ARROWHEAD RESEARCH CORP
Form 10-Q
August 12, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2010

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 000-21898

ARROWHEAD RESEARCH CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**46-0408024**
(State of incorporation)	**(I.R.S. Employer Identification No.)**

201 S. Lake Avenue, Suite 703

Pasadena, California 91101

(626) 304-3400

(Address and telephone number of principal executive offices)

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 x No ¨

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

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

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

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

The number of shares of the registrant s common stock outstanding as of August 9, 2010 was 70,938,013.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Arrowhead Research Corporation and Subsidiaries

(A Development Stage Company)

Consolidated Balance Sheets

	(unaudited) June 30, 2010	September 30, 2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 8,983,445	$ 2,020,224
Trade receivable, net of allowance for doubtful accounts of $90,789 at June 30, 2010 and $30,789 at September 30, 2009	9,464	144,148
Other receivables	727,015	3,109
Prepaid expenses	337,002	316,074
Other current assets	68,950	
TOTAL CURRENT ASSETS	10,125,876	2,483,555
PROPERTY AND EQUIPMENT		
Computers, office equipment and furniture	374,991	374,991
Research equipment	932,683	932,683
Software	150,445	150,445
Leasehold improvements	94,317	94,317
	1,552,436	1,552,436
Less: Accumulated depreciation and amortization	(1,296,459)	(1,025,392)
NET PROPERTY AND EQUIPMENT	255,977	527,044
OTHER ASSETS		
Rent deposit	34,735	109,648
Patents	2,125,742	2,362,460
Investment in Nanotope Inc., equity basis	1,866,740	2,032,467
Investment in Leonardo Biosystems Inc., at cost	187,000	187,000
TOTAL OTHER ASSETS	4,214,217	4,691,575
TOTAL ASSETS	**$ 14,596,070**	**$ 7,702,174**
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 1,032,792	$ 1,013,281
Accrued expenses	686,524	420,077
Accrued payroll and benefits	204,911	160,846
Accrued severance	23,500	23,500
Capital lease obligation	74,845	726,534
Derivative liability	2,617,679	
Note payable	500,000	

TOTAL CURRENT LIABILITIES	5,140,251	2,344,238
LONG-TERM LIABILITIES		
Note payable		500,000
TOTAL LONG-TERM LIABILITIES		500,000
Commitments and contingencies		
STOCKHOLDERS EQUITY		
Arrowhead Research Corporation shareholders equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; no shares issued or outstanding		
Common stock, $0.001 par value; 145,000,000 shares authorized; 70,938,013 and 56,411,774 shares issued and outstanding as of June 30, 2010 and September 30, 2009, respectively	70,953	56,428
Additional paid-in capital	118,780,923	110,070,327
Subscription receivable		(300,000)
Accumulated deficit during the development stage	(108,738,761)	(104,968,819)
Total Arrowhead Research Corporation stockholders equity	10,113,115	4,857,936
Noncontrolling interest	(657,296)	
TOTAL STOCKHOLDERS EQUITY	9,455,819	4,857,936
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	**$ 14,596,070**	**$ 7,702,174**

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

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Arrowhead Research Corporation and Subsidiaries

(A Development Stage Company)

Consolidated Statements of Operations

(unaudited)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Nine Months Ended June 30, 2010	Nine Months Ended June 30, 2009	May 7, 2003 (Inception) to June 30, 2010
REVENUE	**$ 133,990**	**$ 2,633,191**	**$ 439,403**	**$ 3,570,564**	**$ 7,947,043**
OPERATING EXPENSES					
Salaries	914,336	883,800	3,063,560	6,444,954	43,098,098
Consulting	207,746	428,212	387,005	1,360,962	8,219,162
General and administrative expenses	869,307	1,016,199	2,349,268	3,627,303	25,414,097
Research and development	227,804	2,509,675	856,638	7,904,528	54,476,795
Patent amortization	78,906	100,103	236,719	308,189	2,023,184
TOTAL OPERATING EXPENSES	**2,298,099**	**4,937,989**	**6,893,190**	**19,645,936**	**133,231,336**
OPERATING LOSS	(2,164,109)	(2,304,798)	(6,453,787)	(16,075,372)	(125,284,293)
OTHER INCOME (EXPENSE)					
Loss on equity of investments Nanotope	(66,489)	(48,302)	(165,727)	(177,714)	(506,260)
Gain on sale of stock in subsidiary					2,292,800
Gain on sale of equity of investments Ensysce				700,000	700,000
Gain/(loss) on sale of fixed assets, net	13,000	(133,206)	63,000	(80,749)	(14,374)
Realized and unrealized gain in marketable securities					382,264
Interest income (expense), net	(12,877)	(78,526)	(49,678)	(135,040)	2,760,276
Change in value of derivative liability	1,552,228		1,552,228		1,552,228
Other income		55,177	1,895	55,177	179,785
TOTAL OTHER INCOME (EXPENSE)	1,485,862	(204,857)	1,401,718	361,674	7,346,719
LOSS FROM CONTINUING OPERATIONS	(678,247)	(2,509,655)	(5,052,069)	(15,713,698)	(117,937,574)
Gain/(loss) from discontinued operations	(5,549)	(18,962)	(20,753)	(134,726)	(7,587,220)
Gain/(loss) on disposal of discontinued operations			430,000		789,375
INCOME (LOSS) FROM DISCONTINUED OPERATIONS	(5,549)	(18,962)	409,247	(134,726)	(6,797,845)
Provision for income taxes					
NET LOSS	(683,796)	(2,528,617)	(4,642,822)	(15,848,424)	(124,735,419)
Less: Net loss attributable to noncontrolling interests	312,741		872,880	60	16,160,618
NET LOSS ATTRIBUTABLE TO ARROWHEAD	**$ (371,055)**	**$ (2,528,617)**	**$ (3,769,942)**	**$ (15,848,364)**	**$ (108,574,801)**

Earnings per share basic and diluted:				
Income (loss) from continuing operations attributable to Arrowhead common shareholders	$ (0.01)	$ (0.06)	$ (0.07)	$ (0.37)
Income (loss) from discontinued operations attributable to Arrowhead common shareholders			0.01	
Net income (loss) attributable to Arrowhead shareholders	$ (0.01)	$ (0.06)	$ (0.06)	$ (0.37)
Weighted average shares outstanding basic and diluted	64,579,403	43,353,848	62,056,412	43,074,294

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

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Arrowhead Research Corporation and Subsidiaries

(A Development Stage Company)

Consolidated Statement of Stockholders Equity

from inception through June 30, 2010

(Unaudited)

	Common Stock		Additional Paid-in Capital	Subscription Receivable	Accumulated Deficit during the Development Stage	Noncontrolling interest	Totals
	Shares	Amount					
Initial Issuance of Stock:							
Common stock & warrants issued for cash @ $0.001 per unit	3,000,000	$ 3,000	$	$	$	$	$ 3,000
Common stock & warrants issued for cash @ $1.00 per unit	1,680,000	1,680	1,678,320				1,680,000
Stock issuance cost charged to additional paid-in capital			(168,000)				(168,000)
Net loss for period from inception to September 30, 2003					(95,238)		(95,238)
Balance at September 30, 2003	**4,680,000**	**4,680**	**1,510,320**		**(95,238)**		**1,419,762**
Exercise of stock options	75,000	75	14,925				15,000
Common stock & warrants issued for cash @ $1.00 per unit	475,000	475	474,525				475,000
Common stock & warrants issued for marketable securities @ $1.00 per unit	500,000	500	499,500				500,000
Stock issuance cost charged to additional paid-in capital			(96,500)				(96,500)
Common stock and warrants issued for cash @ $1.50 per unit	6,608,788	6,609	9,906,573				9,913,182
Common stock issued in reverse acquisition	705,529	706	(151,175)				(150,469)
Common stock issued as a gift for $1.09 per share	150,000	163	162,587				162,750
Common stock and warrants issued as stock issuance cost @ $1.50 per unit	356,229	356	533,988				534,344
Stock issuance cost charged to additional paid-in capital			(991,318)				(991,318)
Exercise of stock option @ $0.20 per share	75,000	75	14,925				15,000
Exercise of stock options @ $1.00 per share	6,000	6	5,994				6,000
Stock-based compensation			175,653				175,653
Net loss for the year ended September 30, 2004					(2,528,954)	1,777,699	(751,255)
Balance at September 30, 2004	**13,631,546**	**13,645**	**12,059,997**		**(2,624,192)**	**1,777,699**	**11,227,149**
Exercise of warrants @ $1.50 per share	13,812,888	13,813	20,705,522				20,719,335
Exercise of stock options @ $1.00 per share	25,000	25	24,975				25,000
Common stock issued to purchase Insert Therapeutics share @ $3.98 per share	502,260	502	1,999,498				2,000,000
Common stock issued for services	12,500	12	49,988				50,000
Stock-based compensation			508,513				508,513
			230,087				230,087

Change in percentage of ownership in subsidiary						
Net loss for the year ended September 30, 2005				(6,854,918)	121,491	(6,733,427)
Balance at September 30, 2005	**27,984,194**	**27,997**	**35,578,580**	**(9,479,110)**	**1,899,190**	**28,026,657**
Exercise of stock options	115,794	116	341,421			341,537
Common stock issued @ $4.88 per share	204,854	205	999,795			1,000,000
Common stock issued @ $3.84 per share	15,000	15	57,585			57,600
Common stock issued @ $3.50 per share	5,590,000	5,590	19,539,410			19,545,000
Common stock issued @ $5.91 per share	25,364	25	149,975			150,000
Common stock issued to purchase Calando Pharmaceuticals, Inc. @ $5.17 per share	208,382	208	1,077,125			1,077,333
Stock-based compensation			1,369,478			1,369,478
Net loss for the year ended September 30, 2006				(18,997,209)	(964,752)	(19,961,961)
Balance at September 30, 2006	**34,143,588**	**34,156**	**59,113,369**	**(28,476,319)**	**934,438**	**31,605,644**
Exercise of stock options	186,164	186	434,541			434,727
Common stock issued @ $5.78 per share, net	2,849,446	2,849	15,149,366			15,152,215
Arrowhead s increase in proportionate share of Insert Therapeutics equity			2,401,394			2,401,394
Common stock issued for purchase of Carbon Nanotechnologies, Inc. @ $3.77 per share	1,431,222	1,431	5,398,569			5,400,000
Stock-based compensation			2,175,544			2,175,544
Net loss for the year ended September 30, 2007				(29,931,118)	(781,829)	(30,712,947)
Balance at September 30, 2007	**38,610,420**	**38,622**	**84,672,783**	**(58,407,437)**	**152,609**	**26,456,577**
Exercise of stock options	105,357	106	289,921			290,027
Common stock issued at approximately $1.80 per share, net	3,863,989	3,867	6,956,718			6,960,585
Arrowhead s increase in proportionate share of Unidym s equity			1,720,962			1,720,962
Common stock issued @ $2.72 per share to Rice University	50,000	50	135,950			136,000
Common stock issued @ $2.83 per share to purchase shares of Unidym, Inc.	70,547	71	199,929			200,000
Common stock issued @ $2.95 per share to purchase MASA Energy, LLC	105,049	105	309,895			310,000
Common stock issued @ $2.19 per share to Unidym for the acquisition of Nanoconduction	114,155	114	249,886			250,000
Common stock issued @ $2.18 per share	15,000	15	32,685			32,700
Stock-based compensation			3,187,397			3,187,397
Net loss for the year ended September 30, 2008				(27,089,030)	(152,609)	(27,241,639)
Balance at September 30, 2008	**42,934,517**	**42,950**	**97,756,126**	**(85,496,467)**		**12,302,609**
Common Stock issued @ $0.55 per share to Unidym stockholder in exchange for Unidym s shares	2,058,393	2,059	1,131,617			1,133,676
Common Stock issued @ $0.52 per share to TEL Ventures in exchange for Unidym s shares	2,222,222	2,222	1,156,111			1,158,333
Reclassification of former Unidym mezzanine debt to equity			2,000,000			2,000,000
Arrowhead s increase in proportionate share of Calando s equity			2,120,250			2,120,250

Common stock issued @ $0.30 per share	9,196,642	9,197	2,749,796				2,758,993
Change in percentage of ownership in subsidiary			16,297				16,297
Stock-based compensation			2,676,170				2,676,170
Issuance of Series D Preferred Stock for Subscription in Unidym			300,000	(300,000)			
Amortization of discount on Unidym Series D Preferred Stock			163,960		(163,960)		
Net loss for the year ended September 30, 2009					(19,308,392)		(19,308,392)
Balance at September 30, 2009	**56,411,774**	**56,428**	**110,070,327**	**(300,000)**	**(104,968,819)**		**4,857,936**
Exercise of stock options	6,875	7	7,624				7,631
Issuance of Series D Preferred Stock for Subscription in Unidym				300,000			300,000
Issuance of Unidym s common stock to minority shareholders			245,345			54,655	300,000
Common stock issued @ $0.63 per share	5,083,430	5,083	3,217,813				3,222,896
Common stock issued @ $1.312 per share	6,592,989	6,593	3,692,078				3,698,671
Common Stock issued to Calando stockholders in exchange for Calando s shares	1,220,000	1,220	(160,667)			159,447	
Common Stock issued to Unidym stockholders in exchange for Unidym s shares	153,176	153	(1,435)			1,282	
Stock-based compensation			1,039,357				1,039,357
Exercise of warrants	1,469,769	1,469	670,481			200	672,150
Net loss for the Nine month period ended June 30, 2010					(3,769,942)	(872,880)	(4,642,822)
Balance at June 30, 2010	**70,938,013**	**70,953**	**118,780,923**		**(108,738,761)**	**(657,296)**	**9,455,819**

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

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Arrowhead Research Corporation and Subsidiaries

(A Development Stage Company)

Consolidated Statements of Cash Flows

(unaudited)

	Nine Months Ended June 30, 2010	Nine Months Ended June 30, 2009	May 7, 2003 (Date of inception) to June 30, 2010
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Loss	$ (4,642,822)	$ (15,848,424)	$ (124,735,419)
Plus: Net loss attributable to noncontrolling interests	872,880	60	16,160,618
Net loss attributable to Arrowhead	(3,769,942)	(15,848,364)	(108,574,801)
(Income)/loss from discontinued operation	(409,247)	134,726	6,797,845
Realized and unrealized gain on investment		(700,000)	(1,082,263)
Gain from sale of subsidiary			(306,344)
Loss on disposal of fixed assets		80,749	77,374
Stock issued as gift to Caltech			162,750
Stock issued as gift to Rice University			136,000
Stock issued for professional services			232,700
Stock issued for in-process research and development			13,166,347
Change in percentage of ownership in subsidiary			16,297
Change in value of derivative liabillity	(1,552,228)		(1,552,228)
Purchased in-process research and development Nanoconduction		1,661,027	2,685,208
Stock-based compensation	1,039,357	1,978,771	11,132,112
Depreciation and amortization	507,785	792,524	5,245,430
Gain on sale of stock in subsidiary			(2,292,800)
Non-cash loss from equity investment	165,727	177,714	506,260
Noncontrolling interest	(872,880)	(60)	(17,160,806)
Gain on renegotiation of accrued severance			(726,500)
(Increase) decrease of cash flow from:			
Receivables	134,683	(309,197)	(13,414)
Other receivables	(723,906)		(723,906)
Other prepaid expenses	(20,926)	(68,839)	(339,478)
Other current assets	(68,950)		(68,950)
Deposits	74,913	136,675	(36,795)
Accounts payable	19,510	56,603	400,522
Accrued expenses	266,447	103,024	296,988
Accrued severance and other liabilities	44,065	(922,516)	972,100
NET CASH USED IN OPERATING ACTIVITIES OF CONTINUING OPERATIONS	(5,165,592)	(12,727,163)	(91,050,352)
CASH FLOWS FROM INVESTING ACTIVITIES OF CONTINUING OPERATIONS:			
Purchase of marketable securities US Treasury Bills			(18,575,915)
Purchase of property and equipment		(40,245)	(3,550,518)
Purchase of MASA Energy, LLC			(250,000)
Minority equity investment			(2,000,000)
Cash paid for interest in Nanotechnica			(4,000,000)
Cash paid for interest in Aonex			(5,000,000)
Cash paid for interest in Insert			(10,150,000)
Cash paid for interest in Calando		(800,000)	(8,800,000)
Cash paid for interest in Unidym		(1,100,000)	(14,138,003)
Cash paid/obtained for interest in Tego		1,700,000	(801,000)
Cash obtained from interest in Nanotechnica			4,000,000
Cash obtained from interest in Aonex			5,001,250
Cash obtained from interest in Insert			10,529,594

Cash obtained from interest in Calando		800,000	8,800,000
Cash obtained from interest in Unidym		1,100,000	14,138,003
Cash paid/obtained from interest in Tego		(1,700,000)	801,000
Proceeds from sale of marketable securities US Treasury Bills			18,888,265
Proceeds from sale of investments		700,000	1,269,913
Proceeds from sale of subsidiary (net)			359,375
Proceeds from sale of fixed assets		103,011	79,375
Payment for patents			(303,440)
Restricted cash			50,773
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES OF CONTINUING OPERATIONS		762,766	(3,651,328)
CASH FLOWS FROM FINANCING ACTIVITIES OF CONTINUING OPERATIONS:			
Payments of capital leases	(651,689)	(601,744)	(1,602,155)
Proceeds from issuance of Calando debt		2,516,467	2,516,467
Proceeds from sale of stock in subsidiary	300,000	2,000,000	18,875,168
Proceeds from issuance of common stock and warrants, net	12,071,255		90,693,490
NET CASH PROVIDED BY FINANCING ACTIVITIES OF CONTINUING OPERATIONS	11,719,566	3,914,723	110,482,970
Cash flows from discontinued operations:			
Operating cash flows	(20,753)	(134,726)	(7,587,220)
Investing cash flows	430,000		789,375
Net cash provided by (used in) discontinued operations:	409,247	(134,726)	(6,797,845)
NET INCREASE (DECREASE) IN CASH	6,963,221	(8,184,400)	8,983,445
CASH AT BEGINNING OF PERIOD	2,020,224	10,093,585	
CASH AT END OF PERIOD	$ 8,983,445	$ 1,909,185	$ 8,983,445
Supplementary disclosures:			
Interest paid	$ 26,406	$ 76,350	$ 124,920

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

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SUPPLEMENTAL NON-CASH TRANSACTIONS

On March 23, 2005, Arrowhead Research Corporation (Arrowhead) purchased 7,375,000 shares of Insert Therapeutics, Inc. (Insert) common stock from two minority stockholders of Insert for 502,260 newly issued shares of Arrowhead Common Stock valued at $2,000,000 based on the closing market price of Arrowhead Common Stock on NASDAQ on the date of the closing.

On March 31, 2006, Arrowhead purchased 964,000 shares of Calando Pharmaceuticals, Inc. (Calando) common stock from minority stockholders of Calando for $1,928,000 consisting of 208,382 newly issued shares of Arrowhead Common Stock valued at $1,077,333 plus $850,667 in cash. The 208,382 shares of Arrowhead Common Stock were valued based on the average closing price of Arrowhead s Common Stock on NASDAQ the ten trading days immediately prior to the date of the closing.

On April 20, 2007, Arrowhead purchased the Series E Preferred Stock of Carbon Nanotechnologies, Inc. in exchange for 1,431,222 shares of Arrowhead Common Stock with an estimated fair market value of $5,400,000 based on the average closing price of Arrowhead s Common Stock on NASDAQ the ten trading days immediately prior to March 24, 2007, as set forth in the Agreement and Plan of Merger among Unidym, Inc. (Unidym), Carbon Nanotechnologies, Inc., Arrowhead and others.

On April 23, 2008, Arrowhead purchased 200,000 shares of the common stock of Unidym in exchange for 70,547 shares of Arrowhead Common Stock with an estimated fair market value of $200,000 based on the average closing price of Arrowhead s Common Stock on NASDAQ the ten trading days immediately prior to the date of the closing.

On April 29, 2008, Arrowhead purchased all of the membership units of MASA Energy, LLC for $560,000. The purchase price consisted of 105,049 shares of Arrowhead Common Stock with an estimated fair market value of $310,000 based on the average closing price of Arrowhead s Common Stock on NASDAQ the ten trading days immediately prior to the date of the closing, plus $250,000 in cash.

On August 8, 2008, Unidym acquired all of the outstanding stock of Nanoconduction, Inc. in exchange for 114,115 shares of Arrowhead Common Stock with an estimated fair market value of $250,000.

On June 11, 2009, Arrowhead issued 1,324,625 shares of Common Stock with an estimated fair market value of $688,802 in exchange for an equal number of Series A Preferred Stock of Unidym, with minority stockholders of Unidym.

On June 25, 2009, Arrowhead issued 1,944,444 shares of Common Stock with an estimated fair market value of $972,222 in exchange for an equal number of Series C Preferred Stock of Unidym, with a minority stockholder of Unidym.

On September 22, 2009, Arrowhead issued 91,495 shares of Common Stock with an estimated fair market value of $46,662 in exchange for an equal number of Series A Preferred Stock of Unidym with a minority stockholder of Unidym.

On September 28, 2009, Arrowhead issued 642,273 shares of Common Stock with an estimated fair market value of $398,209 in exchange for 5,574 shares of Series A Preferred Stock and 636,699 shares of Series C Preferred Stock of Unidym, with several minority stockholders of Unidym.

On September 30, 2009, Arrowhead issued 277,778 shares of Common Stock with an estimated fair market value of $186,111 in exchange for an equal number of shares of Series C-1 Preferred Stock of Unidym, with a minority stockholder of Unidym.

In October and November 2009, Arrowhead issued 153,176 shares of Common Stock with an estimated fair market value of $47,485 in exchange for an equal number of shares of Series C Preferred Stock of Unidym, with several minority stockholders of Unidym.

In October and November 2009, Arrowhead issued 1,140,000 shares of Common Stock with an estimated fair market value of $706,800 in exchange for 2,850,000 shares of Calando common stock, with several minority stockholders of Calando. In conjunction with the exchange, Arrowhead also issued 240,000 Warrants to purchase Arrowhead Common Stock in exchange for 600,000 Warrants to purchase Calando common stock.

In February 2010, Arrowhead issued 80,000 shares of Common Stock and 24,000 warrants to purchase Arrowhead Common Stock, at an exercise price of $0.50, to several Calando shareholders, in exchange for 200,000 shares of Calando common stock and 60,000 warrants to purchase Calando common stock.

In March 2010, a warrant holder exercised 247,880 warrants to purchase Arrowhead Common Stock, in a cashless exercise, whereby Arrowhead issued to the warrant holder 128,707 shares of Arrowhead Common Stock.

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

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Arrowhead Research Corporation

Notes to Consolidated Financial Statements

(Unaudited)

Unless otherwise noted, (1) the term Arrowhead refers to Arrowhead Research Corporation, a Delaware corporation formerly known as InterActive Group, Inc., (2) the terms the Company, we, us, and our refer to the ongoing business operations of Arrowhead and its subsidiaries, whether conducted through Arrowhead or a subsidiary of Arrowhead, (3) the term ARC refers to Arrowhead Research Corporation, a privately-held California corporation with which Arrowhead consummated a stock exchange transaction in January 2004, (4) the term Subsidiaries refers collectively to Calando Pharmaceuticals, Inc. (Calando), Unidym, Inc. (Unidym), Agonn Systems, Inc. (Agonn ,) and Tego Biosciences Corporation (Tego) and (5) the term Common Stock refers to Arrowhead s Common Stock, $0.001 par value per share, and the term stockholder(s) refers to the holders of Common Stock.

NOTE 1. ***ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES***

Nature of Business

Arrowhead Research Corporation is a development stage nanotechnology holding company that forms, acquires and operates subsidiaries commercializing innovative nanotechnologies. By working closely with leading scientists and universities, Arrowhead identifies advances in nanotechnology and matches them with product development opportunities in high-growth markets. The Company is currently focused on the biotech and electronics industries. Arrowhead owns two majority-owned subsidiaries, Calando and Unidym, and has minority investments in two early-stage nanotechnology companies, Nanotope, Inc. (Nanotope) and Leonardo Biosystems, Inc. (Leonardo).

Arrowhead is incorporated in Delaware and its principal executive offices are located in Pasadena, California.

The Company was originally incorporated in South Dakota in 1989, and was reincorporated in Delaware in 2000. The Company s principal executive offices are located at 201 South Lake Avenue, Suite 703, Pasadena, California 91101, and its telephone number is (626) 304-3400. As of June 30, 2010, Arrowhead Research Corporation had eleven full-time employees at the corporate office and eight full-time employees at its Subsidiary companies.

Financing and Liquidity

At June 30, 2010, the Company had approximately $9.0 million in cash to fund operations. Arrowhead has historically financed its operations through the sale of securities of Arrowhead and its Subsidiaries. During fiscal 2009, the Company obtained $7.3 million in cash through equity and debt financing, including $2.5 million raised by Calando through the sale of senior unsecured convertible promissory notes, and $2.0 million raised by Unidym through the sale of newly issued shares of Series C-1 Preferred Stock. Also during fiscal 2009, the Company obtained an additional $4.4 million from the sales of assets, products and license fees, including the sale by Unidym of its equity interest in Ensysce BioSciences Inc. for $700,000. During the first nine months of fiscal 2010, the Company received $11.7 million in cash through equity financings, $0.7 million from the exercise of warrants, and $1.0 million from revenue and asset sales, including the sale of the Tego IP. The Company s management anticipates that the Company will be able to satisfy the cash requirements of its operations through at least the next twelve months with current cash resources. However, it is anticipated that further equity financings, and/or asset sales and license agreements will be necessary to fund operations in the future.

The Company s strategic plan includes focusing on near term revenue opportunities, conserving cash and seeking sources of additional capital. To execute this plan, the Company will seek to accomplish one or more of the following on favorable terms: the out-license of technology, sale of a Subsidiary, sale of non-core assets, scaling down development efforts, funded joint development or partnership arrangements and/or sale of securities. The likelihood that any of these events will occur is uncertain, especially in light of the lack of liquidity in the current capital and credit markets. Until such time as one or more of these goals is accomplished, the Company has scaled back operating activities at its Subsidiaries.

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Summary of Significant Accounting Policies

Principles of Consolidation The consolidated financial statements of the Company include the accounts of Arrowhead and its wholly-owned and majority-owned Subsidiaries. Prior to April 2008, Arrowhead s Subsidiaries included Insert Therapeutics, Inc. (Insert), which was merged with Calando in April 2008. The merged entity is majority-owned by Arrowhead and continues to operate under the name of Calando. At June 30, 2010, other Subsidiaries included Unidym, Tego, and Agonn. On December 23, 2009, Tego completed a sale of its assets to Luna Innovations, Inc. and is included in the results as Loss from Discontinued Operations. Loss from Discontinued Operations also includes Aonex Technologies, Inc. (Aonex), sold in May 2008 and Nanotechnica, Inc. (Nanotechnica), dissolved in June 2005. All significant intercompany accounts and transactions are eliminated in consolidation, and noncontrolling interests are accounted for in the Company s financial statements.

Basis of Presentation and Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. Significant estimates made in preparing these financial statements include valuing the stock of the Subsidiaries, assumptions to calculate stock-based compensation expense, allowance for doubtful accounts, deferred tax asset valuation allowance, derivative liabilities, noncontrolling interest and useful lives for depreciable and amortizable assets. Actual results could differ from those estimates. Additionally, certain reclassifications have been made to prior period financial statements to conform to the current period presentation. In the opinion of management, all adjustments, including normal recurring accruals considered necessary for a fair presentation, have been included.

Cash and Cash Equivalents The Company considers all liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Credit Risk The Company extends credit to its customers in the normal course of business and generally does not require collateral or other security. The Company performs ongoing credit evaluations of its customers financial condition and historically has not incurred significant credit losses.

Concentration of Credit Risk The Company maintains checking accounts for Arrowhead and separate accounts for each Subsidiary at any of three financial institutions. These accounts are insured by the Federal Deposit Insurance Corporation (FDIC) for up to $250,000 per account. The Company has two wealth management accounts at the same financial institutions that invest in higher yield money market accounts and in government securities. At June 30, 2010, the Company had uninsured cash deposits totaling $8,933,788. The Company has not experienced any losses in such accounts.

Property and Equipment Property and equipment are recorded at cost. Depreciation of property and equipment is recorded using the straight-line method over the respective useful lives of the assets ranging from three to seven years. Leasehold improvements are amortized over the lesser of the expected useful life or the remaining lease term.

Intellectual Property At June 30, 2010, intellectual property consisted of patents and patent applications licensed or purchased in the gross amount of $4,093,624. The accumulated amortization of patents totaled $1,967,882 at June 30, 2010. Patents are amortized over three years to twenty years. The weighted average original amortization period is twelve years. The weighted average remaining amortization period is eight years. Amortization is expected to be $78,906 for the remainder of fiscal 2010, $315,624 in fiscal 2011, and $241,808 for fiscal years 2012, 2013, 2014 and 2015, and $763,980 thereafter. Long-lived assets, such as property, equipment and intangible assets subject to amortization are reviewed for impairment whenever events or circumstances indicate that the carrying amount of these assets may not be recoverable. In reviewing for impairment, we compare the carrying value of such assets to the estimated undiscounted future cash flows expected from the use of the assets and their eventual disposition. When the estimated undiscounted future cash flows are less than their carrying amount, an impairment loss is recognized equal to the difference between the assets fair value and their carrying value.

Equity Investments Arrowhead has a non-controlling equity investment in Nanotope, a privately held biotechnology company, which is recorded in Other Assets. This investment is carried at cost less Arrowhead s proportionate share of Nanotope s operating loss for the period since investment. Arrowhead utilizes the equity method of accounting as it owns more than 20% of the voting equity and has the ability to exercise significant influence over this company. This investment is risky as the markets for technologies or products of Nanotope are still in the development stage and such markets may never be significant. Arrowhead could lose its entire investment in Nanotope. Arrowhead monitors this investment for impairment and makes appropriate reductions in carrying value when necessary.

Minority Equity Investments The Company s minority equity investment in Leonardo, a privately held biotechnology company, is recorded in Other Assets. This investment is accounted for under the cost method of accounting, because Arrowhead owns less than 20% of the voting equity and only has the ability to exercise nominal, not significant, influence over this company. This investment is risky as the markets for technologies or products of Leonardo are still in the development stage and such markets may never be significant. Arrowhead could lose its entire investment in Leonardo. Arrowhead monitors this investment for impairment and makes appropriate reductions in carrying value when necessary.

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Noncontrolling Interests in Majority-Owned Subsidiaries Operating losses applicable to majority-owned Calando and Unidym have periodically exceeded the noncontrolling interests in the equity capital of either Subsidiary. Such excess losses applicable to the noncontrolling interests have been and are borne by the Company as there is no obligation of the noncontrolling interests to fund any losses in excess of their original investment. There is also no obligation or commitment on the part of the Company to fund operating losses of any Subsidiary whether wholly-owned or majority-owned. The Company allocates the noncontrolling interest s share of net loss in excess of the noncontrolling interest s initial investment in accordance with FASB ASC 810-10, which was effective for the Company on October 1, 2009.

When there is a change in the Company s proportionate share of a development-stage Subsidiary resulting from additional equity transactions in a Subsidiary, the change is accounted for as an equity transaction in consolidation. To the extent that the increase in the calculated value of the Company s interest in the equity of the Subsidiary exceeds the Company s investment in the offering, that increase in value is referred to as the Company s increase in its proportionate share of the Subsidiary s equity and the amount is recorded as an increase in the Company s Additional Paid-in Capital.

Revenue Recognition Revenue from product sales are recorded when persuasive evidence of an arrangement exists, title has passed and delivery has occurred, a price is fixed and determinable, and collection is reasonably assured. We may generate revenue from product sales, technology licenses, collaborative research and development arrangements, and research grants. Revenue under technology licenses and collaborative agreements typically consists of nonrefundable and/or guaranteed technology license fees, collaborative research funding and various milestone and future product royalty or profit-sharing payments.

Revenue associated with research and development funding payments, under collaborative agreements, is recognized ratably over the relevant periods specified in the agreement, generally the research and development period. Revenue from up-front license fees and milestones and product royalties are recognized as earned based on the completion of the milestones and product sales, as defined in the respective agreements. Payments received in advance of recognition as revenue are recorded as deferred revenue.

Cost of Goods Sold The production of nanotubes by Unidym has been primarily for research and development activities. Therefore, the nanotubes produced are not capitalized as inventory, nor is a cost of goods sold calculated, even though some nanotubes are eventually sold to third parties.

Allowance for Doubtful Accounts The Company accrues an allowance for doubtful accounts based on estimates of uncollectible revenues by analyzing historical collections, accounts receivable aging and other factors. Accounts receivable are written off when all collection attempts have failed.

Research and Development Costs and expenses that can be clearly identified as research and development are charged to expense as incurred in accordance with FASB ASC 718-10.

Earnings (Loss) per Share Basic earnings (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted earnings (loss) per share are computed using the weighted-average number of common shares and dilutive potential common shares outstanding during the period. Dilutive potential common shares primarily consist of stock options issued to employees and consultants and warrants to purchase Common Stock of the Company. Dilutive earnings (loss) per share has not been presented, because the effect is anti-dilutive.

Stock-Based Compensation The Company accounts for share-based compensation arrangements in accordance with FASB ASC 718, which requires the measurement and recognition of compensation expense for all share-based payment awards to be based on estimated fair values. We use the Black-Scholes option valuation model to estimate the fair value of our stock options at the date of grant. The Black-Scholes option valuation model requires the input of subjective assumptions to calculate the value of stock options. We use historical data among other information to estimate the expected price volatility and the expected forfeiture rate.

Income Taxes The Company accounts for income taxes under the liability method, which requires the recognition of deferred income tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred income tax assets to the amount expected to be realized. The provision for income taxes, if any, represents the tax payable for the period and the change in deferred income tax assets and liabilities during the period.

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Recently Issued Accounting Standards

In January 2010, the FASB issued Accounting Standards Update ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements . This guidance requires new disclosures related to recurring and nonrecurring fair value measurements. The guidance requires disclosure of transfers of assets and liabilities between Level 1 and Level 2 of the fair value measurement hierarchy, including the reasons and the timing of the transfers and information on purchases, sales, issuance, and settlements on a gross basis in the reconciliation of the assets and liabilities measured under Level 3 of the fair value measurement hierarchy. The adoption of this guidance is effective for interim and annual reporting periods beginning after December 15, 2009. We have adopted this guidance in the financial statements presented herein, which did not impact our consolidated financial position or results of operations.

In October 2009, the FASB issued ASU 2009-13, which amends ASC Topic 605, *Revenue Recognition.* This new accounting guidance relates to the revenue recognition of multiple element arrangements. The new guidance states that if vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, companies will be required to develop a best estimate of the selling price for separate deliverables and allocate arrangement consideration using the relative selling price method. We adopted this guidance as of January 1, 2010 on a prospective basis. The adoption of this guidance did not have a material impact on our consolidated financial statements.

On July 1, 2009, the FASB issued the FASB Accounting Standards Codification (the Codification). The Codification became the single source of authoritative non-governmental U.S. generally accepted accounting principles (GAAP), superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. The Codification eliminates the previous US GAAP hierarchy and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. The Codification was effective for interim and annual periods ending after September 15, 2009. The Company adopted the Codification for the year ended September 30, 2009. This guidance did not change GAAP, therefore it did not have an impact on our consolidated financial statements. References within this note and throughout our financial statements to authoritative guidance issued by the FASB are in reference to the codification.

Recent Accounting Guidance Not Yet Adopted

Management does not believe that any recently issued, but not yet effective, accounting standards, if currently adopted, would have a material effect on the accompanying financial statements.

In June 2010, the FASB issued ASU No. 2010-17, *Revenue Recognition Milestone Method (Topic 605): Milestone Method of Revenue Recognition.* This ASU codifies the consensus reached in EITF Issue No. 08-9, Milestone Method of Revenue Recognition. The amendments to the Codification provide guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Consideration that is contingent on achievement of a milestone in its entirety may be recognized as revenue in the period in which the milestone is achieved only if the milestone is judged to meet certain criteria to be considered substantive. Milestones should be considered substantive in their entirety and may not be bifurcated. An arrangement may contain both substantive and nonsubstantive milestones, and each milestone should be evaluated individually to determine if it is substantive. This guidance will be effective for the fiscal year beginning October 1, 2010. The Company does not expect the adoption of these amendments to have a material impact on the consolidated financial statements.

In June 2009, the FASB issued amendments to the accounting rules for variable interest entities (VIEs) and for transfers of financial assets, codified as ASC 860-10. The new guidance for VIEs eliminates the quantitative approach previously required for determining the primary beneficiary of a variable interest entity and requires ongoing qualitative reassessments of whether an enterprise is the primary beneficiary. In addition, qualifying special purpose entities (QSPEs) are no longer exempt from consolidation under the amended guidance. The amendments also limit the circumstances in which a financial asset, or a portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset to an entity that is not consolidated with the transferor in the financial statements being presented, and/or when the transferor has continuing involvement with the transferred financial asset. This guidance is effective as of the beginning of a reporting entity s first annual reporting period that begins after November 15, 2009 and for interim periods within the first annual reporting period. The Company does not expect the adoption of these amendments to have a material impact on the consolidated financial statements.

In June 2009, the FASB issued guidance codified as ASC 470-20, regarding accounting for own-share lending arrangements in contemplation of convertible debt issuance, which changes the accounting for equity share lending arrangements on an entity s own shares when executed in contemplation of a convertible debt offering. This guidance requires the share lending arrangement to be measured at fair value and recognized as an issuance cost. These issuance costs should then be amortized as interest expense over the life of the financing arrangement. Shares loaned under these arrangements should be excluded from computation of earnings per share. This guidance is effective for fiscal years beginning after December 15, 2009 and requires retrospective application for all arrangements outstanding as of the beginning of the fiscal year. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

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In October 2009, the FASB issued authoritative guidance on multiple-deliverable revenue arrangements, ASC 605-25. This guidance amends the existing criteria for separating consideration received in multiple-deliverable arrangements and requires that arrangement consideration be allocated at the inception of the arrangement to all deliverables based on their relative selling price. The guidance establishes a hierarchy for determining the selling price of a deliverable which is based on vendor-specific objective evidence, third-party evidence, or management estimates. Expanded disclosures related to multiple-deliverable revenue arrangements are also required. This guidance is effective for the Company beginning fiscal year 2011. Upon adoption, the guidance may be applied either prospectively from the beginning of the fiscal year for new or materially modified arrangements, or it may be applied retrospectively. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

NOTE 2. ***BASIS OF CONSOLIDATION***

The consolidated financial statements include the accounts of Arrowhead and its Subsidiaries; Calando, Unidym, Tego, and Agonn. All significant intercompany accounts and transactions are eliminated in consolidation and noncontrolling interests were accounted for in the consolidated financial statements.

NOTE 3. ***INVESTMENT IN SUBSIDIARIES***

Unidym, Inc.

Unidym, Inc. was founded by Arrowhead in 2005. Through the license of intellectual property and the acquisition of three development stage nanotechnology companies in 2006, 2007 and 2008, Unidym acquired the rights to key patents for the manufacture and application of carbon nanotubes, and is developing products with applications for the display industry. The consolidated financial statements include the results of the merged companies.

Prior to fiscal 2009, Arrowhead invested $8.3 million in Unidym and provided Arrowhead stock with an aggregate value of $5.4 million to facilitate Unidym acquisitions. In fiscal 2009, Unidym raised a total of $4.7 million through the sale of Series C-1 Preferred Stock, of which $2.7 million was invested by Arrowhead.

In fiscal 2008 and fiscal 2009, Arrowhead increased its ownership interest in Unidym through a series of stock exchanges with minority holders of Unidym. In April 2008, Arrowhead acquired 550,000 shares of Unidym common stock from a director and minority holder of Unidym in exchange for $350,000 in cash and restricted Arrowhead Common Stock valued at $200,000. In fiscal 2009, Arrowhead acquired 4.3 million shares of Unidym preferred stock in exchange for 4.3 million shares of Arrowhead Common Stock.

In September 2009, Arrowhead invested $642,000 in exchange for 2,140,000 shares of Unidym Series D Preferred Stock and a warrant to purchase 3,146,208 shares of Unidym common stock at an exercise price of $0.25 per share with an expiration date three years from the date of issuance. As a condition to this investment, each share of Series C-1 Preferred Stock was converted to six shares of Unidym Series D Preferred Stock. A minority shareholder of Unidym invested $300,000 for 1,000,000 shares of Unidym Series D Preferred Stock and 1,000,000 warrants with similar terms.

In October and November 2009, Arrowhead issued 153,176 shares of Common Stock with an estimated fair market value of $47,485 in exchange for an equal number of shares of Series C Preferred Stock of Unidym, with several minority stockholders of Unidym. In June 2010, Arrowhead received 4,785,077 shares of Series D Preferred Stock of Unidym in exchange for the cancellation of $1,435,523 in accumulated operational loans by Arrowhead to Unidym.

As of June 30, 2010, Arrowhead owned 79% of the outstanding stock of Unidym and 64% on a fully diluted basis.

Calando Pharmaceuticals, Inc. (formerly known as Insert Therapeutics, Inc. Insert)

On April 17, 2008, Calando merged with and into Insert, with Insert as the surviving company. Prior to the merger, Arrowhead invested an aggregate of $23.2 million in Calando through the purchase of equity, and loans. As a condition of the merger, the Preferred Stock of each of Calando and Insert was converted into common stock and the loans were converted to equity. As a result of the merger, shares of Insert common stock were issued to the stockholders of the former Calando, and Insert changed its name to Calando Pharmaceuticals, Inc.

On November 26, 2008, Calando entered into Unsecured Convertible Promissory Note Agreements (Notes) for $2.5 million with accredited investors and Arrowhead, which invested $200,000 in the Notes offering. Arrowhead subsequently invested an additional $600,000 in the same offering. The Notes mature on November 26, 2010 and bear 10% annual interest. The Notes are convertible into Calando common stock and can be redeemed for two times their face value plus interest in the event of a sale of Calando. To facilitate this investment in Calando, Arrowhead subordinated a series of 6% simple interest loans and advances totaling approximately $5.3 million of principal plus interest.

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Effective June 23, 2009, to facilitate licensing transactions with a third party, holders (including Arrowhead) of an aggregate of $2.9 million of the Notes, including accrued but unpaid interest, converted the principal and accrued interest into newly authorized Calando Series A Preferred Stock. The non-voting Series A Preferred Stock has a liquidation preference of 2.5 times the Series A Original Issue Price of $1,000 per share and is convertible into common stock at a conversion price of $0.576647 per share. Arrowhead converted all of its Notes representing a principal balance of $800,000, plus accrued but unpaid interest, into 829 shares of Series A Preferred Stock. One third-party Note for $500,000 plus interest remains outstanding.

As of June 30, 2010, Arrowhead had a series of 6% simple-interest working capital loans and advances outstanding to Calando totaling $7,326,126, inclusive of accrued interest of $540,443, which are payable upon demand.

In fiscal 2010, Arrowhead issued 1,220,000 shares of its Common Stock in exchange for 3,050,000 shares of Calando common stock, with several minority stockholders of Calando. In conjunction with this exchange, Arrowhead also issued 240,000 warrants to purchase Arrowhead Common Stock in exchange for 600,000 warrants to purchase Calando common stock.

As of June 30, 2010, Arrowhead owned 70% of the outstanding shares of Calando and 62% on a fully diluted basis.

Agonn Systems, Inc.

Arrowhead founded Agonn in May 2008 to explore, develop and commercialize nanotechnology-based energy storage devices for electric vehicles and other large format applications. In line with Arrowhead s strategy to conserve cash, Agonn has ceased its development efforts.

Masa Energy LLC

In April 2008, Arrowhead acquired Masa Energy LLC (Masa) a Delaware limited liability company whose sole assets were an approximate 6% ownership interest in each of Nanotope and Leonardo. During the quarter ended March 31, 2010, the stockholdings were transferred to Arrowhead and Masa was dissolved.

Nanotope, Inc.

Nanotope is developing advanced nanomaterials for the treatment of spinal cord injuries and wound healing. In April 2008, Arrowhead acquired a 5.8% ownership interest in Nanotope. In July and September 2008, Arrowhead acquired 1,801,802 shares of Series B Preferred Stock of Nanotope for two payments of $1 million each, increasing Arrowhead s ownership interest in Nanotope to approximately 23%. Since inception, Nanotope s revenue has been negligible. Operating expenses for the three and nine months ended June 30, 2010 were approximately $303,000 and $758,000, respectively. Nanotope s net loss for the three and nine months ended June 30, 2010 was $300,000 and $748,000, respectively. Arrowhead accounts for its investment in Nanotope using the equity method of accounting. As of June 30, 2010, Nanotope had indebtedness to Arrowhead in the amount of $269,780 which is expected to be repaid or converted to equity.

Leonardo Biosystems, Inc.

Leonardo is developing a drug-delivery platform technology based on novel methods of designing spheroid porous silicon microparticles that selectively accumulate in tumor vasculature. In April 2008, Arrowhead acquired a 6.13% ownership interest in Leonardo. Arrowhead accounts for its investment in Leonardo using the cost method of accounting. As of June 30, 2010, Leonardo had indebtedness to Arrowhead in the amount of $273,987 which is expected to be repaid or converted to equity.

NOTE 4. ***DISCONTINUED OPERATIONS TEGO BIOSCIENCES CORPORATION***

On April 20, 2007, Tego, a wholly-owned subsidiary of Arrowhead, acquired for $1,000 the assets of C Sixty, Inc., a Texas-based company developing protective products based on the anti-oxidant properties of fullerenes. On July 3, 2007, Arrowhead capitalized Tego with a purchase of 5,000,000 shares of Tego Series A1 Preferred Stock for $100,000. On October 25, 2007, Arrowhead purchased 15,000,000 shares of Tego Series A-2 Preferred Stock for $2.4 million. In line with Tego s revised strategy to focus on the out-license of its technology and to reduce its internal development activities, on November 21, 2008, Tego repurchased from Arrowhead 5,000,000 shares of Tego Series A-1 Preferred Stock for $1.7 million. Arrowhead owns 100% of the outstanding stock of Tego and 75% on a fully diluted basis. As of June 30, 2010, the Company had incurred approximately $1,003,000 of expenses related to Tego since its inception.

On December 23, 2009, Tego completed the sale of all of its non-cash intellectual property assets (Tego IP) to Luna Innovations, Inc. (Luna) under the terms of the Tego-Luna Asset Purchase Agreement dated November 13, 2009 (APA). The Tego IP includes a portfolio of Tego-owned foreign and domestic patents and patent applications. The Tego IP also includes patent licenses from Siemens AG and Washington University, St. Louis. Under the APA, Luna agreed to assume Tego s role as licensor under a license Tego granted under the Tego IP to The Bronx Project, Inc. (TBP) to develop carboxyfullerenes in the field of neuronal injury (the TBP License). Luna also assumed Tego s role as licensor under the exclusive license Tego granted to Arrowhead s affiliate Unidym, under the Tego IP in the field of industrial non-pharmaceutical fullerenes.

Luna paid to Tego an upfront purchase price of $350,000 and reimbursements of patent and license expenses of $80,000. Further, under the terms of the APA, Luna will pay Tego 10% of any revenues it receives from its licensing or resale of the Tego IP. Tego shall also receive from Luna 50% of any net proceeds Luna receives from the TBP License. Tego shall receive royalties from Luna for any sales of fullerene products covered by the Tego IP, as well as clinical development milestones totaling $4.25 million for each fullerene product it develops that is covered by the Tego IP.

Due to the sale of substantially all of Tego s assets, the operations of Tego ceased and the gain on the sale and the results of historical operations are recorded as discontinued operation in the Company s Statements of Operations. Additionally, the cash flows from Tego are reflected separately as cash flows from discontinued operations. Potential future cash flows associated with the Luna APA, as discussed above, will be reflected as a part of cash flows from discontinued operations in the Company s Consolidated Statements of Cash Flows.

NOTE 5. ***NOTES PAYABLE***

On November 26, 2008, Calando entered into Unsecured Convertible Promissory Note Agreements (Notes) for $2.5 million with accredited investors and Arrowhead, which invested $200,000 in the Notes offering. Arrowhead subsequently invested an additional $600,000 in the same offering. The Notes mature on November 26, 2010 and bear 10% annual interest. Unpaid principal of the Notes and accrued but unpaid interest thereon is convertible into common stock of Calando at a conversion price of $0.576647 per share (subject to adjustment) at any time in the sole discretion of the holder. In the event Calando achieves a liquidation event as defined in the Notes, each note holder has the option to exchange the Notes for two times the then outstanding principal amount owed under the Notes plus accrued and unpaid interest thereon, or convert the outstanding principal and accrued and unpaid interest thereon into Calando common stock at the conversion price.

Except for one Note in the principal amount of $500,000, all Notes and accrued interest were converted into a total of 2,950 shares of Calando Series A Preferred Stock on June 23, 2009.

NOTE 6. ***STOCKHOLDERS EQUITY***

At June 30, 2010, the Company had a total of 150,000,000 shares of capital stock authorized for issuance, consisting of 145,000,000 shares of Common Stock, par value $0.001, and 5,000,000 shares of Preferred Stock, par value $0.001.

At June 30, 2010, 70,938,013 shares of Common Stock were outstanding. At June 30, 2010, 1,532,000 shares and 9,721,435 shares were reserved for issuance upon exercise of options granted under Arrowhead s 2000 Stock Option Plan and 2004 Equity Incentive Plan, respectively.

On July 17, 2009 and August 6, 2009, the Company sold an aggregate of 9,196,642 units in a private placement transaction with institutional and accredited investors. Each unit consisted of one share of Arrowhead Common Stock, at a price of $0.30 per share, and a warrant to purchase an additional share of Common Stock exercisable at $0.50 per share. The warrants became exercisable on January 18, 2010 and February 7, 2010, and remain exercisable until June 30, 2014. The warrants can be called for redemption by the Company as the redemption feature provided for in the warrants has been met. Gross proceeds of the offering totaled approximately $2.76 million.

On December 11, 2009, the Company sold an aggregate of 5,083,430 units in a private placement transaction with accredited investors. Each unit consisted of one share of Arrowhead Common Stock and a warrant to purchase an additional share of Common Stock exercisable at $0.509 per share. The unit price was $0.634, based upon the closing bid price on the Company s Common Stock on December 11, 2009, which was $0.509, plus $0.125 for the purchase of the warrant. The warrants became exercisable on June 12, 2010 and remain exercisable until December 11, 2014. The redemption feature provided for in the warrants has been met and may be called for redemption by the Company on December 12, 2010. Gross proceeds of the offering were approximately $3.2 million.

On June 17, 2010, the Company sold an aggregate of 6,592,989 units at a price of $1.312 per unit in a registered offering to institutional and individual investors. Each unit consisted of one share of Arrowhead Common Stock and a warrant to purchase 0.5 share of Common Stock exercisable at $1.65 per share. The warrants contain an antidilution provision which can result in an adjustment to the exercise price under certain circumstances (see Note 10 for additional information). Gross proceeds from the offering were $8.65 million before deducting placement agent commission and other offering expenses.

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The following table summarizes information about warrants outstanding at June 30, 2010:

Exercise prices	Number of Warrants	Remaining Life in Years
$5.04	1,235,994	0.5
$7.06	948,969	6.9
$2.00	3,863,999	3.1
$0.50	8,265,309	4.0
$0.51	4,925,701	4.5
$1.65	3,296,497	5.5
Total warrants outstanding	22,536,469	

NOTE 7. ***LEASES***

As of June 30, 2010, the Company leased the following facilities:

	Lab/Office Space	Monthly Rent	Lease Commencement	Lease Term
Arrowhead	7,388 sq ft	$ 18,101	March 1, 2006	62 Months
Unidym	20,500 sq ft	$ 26,650	October 1, 2008	60 Months

Facility and equipment rent expense for the three months ended June 30, 2010 and 2009 was $106,994 and $397,578, respectively. Facility and equipment rent expense for the nine months ended June 30, 2010 and 2009 was $360,990 and $1,080,219, respectively. From inception to date, rent expense has totaled $4,656,820.

NOTE 8. ***OBLIGATIONS UNDER CAPITALIZED LEASE***

As part of the purchase of Nanoconduction, the Company assumed a capitalized lease for equipment valued at $1,677,000. Research and development equipment under capitalized lease was allocated a cost of $0 at the Nanoconduction acquisition by Unidym as the equipment has no alternative use.

At June 30, 2010, the future minimum commitments remaining under capitalized leases are as follows:

Capitalized lease payable in one remaining installments of $75,344, due in July 2010, secured by equipment at Unidym.	$ 75,344
Less interest	(499)
Present value of future minimum payments	74,845
Less current portion	74,845
Long term portion	$

NOTE 9. ***STOCK BASED COMPENSATION***

Arrowhead has two plans that provide for equity-based compensation. Under the 2000 Stock Option Plan, 1,532,000 shares of Arrowhead s Common Stock are reserved for issuance upon exercise of non-qualified stock options. No further grants can be made under the 2000 Stock Option Plan. The 2004 Equity Incentive Plan reserves 9,721,435 shares for the grant of stock options, stock appreciation rights, restricted stock awards and performance unit/share awards by the Board of Directors to employees, consultants and others. As of June 30, 2010, there were options granted and outstanding to purchase 1,532,000 and 5,163,838 shares of Common Stock under the 2000 Stock Option Plan and the 2004 Equity Incentive Plan, respectively. During the quarter ended June 30, 2010, 190,000 options were granted under the 2004 Equity Incentive Plan.

In connection with a private offering in fiscal 2009, directors, officers and employees of the Company agreed to forfeit options to purchase 4,005,000 shares of Common Stock with exercise prices ranging from $2.52 to $6.83. In consideration of the forfeiture of the option grants, other existing grants to purchase 450,000 shares were accelerated such that the awards are fully vested on the one year anniversary of the date of grant. The cancellation was effective July 17, 2009.

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The following tables summarize information about stock options:

	Number of Options Outstanding	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at September 30, 2008	8,007,632	$ 3.24		
Granted	460,000	0.85		
Canceled	(5,566,044)	3.88		
Exercised				
Balance at September 30, 2009	2,901,588	1.73		
Granted	2,250,000	0.53		
Canceled				