the Company recorded the fair value of the warrants as long-term liabilities. The fair value of the outstanding warrants is evaluated at each reporting period with any resulting change in the fair value being reflected in the consolidated statements of operations. The change in fair value recognized in the financial statements during the first quarter of 2007 was \$458,000. As the fair value of this derivative may fluctuate significantly from period to period, the resulting change in valuation may have a significant impact on our results of operations.

Item 4. Controls and Procedures

Spiro Rombotis, our President and Chief Executive Officer, and Paul McBarron, our Chief Operating Officer and Executive Vice President, Finance, after evaluating the effectiveness of our “disclosure controls and procedures” (as defined in Securities Exchange Act Rule 13a-15(e)), have concluded that as of March 31, 2007 our disclosure controls and procedures are effective.

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as such term is defined in SEC Rule 13a-15(e), that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934 reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Executive Vice-President of Finance, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Executive Vice-President of Finance, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, our Chief Executive Officer and Executive Vice-President of Finance concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

25

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal proceedings

None

Item 1A. Risk Factors

In analyzing our company, you should consider carefully the following risk factors, together with all of the other information included in this quarterly report on Form 10-Q. Factors that could cause or contribute to differences in our actual results include those discussed in the following subsection, as well as those discussed above in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere throughout this quarterly report on Form 10-Q. Each of the following risk factors, either alone or taken together, could adversely affect our business, operating results and financial condition, as well as adversely affect the value of an investment in our common stock.

We are subject to the following significant risks, among others:

We are at an early stage of development as a company and we do not have, and may never have, any products that generate revenues.

We are at an early stage of development as a company and have a limited operating history on which to evaluate our business and prospects. Since beginning operations in 1996, we have not generated any product revenues. We currently have no products for sale and we cannot guarantee that we will ever have any marketable products. We must demonstrate that our drug candidates satisfy rigorous standards of safety and efficacy for their intended uses before the Food and Drug Administration, or FDA, and other regulatory authorities in the United States, the European Union and elsewhere. Significant additional research, preclinical testing and clinical testing is required before we can file applications with the FDA or other regulatory authorities for premarket approval of our drug candidates. In addition, to compete effectively, our drugs must be easy to administer, cost-effective and economical to manufacture on a commercial scale. We may not achieve any of these objectives. Seliciclib and sapacitabine, our most advanced drug candidates for the treatment of cancer, are currently our only drug candidates in clinical trials and we cannot be certain that the clinical development of these or any other drug candidates in preclinical testing or clinical development will be successful, that we will receive the regulatory approvals required to commercialize them or that any of our other research and drug discovery programs will yield a drug candidate suitable for investigation through clinical trials. Our commercial revenues, if any, will be derived from sales of drugs that we do not expect to become marketable for several years, if at all.

We have a history of operating losses and we may never become profitable. Our stock is a highly speculative investment.

We have incurred operating losses in each year since beginning operations in 1997 due to costs incurred in connection with our research and development activities and general and administrative costs associated with our operations, and we may never achieve profitability. As of March 31, 2007, our accumulated deficit was \$143.1 million. Our net loss for the three months ended March 31, 2006 and 2007 was \$14.2 million and \$4.8 million respectively. Our net loss attributable to ordinary shareholders from inception through March 31, 2007 was \$181.2 million. Our initial drug candidates are in the early stages of clinical testing and we must conduct significant additional clinical trials before we can seek the regulatory approvals necessary to begin commercial sales of its drugs. We expect to incur continued losses for several years, as we continue our research and development of our initial drug candidates, seek regulatory approvals and commercialize any approved drugs. If our initial drug candidates are unsuccessful in clinical trials or we are unable to obtain regulatory approvals, or if our drugs are unsuccessful in the market, we will not be profitable. If we fail to become and remain profitable, or if we are unable to fund our continuing losses, you could lose all or part of your investment.

Table of Contents

We will need to raise substantial additional capital to fund our operations and if we fail to obtain additional funding, we may be unable to complete the development and commercialization of our drug candidates or continue our research and development programs.

We have funded all of our operations and capital expenditures with proceeds from the issuance of public equity securities, private placements of our securities, interest on investments, government grants and research and development tax credits. In order to conduct the lengthy and expensive research, preclinical testing and clinical trials necessary to complete the development and marketing of our drug candidates, we will require substantial additional funds. Based on our current operating plans, we expect our existing resources to be sufficient to fund our planned operations for at least the next 12 months. To meet these financing requirements, we may raise funds through public or private equity offerings, debt financings or strategic alliances. Raising additional funds by issuing equity or convertible debt securities will cause our shareholders to experience substantial dilution in their ownership interests and new investors may have rights superior to the rights of our other stockholders. Raising additional funds through debt financing, if available, may involve covenants that restrict our business activities and options. To the extent that we raise additional funds through collaborations and licensing arrangements, we may have to relinquish valuable rights to our drug discovery and other technologies, research programs or drug candidates, or grant licenses on terms that may not be favorable to us. Additional funding may not be available to us on favorable terms, or at all. If we are unable to obtain additional funds, we may be forced to delay or terminate our clinical trials and the development and marketing of our drug candidates.

Clinical trials are expensive, time consuming and subject to delay.

Clinical trials are expensive and complex, can take many years and have uncertain outcomes. We estimate that clinical trials of our most advanced drug candidates will continue for several years, but may take significantly longer to complete. The designs used in some of the trials have not been used widely by other pharmaceutical companies. Failure can occur at any stage of the testing and we may experience numerous unforeseen events during, or as a result of, the clinical trial process that could delay or prevent commercialization of our current or future drug candidates, including but not limited to:

- delays in securing clinical investigators or trial sites for its clinical trials;
- delays in obtaining institutional review board, or IRB, and other regulatory approvals to commence a clinical trial;
- slower than anticipated rates of patient recruitment and enrollment or reaching the targeted number of patients;
- negative or inconclusive results from clinical trials;
- unforeseen safety issues;
- uncertain dosing issues;
- introduction of new therapies or changes in standards of practice or regulatory guidance that render our clinical trial endpoints or the targeting of our proposed indications obsolete;
- inability to monitor patients adequately during or after treatment or problems with investigator or patient compliance with the trial protocols;
- inability to replicate in large controlled studies safety and efficacy data obtained from a limited number of patients in uncontrolled trials; and
- inability or unwillingness of medical investigators to follow our clinical protocols.

If we suffer any significant delays, setbacks or negative results in, or termination of, our clinical trials, we may be unable to continue development of our drug candidates or generate revenue and our development costs could increase

significantly.

27

Table of Contents

Adverse events have been observed in our clinical trials and may force us to stop development of our product candidates or prevent regulatory approval of our product candidates.

Adverse or inconclusive results from our clinical trials may substantially delay, or halt entirely, any further development of our drug candidates. Many companies have failed to demonstrate the safety or effectiveness of drug candidates in later stage clinical trials notwithstanding favorable results in early stage clinical trials. Previously unforeseen and unacceptable side effects could interrupt, delay or halt clinical trials of our drug candidates and could result in the FDA or other regulatory authorities denying approval of our drug candidates. We will need to demonstrate safety and efficacy for specific indications of use, and monitor safety and compliance with clinical trial protocols throughout the development process. To date, long-term safety and efficacy has not been demonstrated in clinical trials for any of our drug candidates. Toxicity and “severe adverse effects” as defined in trial protocols have been noted in preclinical and clinical trials involving certain of our drug candidates. For example, elevations of liver enzymes and decrease in potassium levels have been observed in some patients receiving our lead drug candidate, seliciclib and neutropenia was observed in patients receiving sapacitabine. In addition, we may pursue clinical trials for seliciclib in more than one indication. There is a risk that severe toxicity observed in a trial for one indication could result in the delay or suspension of all trials involving the same drug candidate. We are currently conducting Phase II clinical trials to test the safety and efficacy of seliciclib and sapacitabine in patients with advanced cancers. If these trials or any future trials are unsuccessful, our business and reputation could be harmed and our share price could be negatively affected.

Even if we believe the data collected from clinical trials of our drug candidates are promising with respect to safety and efficacy, such data may not be deemed sufficient by regulatory authorities to warrant product approval. Clinical data can be interpreted in different ways. Regulatory officials could interpret such data in different ways than we do which could delay, limit or prevent regulatory approval. The FDA, other regulatory authorities or we may suspend or terminate clinical trials at any time. Any failure or significant delay in completing clinical trials for our drug candidates, or in receiving regulatory approval for the commercialization of our drug candidates, may severely harm our business and reputation.

If our understanding of the role played by CDKs or Aurora kinases in regulating the cell cycle is incorrect, this may hinder pursuit of our clinical and regulatory strategy.

We have programs to develop small molecule inhibitors of Cyclin Dependent kinases (CDK) and Aurora kinases. Our lead drug candidate, seliciclib, is a CDK inhibitor, and CYC116 is an Aurora kinase inhibitor, based on our understanding of CDK and Aurora Kinase inhibitors. Although a number of pharmaceutical and biotechnology companies are attempting to develop CDK or Aurora inhibitor drugs for the treatment of cancer, no CDK or Aurora kinase inhibitor has yet reached the market. Our seliciclib program relies on our understanding of the interaction of CDKs with other cellular mechanisms that regulate key stages of cell growth. If our understanding of the role played by CDKs or Aurora kinase inhibitors in regulating the cell cycle is incorrect, our lead drug and CYC116 may fail to produce therapeutically relevant results, hindering our ability to pursue our clinical and regulatory strategy.

If we fail to enter into and maintain successful strategic alliances for our drug candidates, we may have to reduce or delay our drug candidate development or increase our expenditures.

An important element of our strategy for developing, manufacturing and commercializing our drug candidates is entering into strategic alliances with pharmaceutical companies or other industry participants to advance our programs and enable us to maintain our financial and operational capacity.

We face significant competition in seeking appropriate alliances. We may not be able to negotiate alliances on acceptable terms, if at all. In addition, these alliances may be unsuccessful. If we fail to create and maintain suitable alliances, we may have to limit the size or scope of, or delay, one or more of our drug development or research programs. If we elect to fund drug development or research programs on our own, we will have to increase our expenditures and will need to obtain additional funding, which may be unavailable or available only on unfavorable terms.

28

Table of Contents

We are making extensive use of biomarkers, which are not yet scientifically validated, and our reliance on biomarker data may thus lead us to direct our resources inefficiently.

We are making extensive use of biomarkers in an effort to facilitate our drug development and to optimize our clinical trials. Biomarkers are proteins or other substances whose presence in the blood can serve as an indicator of specific cell processes. We believe that these biological markers serve a useful purpose in helping us to evaluate whether our drug candidates are having their intended effects through their assumed mechanisms, and thus enable us to identify more promising drug candidates at an early stage and to direct our resources efficiently. We also believe that biomarkers may eventually allow us to improve patient selection in connection with clinical trials and monitor patient compliance with trial protocols.

For most purposes, however, biomarkers have not yet been scientifically validated. If our understanding and use of biomarkers is inaccurate or flawed, or if our reliance on them is otherwise misplaced, then we will not only fail to realize any benefits from using biomarkers, but may also be led to invest time and financial resources inefficiently in attempting to develop inappropriate drug candidates. Moreover, although the FDA has issued for comment a draft guidance document on the potential use of biomarker data in clinical development, such data are not currently accepted by the FDA or other regulatory agencies in the United States, the European Union or elsewhere in applications for regulatory approval of drug candidates and there is no guarantee that such data will ever be accepted by the relevant authorities in this connection. Our biomarker data should not be interpreted as evidence of efficacy.

To the extent we elect to fund the development of a drug candidate or the commercialization of a drug at our expense, we will need substantial additional funding.

We plan to market drugs on our own, with or without a partner, that can be effectively commercialized and sold in concentrated markets that do not require a large sales force to be competitive. To achieve this goal, we will need to establish our own specialized sales force, marketing organization and supporting distribution capabilities. The development and commercialization of our drug candidates is very expensive. To the extent we elect to fund the full development of a drug candidate or the commercialization of a drug at our expense, we will need to raise substantial additional funding to:

- fund research and development and clinical trials connected with its research;
- fund clinical trials and seek regulatory approvals;

- build or access manufacturing and commercialization capabilities;
- implement additional internal control systems and infrastructure;
- commercialize and secure coverage, payment and reimbursement of our drug candidates, if any such candidates receive regulatory approval;
- maintain, defend and expend the scope of our intellectual property; and
- hire additional management and scientific personnel.

Our future funding requirements will depend on many factors, including:

- the scope, rate of progress and cost of our clinical trials and other research and development activities;
- the costs and timing of seeking and obtaining regulatory approvals;
- the costs of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights;
- the costs associated with establishing sales and marketing capabilities;
- the costs of acquiring or investing in businesses, products and technologies;

29

Table of Contents

- the effect of competing technological and market developments; and
- the payment, other terms and timing of any strategic alliance, licensing or other arrangements that we may establish.

If we are not able to secure additional funding when needed, we may have to delay, reduce the scope of or eliminate one or more of our clinical trials or research and development programs or future commercialization efforts.

Due to our reliance on contract research organizations or other third parties to conduct clinical trials, we are unable to directly control the timing, conduct and expense of our clinical trials.

We do not have the ability to independently conduct clinical trials required to obtain regulatory approvals for our drug candidates. We must rely on third parties, such as contract research organizations, medical institutions, clinical investigators and contract laboratories to conduct our clinical trials. In addition, we rely on third parties to assist with our preclinical development of drug candidates. If these third parties do not successfully carry out their contractual duties or regulatory obligations or meet expected deadlines, if the third parties need to be replaced or if the quality or accuracy of the data they obtain is compromised due to the failure to adhere to our clinical protocols or regulatory requirements or for other reasons, our preclinical development activities or clinical trials may be extended, delayed, suspended or terminated, and we may not be able to obtain regulatory approval for or successfully commercialize our drug candidates.

To the extent we are able to enter into collaborative arrangements or strategic alliances, we will be exposed to risks related to those collaborations and alliances.

Although we are not currently party to any collaboration arrangement or strategic alliance that is material to our business, in the future we expect to be dependent upon collaborative arrangements or strategic alliances to complete the development and commercialization of some of our drug candidates particularly after the Phase II stage of clinical testing. These arrangements may place the development of our drug candidates outside our control, may require us to relinquish important rights or may otherwise be on terms unfavorable to us.

We may be unable to locate and enter into favorable agreements with third parties, which could delay or impair our ability to develop and commercialize our drug candidates and could increase our costs of development and commercialization. Dependence on collaborative arrangements or strategic alliances will subject us to a number of risks, including the risk that:

- we may not be able to control the amount and timing of resources that our collaborators may devote to the drug candidates;
- our collaborators may experience financial difficulties;
- we may be required to relinquish important rights such as marketing and distribution rights;
- business combinations or significant changes in a collaborator's business strategy may also adversely affect a collaborator's willingness or ability to complete its obligations under any arrangement;
- a collaborator could independently move forward with a competing drug candidate developed either independently or in collaboration with others, including our competitors; and
- collaborative arrangements are often terminated or allowed to expire, which would delay the development and may increase the cost of developing our drug candidates.

We have no manufacturing capacity and will rely on third party manufacturers for the late stage development and commercialization of any drugs we may develop.

We do not currently operate manufacturing facilities for clinical or commercial production of our drug candidates under development. We currently lack the resources or the capacity to manufacture any of our products on a clinical or commercial scale. We anticipate future reliance on a limited number of third party manufacturers until we are able to expand our operations to include manufacturing

30

Table of Contents

capacities. Any performance failure on the part of future manufacturers could delay late stage clinical development or regulatory approval of our drug candidates or commercialization of our drugs, producing additional losses and depriving us of potential product revenues.

If the FDA or other regulatory agencies approve any of our drug candidates for commercial sale, or if we significantly expand our clinical trials, we will need to manufacture them in larger quantities. To date, our drug candidates have been manufactured in small quantities for preclinical testing and clinical trials and we may not be able to successfully increase the manufacturing capacity, whether in collaboration with third party manufacturers or on our own, for any of our drug candidates in a timely or economic manner, or at all. For example, the manufacture of our drug candidate sapacitabine and CYC116 require several steps and it is not yet known if scale up to commercial production is feasible. Significant scale-up of manufacturing may require additional validation studies, which the FDA and other regulatory bodies must review and approve. If we are unable to successfully increase the manufacturing capacity for a drug candidate whether for late stage clinical trials or for commercial sale, the drug development, regulatory approval or commercial launch of any related drugs may be delayed or there may be a shortage in supply. Even if any third party manufacturer makes improvements in the manufacturing process for our drug candidates, we may not own, or may have to share, the intellectual property rights to such innovation.

We currently have no marketing or sales staff. If we are unable to conclude strategic alliances with marketing partners or if we are unable to develop our own sales and marketing capabilities, we may not be successful in commercializing

any drugs we may develop.

Our strategy is to develop compounds through the Phase II stage of clinical testing and market or co-promote certain of our drugs on our own. We have no sales, marketing or distribution capabilities. We will depend primarily on strategic alliances with third parties, which have established distribution systems and sales forces, to commercialize our drugs. To the extent that we are unsuccessful in commercializing any drugs ourselves or through a strategic alliance, product revenues will suffer, we will incur significant additional losses and our share price will be negatively affected.

If we evolve from a company primarily involved in discovery and development to one also involved in the commercialization of drugs, we may encounter difficulties in managing our growth and expanding our operations successfully.

If we advance our drug candidates through clinical trials, we will need to expand our development and regulatory capabilities and develop manufacturing, marketing and sales capabilities or contract with third parties to provide these capabilities for us. If our operations expand, we expect that we will need to manage additional relationships with various collaborative partners, suppliers and other third parties. Our ability to manage our operations and any growth will require us to make appropriate changes and upgrades (as necessary) to our operational, financial and management controls, reporting systems and procedures where we may operate. Any inability to manage growth could delay the execution of our business plan or disrupt our operations.

The failure to attract and retain skilled personnel could impair our drug development and commercialization efforts.

We are highly dependent on our senior management and key scientific and technical personnel. The loss of the services of any member of our senior management, scientific or technical staff may significantly delay or prevent the achievement of drug development and other business objectives and could have a material adverse effect on our business, operating results and financial condition. We also rely on consultants and advisors to assist us in formulating our research and development strategy. All of our consultants and advisors are either self-employed or employed by other organizations, and they may have conflicts of interest or other commitments, such as consulting or advisory contracts with other organizations, that may affect their ability to contribute to us.

31

Table of Contents

We intend to expand and develop new drug candidates. We will need to hire additional employees in order to continue our clinical trials and market our drug candidates. This strategy will require us to recruit additional executive management and scientific and technical personnel. There is currently intense competition for skilled executives and employees with relevant scientific and technical expertise, and this competition is likely to continue. The inability to attract and retain sufficient scientific, technical and managerial personnel could limit or delay our product development efforts, which would adversely affect the development of our drug candidates and commercialization of our potential drugs and growth of our business.

Our drug candidates are subject to extensive regulation, which can be costly and time-consuming, and we may not obtain approvals for the commercialization of any of our drug candidates.

The clinical development, manufacturing, selling and marketing of drug candidates are subject to extensive regulation by the FDA and other regulatory authorities in the United States, the European Union and elsewhere. These

regulations also vary in important, meaningful ways from country to country. We are not permitted to market a potential drug in the United States until we receive approval of a New Drug Application, or NDA, from the FDA. We have not received an NDA approval from the FDA for any of our drug candidates.

Obtaining an NDA approval is expensive and is a complex, lengthy and uncertain process. The FDA approval process for a new drug involves completion of preclinical studies and the submission of the results of these studies to the FDA, together with proposed clinical protocols, manufacturing information, analytical data and other information in an Investigational New Drug application, or IND, which must become effective before human clinical trials may begin. Clinical development typically involves three phases of study: Phase I, II and III. The most significant costs associated with clinical development are the Phase III clinical trials as they tend to be the longest and largest studies conducted during the drug development process. After completion of clinical trials, an NDA may be submitted to the FDA. In responding to an NDA, the FDA may refuse to file the application, or if accepted for filing, the FDA may grant marketing approval, request additional information or deny the application if it determines that the application does not provide an adequate basis for approval. In addition, failure to comply with FDA and other applicable foreign and U.S. regulatory requirements may subject it to administrative or judicially imposed sanctions. These include warning letters, civil and criminal penalties, injunctions, product seizure or detention, product recalls, total or partial suspension of production and refusal to approve either pending NDAs, or supplements to approved NDAs.

Despite the substantial time and expense invested in preparation and submission of an NDA or equivalents in other jurisdictions, regulatory approval is never guaranteed. The FDA and other regulatory authorities in the United States, the European Union and elsewhere exercise substantial discretion in the drug approval process. The number, size and design of preclinical studies and clinical trials that will be required for FDA or other regulatory approval will vary depending on the drug candidate, the disease or condition for which the drug candidate is intended to be used and the regulations and guidance documents applicable to any particular drug candidate. The FDA or other regulators can delay, limit or deny approval of a drug candidate for many reasons, including, but not limited to:

- those discussed in the risk factor which immediately follows;
- the fact that FDA or other regulatory officials may not approve our or our third party manufacturer's processes or facilities; or
- the fact that new regulations may be enacted by the FDA or other regulators may change their approval policies or adopt new regulations requiring new or different evidence of safety and efficacy for the intended use of a drug candidate.

Following regulatory approval of any drug candidate, we would be subject to ongoing regulatory obligations and restrictions, which may result in significant expense and limit our ability to commercialize our potential drugs.

If one of our drug candidates is approved by the FDA or by another regulatory authority, we would be held to extensive regulatory requirements over product manufacturing, labeling, packaging, adverse

32

Table of Contents

event reporting, storage, advertising, promotion and record keeping. Regulatory approvals may also be subject to significant limitations on the indicated uses or marketing of the drug candidates. Potentially costly follow-up or post-marketing clinical studies may be required as a condition of approval to further substantiate safety or efficacy, or to investigate specific issues of interest to the regulatory authority. Previously unknown problems with the drug candidate, including adverse events of unanticipated severity or frequency, may result in restrictions on the marketing

of the drug, and could include withdrawal of the drug from the market.

In addition, the law or regulatory policies governing pharmaceuticals may change. New statutory requirements may be enacted or additional regulations may be enacted that could prevent or delay regulatory approval of our drug candidates. We cannot predict the likelihood, nature or extent of adverse government regulation that may arise from future legislation or administrative action, either in the United States or elsewhere. If we are not able to maintain regulatory compliance, we might not be permitted to market our drugs and our business could suffer.

Our applications for regulatory approval could be delayed or denied due to problems with studies conducted before we in-licensed some of our product candidates.

We currently license some of the compounds and drug candidates used in its research programs from third parties. These include sapacitabine, licensed from Sankyo Co., Ltd and CYC381 and related intellectual property, licensed from Lorus Therapeutics, Inc. Our present research involving these compounds relies upon previous research conducted by third parties over which we had no control and before we in-licensed the drug candidates. In order to receive regulatory approval of a drug candidate, we must present all relevant data and information obtained during our research and development, including research conducted prior to our licensure of the drug candidate. Although we are not currently aware of any such problems, any problems that emerge with preclinical research and testing conducted prior to our in-licensing may affect future results or our ability to document prior research and to conduct clinical trials, which could delay, limit or prevent regulatory approval for our drug candidates.

We face intense competition and our competitors may develop drugs that are less expensive, safer, or more effective than our drug candidates.

We are engaged in a rapidly changing and highly competitive field. We are seeking to develop and market products that will compete with other products and drugs that currently exist or are being developed. We compete with companies that are developing small molecule drugs, as well as companies that have developed drugs or are developing alternative drug candidates for cancer or other serious disorders where there is abnormal cell proliferation. We believe that other companies are currently developing drugs targeting cancer that may compete with our drug candidates, including Astex, AstraZeneca, Eisai, Kyowa Hakko, Onconova, Pfizer, Schering AG, and Sunesis. Although Aventis, a predecessor of Sanofi-Aventis, had previously announced that it has ceased Phase II development of alvocidib or flavopiridol, a CDK inhibitor, we believe that the National Cancer Institute's Cancer Therapy Evaluation Program is continuing to enroll patients in a Phase II trial and that Sanofi-Aventis has reinitiated development of alvocidib in Phase III clinical trials in patients with chronic leukemia. Several pharmaceutical and biotechnology companies have nucleoside analogs on the market or in clinical trials for oncology indications, Clavis Pharmaceuticals, Eli Lilly, Genzyme, GlaxoSmithKline and Supergen. A number of companies are pursuing discovery and research activities in each of the other areas that are the subject of our research and drug development programs. We believe that Astex, AstraZeneca, Merck, jointly with Vertex, Millennium, Nerviano Medical Sciences and Serono have commenced Phase II or Phase I clinical trials of Aurora kinase inhibitors in patients with advanced cancers. Several companies have reported selection of Aurora kinase inhibitor candidates for development, including Entremed and Sunesis, and may have started or are expected to start clinical trials within the next twelve months. We believe that Boehringer Ingelheim and Onconova have entered clinical development with Plk inhibitor candidates for oncology indications.

Our competitors, either alone or together with collaborators, may have substantially greater financial resources and research and development staff. Our competitors may also have more experience:

- developing drug candidates;
- conducting preclinical and clinical trials;
- obtaining regulatory approvals; and
- commercializing drug candidates.

Our competitors may succeed in obtaining patent protection and regulatory approval and may market drugs before we do. If our competitors market drugs that are less expensive, safer, more effective or more convenient to administer than our potential drugs, or that reach the market sooner than our potential drugs, we may not achieve commercial success. Scientific, clinical or technical developments by our competitors may render our drug candidates obsolete or noncompetitive. We anticipate that we will face increased competition in the future as new companies enter the markets and as scientific developments progress. If our drug candidates obtain regulatory approvals, but do not compete effectively in the marketplace, our business will suffer.

The commercial success of our drug candidates depends upon their market acceptance among physicians, patients, healthcare providers and payors and the medical community.

If our drug candidates are approved by the FDA or by another regulatory authority, the resulting drugs, if any, may not gain market acceptance among physicians, healthcare providers and payors, patients and the medical community. The degree of market acceptance of any of our approved drugs will depend on a variety of factors, including:

- timing of market introduction, number and clinical profile of competitive drugs;
- our ability to provide acceptable evidence of safety and efficacy;
- relative convenience and ease of administration;
- cost-effectiveness;
- availability of coverage, reimbursement and adequate payment from health maintenance organizations and other third party payors;
- prevalence and severity of adverse side effects; and
- other potential advantages over alternative treatment methods.

If our drugs fail to achieve market acceptance, we may not be able to generate significant revenue and our business would suffer.

There is uncertainty related to coverage, reimbursement and payment by healthcare providers and payors for newly approved drugs. The inability or failure to obtain coverage could affect its ability to market our future drugs and decrease our ability to generate revenue.

The availability and levels of coverage and reimbursement of newly approved drugs by healthcare providers and payors is subject to significant uncertainty. The commercial success of our drug candidates in both the U.S. and international markets is substantially dependent on whether third party coverage and reimbursement is available. The U.S. Centers for Medicare and Medicaid Services, health maintenance organizations and other third party payors in the United States, the European Union and other jurisdictions are increasingly attempting to contain healthcare costs by limiting both coverage and the level of reimbursement of new drugs and, as a result, they may not cover or provide adequate payment for its potential drugs. Our drug candidates may not be considered cost-effective and reimbursement may not be available to consumers or may not be sufficient to allow our drug candidates to be marketed on a competitive basis.

Table of Contents

In some countries, pricing of prescription drugs is subject to government control. In such countries, pricing negotiations with governmental authorities can take three to 12 months or longer following application to the competent authorities. To obtain reimbursement or pricing approval in such countries may require conducting an additional clinical trial comparing the cost-effectiveness of the drug to other alternatives. In the United States, the Medicare Part D drug benefit implemented in 2006 will limit drug coverage through formularies and other cost and utilization management programs, while Medicare Part B limits drug payments to a certain percentage of average price or through restrictive payment policies of “least costly alternatives” and “inherent reasonableness.” Our business could be materially harmed if coverage, reimbursement or pricing is unavailable or set at unsatisfactory levels.

We may be exposed to product liability claims that may damage our reputation and we may not be able to obtain adequate insurance.

Because we conduct clinical trials in humans, we face the risk that the use of our drug candidates will result in adverse effects. We believe that we have obtained reasonably adequate product liability insurance coverage for our trials. We cannot predict, however, the possible harm or side effects that may result from our clinical trials. Such claims may damage our reputation and we may not have sufficient resources to pay for any liabilities resulting from a claim excluded from, or beyond the limit of, our insurance coverage.

Once we have commercially available drugs based on our drug candidates, we will be exposed to the risk of product liability claims. This risk exists even with respect to those drugs that are approved for commercial sale by the FDA or other regulatory authorities in the United States, the European Union or elsewhere and manufactured in facilities licensed and regulated by the FDA or other such regulatory authorities. We intend to secure limited product liability insurance coverage, but may not be able to obtain such insurance on acceptable terms with adequate coverage, or at a reasonable cost. There is also a risk that third parties that we have agreed to indemnify could incur liability. Even if we were ultimately successful in product liability litigation, the litigation would consume substantial amounts of our financial and managerial resources and may create adverse publicity, all of which would impair our ability to generate sales of the litigated product as well as our other potential drugs.

We may be subject to damages resulting from claims that our employees or we have wrongfully used or disclosed alleged trade secrets of their former employers.

Many of our employees were previously employed at universities or other biotechnology or pharmaceutical companies, including our competitors or potential competitors. Although no claims against us are currently pending, we may be subject to claims that these employees or we have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. If we fail in defending such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights or personnel. A loss of key research personnel or their work product could hamper or prevent our ability to commercialize certain potential drugs, which could severely harm its business. Even if we are successful in defending against these claims, litigation could result in substantial costs and be a distraction to management.

Defending against claims relating to improper handling, storage or disposal of hazardous chemical, radioactive or biological materials could be time consuming and expensive.

Our research and development involves the controlled use of hazardous materials, including chemicals, radioactive and biological materials such as chemical solvents, phosphorus and bacteria. Our operations produce hazardous waste products. We cannot eliminate the risk of accidental contamination or discharge and any resultant injury from those materials. Various laws and regulations govern the use, manufacture, storage, handling and disposal of hazardous

materials. We may be sued for any injury or contamination that results from our use or the use by third parties of these materials. Compliance with environmental laws and regulations may be expensive, and current or future environmental regulations may impair our research, development and production efforts.

35

Table of Contents

If we fail to enforce adequately or defend our intellectual property rights our business may be harmed.

Our commercial success depends in large part on obtaining and maintaining patent and trade secret protection for our drug candidates, the methods used to manufacture those drug candidates and the methods for treating patients using those drug candidates. Specifically our two lead drug candidates have composition of matter patents that expire at the earliest case at 2016 and 2014 respectively. Failure to obtain, maintain or extend the patents could adversely affect our business. We will only be able to protect our drug candidates and our technologies from unauthorized use by third parties to the extent that valid and enforceable patents or trade secrets cover them.

Our ability to obtain patents is uncertain because legal means afford only limited protections and may not adequately protect our rights or permit it to gain or keep any competitive advantage. Some legal principles remain unresolved and the breadth or interpretation of claims allowed in patents in the United States, the European Union or elsewhere can still be difficult to ascertain or predict. In addition, the specific content of patents and patent applications that are necessary to support and interpret patent claims is highly uncertain due to the complex nature of the relevant legal, scientific and factual issues. Changes in either patent laws or in interpretations of patent laws in the United States, the European Union or elsewhere may diminish the value of our intellectual property or narrow the scope of our patent protection. Our existing patents and any future patents we obtain may not be sufficiently broad to prevent others from practicing our technologies or from developing competing products and technologies. In addition, we generally do not control the patent prosecution of subject matter that we license from others and have not controlled the earlier stages of the patent prosecution. Accordingly, we are unable to exercise the same degree of control over this intellectual property as we would over our own.

Even if patents are issued regarding our drug candidates or methods of using them, those patents can be challenged by our competitors who may argue such patents are invalid and/or unenforceable. Patents also will not protect our drug candidates if competitors devise ways of making or using these product candidates without legally infringing our patents. The U.S. Federal Food, Drug and Cosmetic, or FD&C, Act and FDA regulations and policies and equivalents in other jurisdictions provide incentives to manufacturers to challenge patent validity or create modified, noninfringing versions of a drug in order to facilitate the approval of abbreviated new drug applications for generic substitutes. These same types of incentives encourage manufacturers to submit new drug applications that rely on literature and clinical data not prepared for or by the drug sponsor.

Proprietary trade secrets and unpatented know-how are also very important to our business. We rely on trade secrets to protect our technology, especially where we do not believe that patent protection is appropriate or obtainable. However, trade secrets are difficult to protect. Our employees, consultants, contractors, outside scientific collaborators and other advisors may unintentionally or willfully disclose our confidential information to competitors, and confidentiality agreements may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. Enforcing a claim that a third party obtained illegally and is using trade secrets is expensive and time consuming, and the outcome is unpredictable. Moreover, our competitors may independently develop equivalent knowledge, methods and know-how. Failure to obtain or maintain trade secret protection could adversely affect our competitive business position.

If we infringe intellectual property rights of third parties, we may increase our costs or be prevented from being able to commercialize our drug candidates.

There is a risk that we are infringing or will infringe the proprietary rights of third parties because patents and pending applications belonging to third parties exist in the United States, the European Union and elsewhere in the world in the areas our research explores. Others might have been the first to make the inventions covered by each of our or our licensors' pending patent applications and issued patents and might have been the first to file patent applications for these inventions. In addition, because the patent application process can take several years to complete, there may be currently pending applications, unknown to us, which may later result in issued patents that cover the production, manufacture, commercialization or use of our drug candidates. In addition, the production, manufacture, commercialization or use of our product candidates may infringe existing

36

Table of Contents

patents of which we are not aware. Numerous third-party United States and foreign issued patents and pending applications exist in the area of kinases, including CDK, Aurora and Plk for which we have research programs. Because patent applications can take several years to issue, there may be pending applications that may result in issued patents that cover our technologies or product candidates. For example, some pending patent applications contain broad claims that could represent freedom to operate limitations for some of our kinase programs should they be issued unchanged. If we wish to use the technology or compound claimed in issued and unexpired patents owned by others, we will need to obtain a license from the owner, enter into litigation to challenge the validity of the patents or incur the risk of litigation in the event that the owner asserts that we infringe its patents. In one case we have opposed a European patent relating to human aurora kinase. We are also aware of a corresponding U.S. patent containing method of treatment claims for specific cancers using aurora kinase modulators which, if held valid, could potentially restrict the use of our aurora kinase inhibitors once clinical trials are completed.

There has been substantial litigation and other proceedings regarding patent and other intellectual property rights in the pharmaceutical and biotechnology industries. Defending against third party claims, including litigation in particular, would be costly and time consuming and would divert management's attention from our business, which could lead to delays in our development or commercialization efforts. If third parties are successful in their claims, we might have to pay substantial damages or take other actions that are adverse to our business. As a result of intellectual property infringement claims, or to avoid potential claims, we might:

- be prohibited from selling or licensing any product that we may develop unless the patent holder licenses the patent to us, which it is not required to do;
- be required to pay substantial royalties or grant a cross license to our patents to another patent holder;
- decide to move some of our screening work outside Europe;
- be required to pay substantial damages for past infringement, which we may have to pay if a court determines that our product candidates or technologies infringe a competitor's patent or other proprietary rights; or
- be required to redesign the formulation of a drug candidate so it does not infringe, which may not be possible or could require substantial funds and time.

The development programs for our two lead drug candidates are based in part on intellectual property rights we licensed from others, and any termination of those licenses could seriously harm our business.

We have in-licensed certain patent rights in connection with the development programs for each of our two lead drug candidates. With respect to seliciclib, we hold a license from Centre National de Recherche Scientifique, or CNRS, and Institut Curie. With respect to sapacitabine, we hold a license from Sankyo Co., Ltd. of Japan. Both of these license agreements impose payment and other material obligations on us. Under the CNRS/Institut Curie license, we are obligated to pay license fees, milestone payments and royalties. We are also obligated to use reasonable efforts to develop and commercialize products based on the licensed patents. Under the Sankyo license we are obligated to pay license fees, milestone payments and royalties. We are also obligated to use commercially reasonable efforts to commercialize products based on the licensed rights and to use reasonable efforts to obtain regulatory approval to sell the products in at least one country by September 2011. Although we are currently in compliance with all of our material obligations under these licenses, if we were to breach any such obligations our counterparties would be permitted to terminate the licenses. This would restrict or delay or eliminate our ability to develop and commercialize these drug candidates, which could seriously harm our business.

37

Table of Contents

Intellectual property rights of third parties could adversely affect our ability to commercialize our drug candidates.

If patents issued to third parties contain valid claims that cover our compounds or their manufacture or uses relevant to our development plans, we may be required to obtain licenses to these patents or to develop or obtain alternative technology. We are aware of several published patent applications, and understand that others may exist, that could support claims that, if granted, could cover various aspects of our developmental programs, including in some cases particular uses of our lead drug candidate, seliciclib, sapacitabine or other therapeutic candidates, or gene sequences and techniques that we use in the course of our research and development. In addition, we understand that other applications exist relating to potential uses of seliciclib and sapacitabine that are not part of our current clinical programs for these compounds. Although we intend to continue to monitor these applications, we cannot predict what claims will ultimately be allowed and if allowed what their scope would be. If a patent is issued that covers our compounds or their manufacture or uses or screening assays related to our development plans then we may not be in a position to commercialize the related drug candidate unless we successfully pursue litigation to have that patent invalidated or enter into a licensing arrangement with the patent holder. Any such litigation would be time consuming and costly, and its outcome would not be guaranteed, and we cannot be certain that we would be able to enter into a licensing arrangement with the patent holder on commercially reasonable terms. In either case, our business prospects could be materially adversely affected. In one case we have opposed a granted European patent related to human aurora kinase. We are also aware of a corresponding US patent containing method of treatment claims for specific cancers using aurora kinase modulators, which if held valid, could potentially restrict the use of certain of our aurora kinase inhibitors.

We have limited experience attempting to comply with public company obligations. Attempting to comply with these requirements will increase our costs and require additional management resources, and we still may fail to comply.

As a newly public company, we face and will continue to face increased legal, accounting, administrative and other costs and expenses as a public company that we did not incur as a private company. Compliance with the Sarbanes Oxley Act of 2002, as well as other rules of the SEC, the Public Company Accounting Oversight Board and The Nasdaq Global Market has resulted in a significant initial cost to us as well as an ongoing increase in our legal, audit and financial compliance costs. As a public company, we are subject to Section 404 of the Sarbanes Oxley Act relating to internal control over financial reporting and although we have developed processes to evaluate our internal controls for purposes of Section 404, we cannot assure that our internal control over financial reporting will prove to

be effective.

Effective internal controls over financial reporting are necessary for us to provide reliable financial reports and, together with adequate disclosure controls and procedures, are designed to prevent fraud. If we cannot provide reliable financial reports or prevent fraud, our operating results could be harmed. However, guidance from regulatory authorities in the area of internal controls continues to evolve and substantial uncertainty exists regarding our on-going ability to comply by applicable deadlines. Any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. Ineffective internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our common stock.

Our common stock may have a volatile public trading price.

An active public market for our common stock has not developed. Our stock can trade in small volumes which may make the price of our stock highly volatile. The last reported price of our stock may not represent the price at which you would be able to buy or sell the stock. The market prices for securities of companies comparable to us have been highly volatile. Often, these stocks have

38

Table of Contents

experienced significant price and volume fluctuations for reasons unrelated to the operating performance of the individual companies. Factors giving rise to this volatility may include:

- disclosure of actual or potential clinical results with respect to product candidates we are developing;
- regulatory developments in both the United States and abroad;
- developments concerning proprietary rights, including patents and litigation matters;
- public concern about the safety or efficacy of our product candidates or technology, or related technology, or new technologies generally;
- concern about the safety or efficacy of our product candidates or technology, or related technology, or new technologies generally;
- public announcements by our competitors or others; and
- general market conditions and comments by securities analysts and investors.

Fluctuations in our operating losses could adversely affect the price of our common stock.

Our operating losses may fluctuate significantly on a quarterly basis. Some of the factors that may cause our operating losses to fluctuate on a period-to-period basis include the status of our preclinical and clinical development programs, level of expenses incurred in connection with our preclinical and clinical development programs, implementation or termination of collaboration, licensing, manufacturing or other material agreements with third parties, non-recurring revenue or expenses under any such agreement, and compliance with regulatory requirements. Period-to-period comparisons of our historical and future financial results may not be meaningful, and investors should not rely on them as an indication of future performance. Our fluctuating losses may fail to meet the expectations of securities analysts or investors. Our failure to meet these expectations may cause the price of our common stock to decline.

Anti-takeover provisions in our charter documents and provisions of Delaware law may make an acquisition more difficult and could result in the entrenchment of management.

We are incorporated in Delaware. Anti-takeover provisions of Delaware law and our amended and restated certificate of incorporation and amended and restated bylaws may make a change in control or efforts to remove management more difficult. Also, under Delaware, our board of directors may adopt additional anti-takeover measures.

We have the authority to issue up to 5,000,000 shares of preferred stock and to determine the terms of those shares of stock without any further action by our stockholders. If the board of directors exercises this power to issue preferred stock, it could be more difficult for a third party to acquire a majority of our outstanding voting stock and vote the stock they acquire to remove management or directors.

Our amended and restated certificate of incorporation and amended and restated bylaws also provides staggered terms for the members of our board of directors. Under Section 141 of the Delaware General Corporation Law, our directors may be removed by stockholders only for cause and only by vote of the holders of a majority of voting shares then outstanding. These provisions may prevent stockholders from replacing the entire board in a single proxy contest, making it more difficult for a third party to acquire control of us without the consent of our board of directors. These provisions could also delay the removal of management by the board of directors with or without cause. In addition, our directors may only be removed for cause and amended and restated bylaws limit the ability of our stockholders to call special meetings of stockholders.

Under Section 203 of the Delaware General Corporation Law, a corporation may not engage in a business combination with any holder of 15% or more of its capital stock until the holder has held the stock for three years unless, among other possibilities, the board of directors approves the transaction. Our board of directors could use this provision to prevent changes in management. The existence of the foregoing provisions could limit the price investors might be willing to pay in the future for shares of our common stock.

39

Table of Contents

Our certificate of incorporation and bylaws and certain provisions of Delaware law may delay or prevent a change in our management and make it more difficult for a third party to acquire us.

Our certificate of incorporation and bylaws contain provisions that could delay or prevent a change in our board of directors and management teams. Some of these provisions:

- authorize the issuance of preferred stock that can be created and issued by the board of directors without prior stockholder approval, commonly referred to as “blank check” preferred stock, with rights senior to those of our common stock;
- provide for the board of directors to be divided into three classes; and
- require that stockholder actions must be effected at a duly called stockholder meeting and prohibit stockholder action by written consent.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which limits the ability of large stockholders to complete a business combination with, or acquisition of, us. These provisions may prevent a business combination or acquisition that would be attractive to stockholders and could limit the price that investors would be willing to pay in the future for our stock.

These provisions also make it more difficult for our stockholders to replace members of our board of directors. Because our board of directors is responsible for appointing the members of our management team, these provisions could in turn affect any attempt to replace our current management team. Additionally, these provisions may prevent an acquisition that would be attractive to stockholders and could limit the price that investors would be willing to pay in the future for our common stock.

We may have limited ability to pay cash dividends on the convertible preferred stock.

Delaware law may limit our ability to pay cash dividends on the convertible preferred stock. Under Delaware law, cash dividends on our capital stock may only be paid from “surplus” or, if there is no “surplus,” from the corporation’s net profits for the current or preceding fiscal year. Delaware law defines “surplus” as the amount by which the total assets of a corporation, after subtracting its total liabilities, exceed the corporation’s capital, as determined by its board of directors. Since we are not profitable, our ability to pay cash dividends will require the availability of adequate surplus. Even if adequate surplus is available to pay cash dividends on the convertible preferred stock, we may not have sufficient cash to pay dividends on the convertible preferred stock. If that was to happen, holders of preferred stock would be granted certain additional rights until such dividends were repaid.

Our common and convertible preferred stock may experience extreme price and volume fluctuations, which could lead to costly litigation for the Company and make an investment in the Company less appealing.

The market price of our common and convertible preferred stock may fluctuate substantially due to a variety of factors, including:

- additions to or departures of our key personnel;
- announcements of technological innovations or new products or services by us or our competitors;
- announcements concerning our competitors or the biotechnology industry in general;
- new regulatory pronouncements and changes in regulatory guidelines;
- general and industry-specific economic conditions;
- changes in financial estimates or recommendations by securities analysts;
- variations in our quarterly results;

40

Table of Contents

- announcements about our collaborators or licensors; and
- changes in accounting principles.

The market prices of the securities of biotechnology companies, particularly companies like us without product revenues and earnings, have been highly volatile and are likely to remain highly volatile in the future. This volatility has often been unrelated to the performance of particular companies. In the past, companies that experience volatility in the market price of their securities have often faced securities class action litigation. Moreover, market prices for stocks of biotechnology-related and technology companies frequently reach levels that bear no relationship to the performance of these companies. These market prices generally are not sustainable and are highly volatile. Whether or not meritorious, litigation brought against us could result in substantial costs, divert our management’s attention and resources and harm our financial condition and results of operations.

The future sale of our common and convertible preferred stock, and future issuances of our common stock upon conversion of our convertible preferred stock and upon the payment of make-whole dividends, if any, could

negatively affect our stock price.

If our common or convertible preferred stockholders sell substantial amounts of its stock in the public market, or the market perceives that such sales may occur, the market price of our common and convertible preferred stock could fall.

In addition, if we exercise our rights to pay make-whole dividends in common stock rather than in cash upon conversion of our convertible preferred stock to common stock, then the sale of such shares of common stock or the perception that such sales may occur could cause the market price of our stock to fall. Additionally, after our convertible preferred stock offering, the holders of our convertible preferred stock had the right to convert each share of convertible preferred stock into approximately 0.42553 shares of our common stock. Such conversion rate is subject to certain antidilution adjustments that, upon the occurrence of certain events, will increase the number of shares of common stock that each holder of convertible preferred stock will receive upon conversion into common stock. Such antidilution price adjustments may apply in the case of any strategic alternative that we pursue which may result in further dilution to the holders of outstanding common stock. The conversion of our convertible preferred stock into common stock and the payment of any make-whole dividends in shares of common stock in lieu of cash, may result in substantial dilution to the interests of our holders of common stock.

If we exchange the convertible preferred stock for debentures, the exchange will be taxable but we will not provide any cash to pay any tax liability that any convertible preferred stockholder may incur.

An exchange of convertible preferred stock for debentures, as well as any dividend make-whole or interest make-whole payments paid in our common stock, will be taxable events for U.S. federal income tax purposes, which may result in tax liability for the holder of convertible preferred stock without any corresponding receipt of cash by the holder. In addition, the debentures may be treated as having original issue discount, a portion of which would generally be required to be included in the holder's gross income even though the cash to which such income is attributable would not be received until maturity or redemption of the debenture. We will not distribute any cash to you to pay these potential tax liabilities.

If we automatically convert the convertible preferred stock, there is a substantial risk of fluctuation in the price of our common stock from the date we elect to automatically convert to the conversion date.

We may elect to automatically convert the convertible preferred stock on or prior to maturity if our common stock price has exceeded 150% of the conversion price for at least 20 trading days during a 30-day trading period ending within five trading days prior to the notice of automatic conversion. You should be aware that there is a risk of fluctuation in the price of our common stock between the time when we may first elect to automatically convert the preferred and the automatic conversion date.

We do not intend to pay cash dividends on our common stock in the foreseeable future.

We do not anticipate paying cash dividends on our common stock in the foreseeable future. Any payment of cash dividends will depend on our financial condition, results of operations, capital

requirements, the outcome of the review of our strategic alternatives and other factors and will be at the discretion of our board of directors. Accordingly, investors will have to rely on capital appreciation, if any, to earn a return on their investment in our common stock. Furthermore, we may in the future become subject to contractual restrictions on, or prohibitions against, the payment of dividends.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

- 31.1 Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14
(a) As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a) As
Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of
2002
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of
2002

42

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, in Berkeley Heights, New Jersey, on May 9, 2007.

Dated: May 9, 2007

CYCLACEL PHARMACEUTICALS, INC.

By: /s/ Paul McBarron
Paul McBarron

Chief Operating Officer and Executive
Vice President, Finance